

ECONOMIES OF SCALE IN RELATION TO LOCAL GOVERNMENTS  
AND SERVICES COMMONLY PRODUCED BY THEM

by

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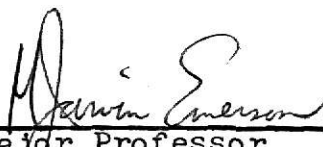
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## CHAPTER I

### INTRODUCTION

In recent years, the costs of providing public goods and services at the local level have continued to rise at an ever increasing rate. Police and fire protection, highways and streets, sanitary services, recreation, education, health services, and administrative service costs have all risen. Among the causes of increased costs in the provision of these services at the local level are: increases in per capita incomes, urbanization pressures, and the development of new public services, programs and facilities to improve the lot of the aged and the poor.

Schools are of special interest among the locally produced public services because of their magnitude among local government expenditures. In 1967, 37 percent of all state and local spending was for education. Of the \$40 billion spent on education that year, 60 percent was financed at the local level.<sup>1</sup>

Among all of the local services, the cost of health services have increased most significantly. The more recent major cause of this phenomenon was the enactment of Medicare

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<sup>1</sup>James M. Buchanan. The Public Finances (Homewood, Illinois: Richard D. Irwin, Inc., 1970), pp. 342-344.

and Medicaid in the mid-sixties. "The result has been a substantial addition to the total demand for medical care services... Since nothing was done to expand supply, prices for medical care services at all levels increased dramatically in the late 1960's... prices will continue to increase rapidly in the 1970's."<sup>2</sup> A system of hospitals that had appeared to be nearly adequate for the needs of the society, quickly became inadequate.

Not only has the burden of increasing costs caused increasing pressure on revenue sources in urban areas, but also some effects have occurred in rural areas. The outmigration from rural areas that fed the urbanization trend has resulted in a declining tax base. This declining tax base has caused an increase in the burden of financing public services for those people who did not migrate to the cities.

#### THE PROBLEM

Can anything be done about these high and rising costs at the local government level? One approach, would be to determine if there is any significant relationship between constituents served and per capita or per unit costs, as indicated in the production function for a particular service, i.e. determine if economies of scale occur.

If economies of scale occur, and the quality is not hampered, perhaps some services should be produced by a form

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<sup>2</sup>Ibid., pp. 355-356.