The governance of cities was an afterthought in the writing of the U.S. Constitution. The Constitution makes no mention of cities, towns, villages, or any other type of local government. The federal and state governments were preeminently on the minds of those who wrote, debated, and ratified the document that governs our nation. Local government was left to the states to create, regulate, and, when necessary, eliminate. Consequently, it should come as no surprise that those who study the politics of local taxing and spending focus on the subsidiary role of cities in the American federal system. Students of urban governance have long debated whether the taxing and spending decisions of cities are significantly constrained by their subordinate position. Some argue that politics has a negligible role in the formulation of urban taxing and spending decisions and that cities are in every sense creations of higher-level government. States heavily regulate the scope, content, and means by which cities fulfill the policy demands of their citizens. As a consequence, local politics (that is, the representation of local demands) has a very muted effect on the taxing and spending decisions of local governments.

This chapter reviews the literature on the politics of urban taxing and spending decisions. It centers on the debate over whether and how politics shapes the scope and content of these policies. For the purposes of this essay, politics is defined as the process by which individual and/or group preferences shape the government’s authoritative allocation of scarce resources (taxing and spending decisions), perhaps the most important policy outputs of the urban political system (see Lasswell 1936).

Local governments have the legal authority to tax their residents and to make decisions that are legally binding on them. There is a limit, however, to the amount of revenue cities can raise through taxation, because everyone prefers to be taxed less rather than more. In addition, local residents preferences for taxing and spending are both diverse and subject to change. Consequently, decisions on these matters are the subject of considerable debate and sometimes bitter contention. Without the local government’s legal authority to make binding policy decisions, competing interests would subject cities to political instability.

The first section of this chapter reviews the basic features of urban public finance, identifying the principal sources of municipal revenues and the functions that cities fulfill. The second section reviews the literature on the politics of urban taxing and spending decisions, which has centered on the dichotomy debate and a review of early research addressing the dichotomy, see David N. Ammons and Charldean Newell, City Executives (Albany: State University of New York, 1989), 41–52. For a more recent study addressing the involvement of city managers in politics, see Sally Coleman Selden, Gene A. Brewer, and Jeffrey L. Bradney, "The Role of City Managers: Are They Principals, Agents, or Both?" American Review of Public Administration 29 (June 1999): 124–148.


The second section reviews the major theories of urban public finance and supporting empirical evidence for these theories. This section concludes with a discussion of the paradox present in many municipalities: despite theoretically sound advice and supporting evidence, they pursue popular policies that seem to undermine the community's economic and social well-being. How is this possible? The third section offers an answer to this paradox and an alternative explanation of how cities cope with it.

Basic Features of Municipal Revenue and Spending Policies

With some notable exceptions, the basic features of municipal revenue and spending policies have remained largely unchanged over the past fifty years. Moreover, municipal governments draw from a variety of revenue sources but spend their revenues on a relatively narrow range of goods and services.

Revenue Sources

Municipal governments draw upon several sources to finance their public policy outputs. In addition to state and federal aid, these include a variety of taxes, including taxes on property (mainly residential and commercial) and on income (both personal and business), the sale of goods and services, fees and charges for the use of specific goods and services, and bonded indebtedness. State law often governs the specific mix of these revenue sources available to local governments. It is important to distinguish between the sources of municipal revenues. Individuals and businesses residing, working, or partaking in recreation in the community provide revenues such as property taxes and fees. Other revenues, such as federal and state aid, originate outside the community and are paid in part by entities other than residents of the community. Figure 9-1 shows the percentage of total municipal revenues from selected tax and user-fee sources.

The largest single own source of revenues for all municipal governments is a tax on residential and personal property (for example, home furnishings). City governments have traditionally preferred levying taxes on property, because, unlike personal income, it is not mobile and its value can be more readily assessed. Historically the property tax has been the workhorse of municipal governments, though its dominance has waned considerably over the past forty years. In 1962 the property tax accounted for half of all revenues and nearly all tax revenues raised by municipal governments in the United States. In 1998, however, the percentage of own-source revenues and tax revenues raised through property declined to below 40 percent.

The second largest reserve of own-source revenues is fees and charges. These include water, garbage, and sewerage services and charges for the use of parks and other facilities such as golf courses and municipal swimming pools. Sales tax and other taxes, including personal income and corporate income taxes, constitute a smaller portion of the own-source municipal revenues.

An external source of funding is federal and state aid, which comes in a variety of forms, often with mandates and conditions that require the recipient government to perform certain functions. Historically, federal assistance to cities has focused on social services (health, education, and welfare) that redress the fiscal disparities between center city residents and their suburban neighbors. Federal assistance to cities reached its highest point during President Lyndon B. Johnson's Great Society and War on Poverty initiatives during the 1960s. Since 1964, federal assistance to cities has declined steadily. Now a large portion of federal assistance to cities is transferred directly to state governments, which disburse these moneys to cities and other localities. State aid to municipal governments generally comes from funds raised by states on their own taxing authority. States generally levy a tax on the sale of goods and services. These taxes are collected by local merchants and businesses and remitted to the state government. In turn, the state governments return a portion of sales tax receipts to
the jurisdictions where the sales were made. Another significant purpose of state aid is to fund local primary and secondary education, highway construction and maintenance, and public assistance.

In addition to tax revenues and user fees, municipal governments have variable authority to borrow money. The ability of local governments to incur debt is generally regulated by state law. Cities incur debt by means of general obligation bonds and revenue bonds. A general obligation bond allows municipalities to borrow in the commercial credit market. The amount lent (the principal) and the interest paid to the lender are repaid by the city's authority to tax its residents. This is sometimes known as the "full faith and credit" of the city. This type of borrowing mechanism is attractive to lenders, because they enjoy certain tax advantages (for example, income from a general obligation bond is free from federal income taxes), and the income from the interest and repayment of the principal are generally assured, providing a high degree of safety for the lender. General obligations bonds enable cities to borrow funds in the commercial credit market, but under restrictions imposed by the state.

One significant restriction on the use of general obligation bonds is the need for voter approval through a public referendum. These referenda set limits on the amount of money that can be borrowed and the functions for which it can be used. These restrictions are sufficiently onerous to make many cities seek other means of borrowing money that are not restricted by voter approval and state-imposed requirements. An increasingly popular alternative is the revenue bond, which generally does not require voter approval. Revenue bonds raise money for specific projects and are often issued to pay for capital projects such as the construction of roads, buildings, and other large structures. The repayment of these bonds is made from the revenues generated by the newly constructed facility. Construction of many municipal stadiums, parking garages, and roads is funded from moneys generated by use of the constructed facility (for example, tolls on new roadways).

As previously noted, the relative importance of these revenue sources has changed over time. An overwhelming majority of local revenues traditionally came from property taxes. Today, however, revenue generated from user fees and bonds is often greater than that obtained from the property tax. There are several reasons why U.S. cities have reduced their reliance on the property tax. First, it is a regressive tax. This means that the poor and the middle class often pay a much higher percentage of their personal income on personal and residential property taxes than the wealthiest citizens do. As a result, the property tax is one of the most unpopular forms of taxation levied by any level of government (Conlan 1998).

The regressive nature of the property tax is particularly troublesome for low-income and property-poor communities. Communities, like individuals, can be described in terms of the value of their personal property. A community's tax base is the sum of all property values to be taxed in that locality. Two communities of equal size but with very different tax bases present a picture of disparity and unequal access to basic goods and services. Consider two hypothetical cities, Dorchester and Exeter, each composed of 50,000 households. The tax base of Exeter is $1.5 billion, but that of Dorchester is only $1 billion. Assuming both communities provide the same functions and services for their citizens, the per capita cost to Dorchester's residents will be 33 percent higher than it is for the people in Exeter. If Dorchester prefers to maintain a lower tax per household, the city can, of course, choose not to provide its residents with certain services, but this choice would deprive the community of some services. Efforts to reduce and eliminate the regressiveness of the property tax by providing exemptions for the poor and the elderly have succeeded in equalizing the percentage of personal income paid in property taxes across households with different incomes.3

Second, the property tax is an inefficient form of taxation. The assignment of property values is a complicated, contentious, and expensive activity that is essential to the levying and raising of these taxes. In some cases, citizens in many communities have protested what they see as arbitrary and unfair tax assessments. This has resulted in the establishment of assessment boards to oversee the process and appeal procedures to ensure that citizens' complaints are heard. One consequence of these safety nets is the increased cost of levying the property tax.

Accompanying the decline in municipal governments' reliance on the property tax is the rise of user fees, bond indebtedness, especially revenue bonds, and taxes on income, both personal and business. Bond indebtedness refers to the amount of principal and interest that cities owe to lenders. This indebtedness is repaid over a fixed period of time (for example, fifteen years) from taxes and other revenues raised by the city. User fees and bonded indebtedness, however, have significant administrative and political advantages over the traditional property tax. Indebtedness of any sort allows the municipal borrower to obtain immediate benefits (and political gratification) without an immediate expenditure by taxpayers. Like any private consumer, cities like "buy now and pay later." Bonds enable cities to pay at a later time for what the city and its residents can receive immediately. An electorate grateful for benefits they do not immediately have to pay for in full is likely to show its gratitude by reelecting incumbent officeholders. Bonds, especially revenue bonds, are paid for with future revenues and by future taxpayers and voters. This practice allows politicians to shift forward the cost of benefits they bestow on the citizenry.

**Functional Spending**

Figure 9-2 reports the mean percentage of total municipal expenditures by selected functions. Two important observations can be made about the scope and content of
municipal functional responsibility. First, cities are largely responsible for a narrow range of functions. These are confined to basic, or "housekeeping" activities and services essential to the operation of any municipality. Public safety (police and fire) and roads and utilities (water, solid waste collection, and sewerage) dominate the spending of municipal governments. These are services that individual citizens cannot readily purchase and consume privately, making some form of collective action necessary.

Also indicated in Figure 9-2 is the limited scope of municipal responsibility and level of spending for many social services, including public health programs, hospitals, and general welfare. Several of the theories of municipal taxing and spending policy discussed in this chapter explain the paucity of municipal spending on social services as being both desirable and a product of the constraints placed on cities by their state governments and their unique position in the American federal system. Other explanations of municipal taxing and spending policy, however, argue that the limited spending for social services is neither desirable nor inevitable and can be reversed.

Although the property tax remains the main source of revenues for municipal governments, its dominance has declined over the past several decades. User fees, bond indebtedness, and intergovernmental aid transfers have increased in size and importance for municipal governments. Their spending has been constrained to a narrow range of basic goods and services. Cities have some responsibility, albeit limited, for social services.

### Theories of Municipal Fiscal Policies

Several prominent theories and explanations of the politics of urban revenue and expenditure policies can be identified in the literature. Central to each of these theories is a single question: who has the power to makes decisions in the city? The first two, the elitist and the pluralist theories, are competing explanations. A third, market theory, comes from the field of economics and explains urban public policies in those terms. The remaining literature reviewed examines institutional explanations of the politics of taxing and spending policies in U.S. cities.

**Elitist Theory**

Sociologists were among the early students of local government who asked, Who has the power to make decisions? Helen and Robert Lynd provided an answer to this question in their comprehensive study of local decision making in Muncie, Indiana. With the publication of *Middletown* (1929), the Lynds put forth an explanation of local decision making that emphasized the importance of individuals—specifically elites—whose powerful positions in the community enabled them to influence, if not determine, policy decisions. In the case of Muncie, the Lynds identified a local business family whose financial interests in the community were so dominant that their preferences on various public policies strongly influenced the decisions of local elected officials. The Lynds' analysis focused on economic elites, reasoning that those who control capital and the hiring of labor are instrumental, if not dominant, in the public sector. Subsequent work by Floyd Hunter on Atlanta (1953; 1963; 1980) and national studies by C. Wright Mills (1956) and G. William Domhoff (1967) established the power-elite thesis of government decision making. Extending the Lynds' work, these scholars identified the power elite as composed of men whose positions enable them to transcend the ordinary environments of ordinary men and women; they are in positions to make decisions having major consequences. ... [E]lites are among the wealthiest, most celebrated people. ... [A] power elite "creates" demands and causes others to meet them. (Mills 1956)

Hunter provided an important addition to elite theory by devising a standard methodology for identifying the power elite. He asked individuals from four
groups—business, government, civic associations, and "society"—who, in their opinion, were members of the community’s power elite. The reputational technique provided researchers with a low-cost method for identifying community elites. This methodology solidified the prominence of an elite explanation of local decision making during the 1960s and 1970s. It allowed for an empirical test of elite theory by examining the congruence between the taxing and spending decisions of local governments and the preferences of those identified as the power elite. When researchers could not establish this relationship, they would conveniently explain the nonfindings in terms of their failure to properly identify elites in the community.

Elite theory also provided a convenient explanation for the significant social disparity that existed and continues to pervade American society. Disparities in the distribution of wealth and public services, particularly between Anglo and non-Anglo populations, have conveniently been explained in terms of a self-interested power elite. Moreover, this continuing and widening social inequality is often cited as further evidence of the existence and influence of power elites.

Elite-influenced taxing and spending decisions are expected to produce policies favorable to the wealthy and propertied interests. Elite theorists found a strong bias against spending for redistributive social services that help the poor (welfare, housing, and health services) and an equally strong preference for spending on capital-intensive infrastructure that ultimately helps the wealthy (such as roads and water and sewer systems) and subsidies for new businesses and industry. Curiously, this empirical finding is not unique to elite theory. Advocates of several other explanations of municipal taxing and spending policies have found that in central cities and surrounding suburbs these policies significantly favor business and commercial interests (Peterson 1981).

There are several problems with elite theory. Scholars such as (Polsby 1963) have noted that it is nonfalsifiable. Elites are assumed to exist, and failure to identify them and their influence on policy is merely a methodological problem, not one of theory. Critics of elite theory further suggest that even among the power elite there is considerable variation, even disagreement, on the proper role of local government. Furthermore, the existence of a power elite does not provide a compelling reason to believe these individuals have unitary interests when it comes to the government’s taxing and spending decisions. Elite theory and its critics have had an important influence on American politics, particularly on urban politics. In the 1960s many governments implemented programs to ensure that local governments would be more accessible to groups and individuals who were traditionally excluded from government decision-making processes. Federal and municipal requirements for greater direct citizen participation resulted in the creation of a host of new government institutions and structures, including civilian police review boards and community action councils that empowered citizens with policymaking authority.

Increased citizen participation, however, was often difficult to sustain and did not always accomplish its intended goals. For example, New York City decentralized its school board in 1968, creating thirty-two district boards. Representation on these boards better approximated the composition of local school districts and brought many more racial and ethnic minorities into the governance of the city’s public schools. Nearly thirty-three years later this experiment in greater citizen participation was reversed. In June 2002 the New York State legislature passed an act that returned control of the city’s school system to the mayor and abolished the thirty-two district boards. Dissatisfaction with school performance under the system of district boards provided the impetus for this change. One policy analyst explained, “We are now putting authority for the schools in the hands of experts, not in the hands of all kinds of amateurs.”

In the 1970s Atlanta experienced a significant renaissance of organized citizen involvement in community planning. Stone (1989) reports that a substantial number of neighborhood organizations were brought into the city’s decision-making process for the first time. He notes, however, that greater citizen participation did not always result in policies congruent with the newly empowered citizen groups, nor were these groups able to sustain political power indefinitely.

**Pluralist Theory**

In response to the deficiencies of elite theory, some scholars argued that considerably more interests are involved in local decision making than a small homogeneous group of high-status persons. Pluralists believe that decision making in communities resides in a larger and more diverse cross section of the community. Furthermore, pluralists replaced a reputational methodology for testing theories of decision making with one based on observable behavior, documenting who actually makes policy decisions.

In *Who Governs? Democracy and Power in an American City*, Robert Dahl (1961) set out the arguments for a pluralist theory of community decision making. Dahl and others (Wolfinger 1974; Polsby 1963) did not dispute the existence of unequally distributed wealth, political resources, and government services. Instead they contested the positive relationship between the distribution of political resources and the distribution of community influence. They argued that numerous types of political resources are not evenly distributed among the residents of a community. Different groups and individuals control different resources that may be used to influence different types of public policies. Dahl found that prior to 1900 economic elites did, in fact, have a disproportionate amount of influence on the policy outputs of municipal governments. However, with industrialization and the accompanying increase in immigration to the United States, the sheer number of new voters, entrepreneurs, and diverse social and economic interests supplanted the power of preindustrial elites.
Pluralist theory readily accommodates the possibility that elites influence public policy, but not to the exclusion of other groups or organized interests. Dahl found that decision-making power is not concentrated in any one group but rather is distributed to a wide range of individuals and groups across several different policy areas.

Pluralists did, however, find that these municipal policies could not be linked with the actions of a homogeneous group of economic interests. On the contrary, pluralist researchers found that whatever the content of urban public policy, its origins emanated from a diverse group of individuals and interests. Consequently, the diversity of preferences that shaped urban taxing and spending policies could not be consistently linked with either a pro-business or other distinctive interest group.

Pluralists assumed that the preferences of those who had power would, under the proper conditions, mirror the policy preferences of the public. This is true, of course, only if those who have power are representative of the public's preferences. Otherwise, those who make decisions must be willing or be induced to represent the public interest rather than a minority policy choice. Pluralists left unanswered an important question: what is the link between urban policy and the preferences of urban residents, and what facilitates (or impedes) this relationship?

For example, several researchers (Welch 1975; Peterson 1981) have demonstrated that the greater representation of African Americans and other historically underrepresented minorities has not always produced policies that reflect the needs and demands of these constituencies. Pluralism has fallen short of explaining why the greater representation of these constituencies has not produced taxing and spending policies that approximate the preferences of these newly empowered groups.

Market Theory

As a means of explaining local taxing and spending decisions, the debate between elite and pluralist theory focuses on who has power and who exercises it in a community. These explanations of local governance argue that the resolution of competing preferences is the essential process by which taxing and spending decisions are formulated. Market theorists ask a different question: what do governments do and why? In contrast to elite and pluralist theorists, market theorists expanded their explanation of municipal taxing and spending decisions to include forces both inside and outside the city. At the national level the answer to this question is straightforward: government's role is limited to those activities and responsibilities for which the private market is ill suited. The scope of government's functional responsibilities is identified by those goods and services that private-sector vendors are unable to produce due to significant inefficiencies and external factors. For example, the inability to exclude individuals from obtaining certain goods and services (such as clean air and national defense) limits the role of private markets in providing these goods and services. Consequently, the national government assumes a large, if not exclusive, responsibility for supplying them.

Tiebout's (1956) model of local public expenditures has provided the theoretical foundation for most of the empirical research on the market determinants of urban and metropolitan area public policies. Tiebout maintains that individuals select communities in accordance with their preferences for publicly provided goods and services, that is, they "vote with their feet." The content and level of municipal service packages are defined by the preferences of the average voter in each community. For Tiebout, an efficient market mechanism for the production of goods and services exists by virtue of (1) the number and diversity of states and communities, and (2) the mobility of voters to choose from among these communities the one that best approximates their preferences for goods and services. From these assumptions, a number of testable propositions have been derived (Dowding, John, and Biggs 1994, 768):

- The larger the number of competing jurisdictions, the greater the satisfaction level of consumer voters.
- The larger the number of jurisdictions in the same metropolitan area, the greater the competition between them for consumer voters.
- The larger the number of competing jurisdictions, the more homogeneous each jurisdiction will be.
- Taxes as well as services influence residential mobility.
- The higher the quality of the services (tax levels), the higher (or lower) the property values in the jurisdiction.

Tiebout's model of local expenditures is neutral regarding the content of governmental functional responsibility and the functions that state and national governments should assume. For example, Tiebout does not identify a set of services like public safety, utilities, and roads as being essential to the operation of municipal government. Instead, he argues that the content of functional responsibilities is limited only by the median voter's preferences. Tiebout provides an engine, namely, the market, for assigning service responsibilities. Others have used this market engine to deduce a set of hypotheses for assigning functional responsibilities across different levels of government, thereby defining the taxing and spending decisions of municipal governments.

Buchanan (1971), Peterson (1981), and Miller (1981) introduce an important qualification to Tiebout's theory of local expenditures that significantly informed the debate on the scope and content of municipal public policy. Each author notes that the mobility of residents in a metropolitan area produces a significant bias for the retention of wealthier residents. Buchanan demonstrates that municipal governance under majority rule will advantage low-income citizens at the expense of high-income residents. The
result is income redistribution, a cost for middle- and high-income persons that can be avoided if they migrate to another locale. Peterson further explores this bias toward the retention of wealthy residents. His thesis is that "local politics is not like national politics"; consequently, "there are crucial kinds of public policies that local governments simply cannot execute" (Peterson 1981, 4). By inference, he claims there are policies that only the national government can efficiently perform.

Peterson maintains that the scope and level of a community's functional responsibilities are constrained by the inability of cities, and to a lesser extent states, to control the mobility of capital and labor across their respective borders. Though national governments can control the flow of money and people across their borders, states and cities are less effective at preventing their citizens, businesses, and capital base from migrating to other locales where tax-to-benefit ratios are superior. Consequently, local governments seek to maximize their economic well-being by pursuing policies that enhance the community's economic base while avoiding those policies and activities that threaten the community with the loss of productive capital and labor. This means that cities, states, and other subnational units of government pursue developmental policies (roads and highways) that generate economic resources (tax base) that can in turn be used for the community's collective welfare. At the same time, city governments are expected to avoid redistributive public policies that benefit dependent and nonproductive persons (for example, welfare, housing, and health care), because these policies draw resources away from productive citizens without providing them with commensurate benefits. Again, by implication, the responsibility for redistributive policies is less harmful to states and national governments than it is to local governments because of the significant transaction costs associated with migration between states and nations.

For Buchanan, Miller, and Peterson, the hypotheses derived from Tiebout's work provide the theoretical foundation for their own empirical expectations about the assignment of functional responsibility in a federal system. These hypotheses include:

- Expenditures on redistributive services are a function of fiscal capacity (wealth), not demand and public preferences in the community.
- Expenditures on developmental services are a function of demand (population size).
- Tax rates and tax burden (local taxes as a percentage of personal income) will tend toward uniformity among communities competing in the same market for consumer voters (that is, a metropolitan area).

For political scientists, a number of significant implications flow from the theoretical work of Tiebout, Buchanan, and Peterson. First, politics, at least at the subnational level, is marginalized, because demand and public preferences do not drive spending policies for redistributive social services. Spending for redistributive policies at the subnational level is largely a function of wealth. Politics is not important to the formation of most municipal public policies, at least not for those associated with significant redistributive effects. Finally, by implication, subnational units of government are more efficacious when they engage in developmental policies, and less efficacious when pursuing redistributive social policies. The delivery of redistributive social services is more efficiently handled by the national government.

The evidence to support Peterson's empirical hypotheses is mixed. Municipalities spend considerably more on developmental and allocation functions (road, street, water, and other infrastructure) than on redistributive goods and services (health, welfare, and housing). Peterson further shows that demand for social services is unrelated to spending for redistributive social services. If policies mattered in the formation of urban taxing and spending policies, we would expect to observe a positive relationship between indicators of poverty and municipal spending for social services. Peterson (1981), however, reports that municipal spending for an array of social services, including housing, welfare, public hospitals and health services, is unrelated to indicators of poverty, minority population, and other related indices of need and demand.

Stein (1990) reports, however, considerable variation in the range of municipal spending on redistributive social services. Many more communities play an active role in the provision of social policies that are potentially harmful to the interests of the city than Peterson or other market theorists would lead us to believe. Why?

Institutional Determinants

Rules governing how cities make decisions (by plurality, simple majority, or supermajority), the method of representation (at-large or single-member districts, and partisan or nonpartisan elections), and the nature of the executive office (elected mayor or city manager) have been found to directly influence the content of urban public policies. Several researchers have found that different rules and procedures favor certain types of spending and taxing policies that impose disproportionate costs and benefits on different segments of a community.

Banfield and Wilson (1963) were the first to argue that certain institutional arrangements promote the interests and preferences of different groups and also translate those preferences into policy outputs. The authors observed that reformed municipal governments with single-member district representation, partisan elections, and a mayoral form of government tend to produce policies that are more private regarding rather than public regarding. Public-regarding policies focus on the needs and interests of the entire community, whereas the narrower private-regarding policy outputs distribute benefits to specific geographic areas and ethnic and partisan
interests, independent of the need for these policies. Governments with reformed structures, including nonpartisan elections, a city manager, and at-large elections are thought to minimize partisan, ethnic/racial, and geographic influences on the formulation of local public policies.

Empirical tests of Banfield and Wilson’s thesis have produced mixed and inconclusive findings. Lineberry and Fowler (1967) found significant differences in the taxing and spending decisions of local governments with reformed and unreformed institutional arrangements, confirming Banfield and Wilson’s hypotheses. More sophisticated time-series analysis by Morgan and Pelissero (1980), however, failed to produce significant differences in the spending and taxing outputs of reformed and unreformed governments, leading these authors to conclude that “in the long run, government structure may matter very little—at least when it comes to city taxing and spending policies” (p. 105). This conclusion may be premature and overlooks other important rules and procedures governing the urban policymaking process.

A different perspective on the institutional determinants of urban taxing and spending decisions identifies alternative ways for cities to provide various goods and services. Stein (1990, 3) argues that “the way in which governments organize themselves to perform policy functions has a significant effect on the scope and content of municipal policy performance.” The conventional view of municipal public policy is that urban governments are solely responsible for all phases of service provision, including the choice of services, the means of funding, and producing and delivering goods and services. This view, however, is both naive and wrong. A wide range of urban public policies are financed, produced, and delivered by a host of alternative methods that involve agencies in the private, nonprofit, and public sector. These alternative arrangements are associated with significant savings in providing certain types of services. The quandary of cities providing redistributive social services is partly answered by the use of alternative institutional arrangements. Stein and several other researchers (see Hodge 2000) have demonstrated that these alternative arrangements produce significant savings to cities that mitigate the potentially harmful consequences associated with the municipal provision of social services.

A Paradox Partially Answered: Municipal Service Arrangement

The paradox in the taxing and spending policies of U.S. municipalities has been a central theme in this chapter. Despite sound theoretical advice, many municipalities pursue service responsibilities that potentially undermine their economic, social, and political well-being. Several theories have been advanced to address this paradox, and each has been found deficient in its explanation and supporting empirical evidence. How cities pursue spending and taxing policies that are antithetical to their interests can be explained in terms of how they organize for the provision and production of services.

Cities face two choices when arranging to provide a specific service. They can produce the service with their own resources, using their own public employees and equipment to collect the garbage, clean the water supply, trim trees, or perform any other function the city chooses to provide. Alternatively, cities can purchase needed services from other governments (for example, adjacent cities or an overlapping county) or private companies. Governments choose such an alternative either to save on production costs or to obtain access to goods and/or services that might not be within the city’s means to provide. For example, many communities are too small to pay for the construction of their own sewage treatment plant or to purchase garbage trucks for the collection of solid waste. For smaller-sized communities, contracting with a larger adjacent community or a private vendor may be the only way to obtain these services for their citizens. For example, Houston, Texas, sells water as well as sewage treatment services to several metropolitan area suburbs. These communities could not raise the tax dollars or borrow the funds needed to construct sewage treatment plants or a water distribution system without imposing higher taxes on their citizens. Larger communities or private vendors who can service large populations experience a lower per unit cost of production for services like sewerage, water, solid waste collection, and other public utilities. This is known as an economy of scale: costs per unit of production decline with an increase in production. A municipal bus system exemplifies an economy of scale. Public buses have relatively fixed costs, such as the purchase of the vehicle, gas, and wages for a driver. If ten people ride the bus each day, the cost per rider is one-tenth of the total cost of operating the bus for one day. However, if 3,000 persons ride the bus in one day, the unit cost of operating the bus plummets, because it is getting revenue from 3,000 rather than ten passengers without significantly increasing its cost of operation.

Even large communities may find it advantageous to use other governmental units or private companies to produce and deliver city services. Cities, for obvious political reasons, rely on union labor, which receives higher wages and more generous health and retirement benefits than nonunion labor does. Private-sector vendors can better resist the political pressures to hire union workers and can therefore reduce their labor costs by employing nonunion workers.

Contracting out for some services can produce significant savings for a city, especially when the largest production cost is human labor. For many social services, including public health programs and hospital and mental health services, labor is the largest expense. For other core city functions, including solid waste collection, water, sewerage, and roads, the principal factor of production is money for the construction
of plants and equipment purchases. The labor costs of operating these facilities are a small portion of the total cost of providing these services. For example, many cities use side-loading garbage trucks that enable the driver to use automated equipment to lift garbage cans and deposit their contents in the truck. As a result, only one person is needed to operate the truck, rather than a crew of four (one driver and three loaders).

The savings realized from the use of nonmunicipal employees, as well as the reduced costs associated with the economies of scale that accompany nonmunicipal vendors, might resolve the paradox of municipal service responsibility. The incidence of cities using vendors and employees other than their own to provide redistributive social services may account for how cities are able to offer these potentially problematic services without suffering the economic and political ills predicted by Peterson, Buchanan, and Miller. The savings from using more efficient vendors to provide these services mitigates the income redistribution associated with municipal responsibility for these social services.

Stein reports a 1982 survey of municipal governments indicating that “if alternatives to direct service provision and production are not available, the mean scope of functional responsibility for social services would drop from 43.3 percent to only 24.3 percent for the surveyed cities” (1990, 198).

Table 9-1 reports the findings of a 1997 national survey of 1,200 municipal governments. The study queried municipalities about their responsibility for sixty-four different services and how they arranged to provide them. The first column reports the percentage of cities that reported responsibility for selected services. The second column reports the percentage of cities with responsibility for each function that reported using only municipal employees to provide each service. For all but one social service (programs for the elderly), 75 percent of the cities that reported responsibility for a social service stated that the service was provided by employees from another government and/or private entity.

As expected, the most frequent means for providing social services is use of other vendors and their employees. The tentative conclusion that can be drawn from these findings is that cities seeking savings by outsourcing the provision and production of services are more likely to assume responsibility for social services and functions that are potentially contentious. Moreover, this finding provides a more nuanced explanation of the role that municipal politics plays in shaping the taxing and spending policies of American cities. What governments do and specifically how they perform their functional responsibilities appear to be determined by the policy demands that arise among needier and high-demand constituents: the poor, elderly and, infirm. The effect of these demands on taxing and spending policies is mediated by the choices municipal governments make about the scope and content of functional responsibilities and how they organize for the provision and production of these services. Consequently, politics matters in the making of urban public policy, but not always in a manner that is transparent or direct.

### Table 9-1 Functional Responsibility and Mode of Service Arrangement for Selected Services, 1997 (in percent)

<table>
<thead>
<tr>
<th>Function</th>
<th>Cities responsible for services</th>
<th>Cities using only municipal employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Roads</td>
<td>92.5%</td>
<td>39.3%</td>
</tr>
<tr>
<td>Sewerage</td>
<td>69.1</td>
<td>59.3</td>
</tr>
<tr>
<td>Solid waste collection</td>
<td>62.5</td>
<td>36.3</td>
</tr>
<tr>
<td>Police</td>
<td>96.2</td>
<td>89.1</td>
</tr>
<tr>
<td>Average</td>
<td>80.7</td>
<td>56.0</td>
</tr>
<tr>
<td>Social services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Homeless</td>
<td>19.1</td>
<td>1.7</td>
</tr>
<tr>
<td>Mental health</td>
<td>27.3</td>
<td>10.4</td>
</tr>
<tr>
<td>Hospitals</td>
<td>17.5</td>
<td>5.1</td>
</tr>
<tr>
<td>Day care</td>
<td>20.5</td>
<td>16.0</td>
</tr>
<tr>
<td>Child welfare</td>
<td>29.9</td>
<td>23.1</td>
</tr>
<tr>
<td>Elderly services</td>
<td>59.8</td>
<td>26.1</td>
</tr>
<tr>
<td>Average</td>
<td>29.0</td>
<td>13.2</td>
</tr>
</tbody>
</table>


### Conclusion

What conclusions can we glean from the literature on the politics of municipal taxing and spending? The politics of municipal taxing and spending is very much a story of constrained behavior. Cities occupy an institutionally and physically weak position in the American federalist system. Unlike nations and states, cities have porous borders. Productive capital and labor are free to choose from among a host of metropolitan area governments without incurring any significant moving costs. Municipal borders matter, because they place metropolitan area communities in competition with one another for the most productive capital and labor in the region. As creations of state government, cities do not have sufficient authority to be completely sovereign over their taxing and spending policies. State home-rule laws and restrictions on municipal taxing and spending policies influence the scope and content of urban public policies.
An enduring debate in the literature concerns the role of politics in shaping local public policy, especially fiscal policies. This question is about whether localities are able to operate independent of their physical and institutional constraints. Market theorists (Peterson, Miller, and Buchanan) downplay the influence of politics—and public preferences—on the formation of urban policies. Elite, pluralist, and regime theorists identify politics as a seminal force in shaping urban public policies. The tension in this debate is between the fulfillment of individual and group preferences and the interests of the city, that is, the attraction and retention of productive capital and labor. The empirical literature suggests that cities do act in a manner that is at variance with market theorists’ predictions (prescriptions) to eschew responsibility for taxing and spending policies harmful to the city’s interests. Moreover, the incidence of this policy practice parallels public support for these policies. Curiously, however, cities appear to succeed at providing redistributive social services without suffering excessive losses of productive capital and labor and related social and economic problems. Why? One explanation is the way cities organize themselves for the provision of services. Employing alternative modes of service provision can enable cities, through sufficient gains in efficiency, to partially offset the expenses associated with costly social services. But whatever the savings garnered from these alternative modes, they do not provide an absolute defense against the dangers of porous borders.

**Suggested Readings**


Peterson, Paul. 1981. *City Limits*. Chicago: University of Chicago Press. An important restatement of Tiebout’s classic thesis about urban politics and public policy, which argues that cities have a unique “self-interest” focusing on policies that develop their economy, preventing them from pursuing redistributive social services.


**References**


**Notes**


### 10 Economic Development Policies

Richard D. Bingham

**What Is Economic Development?**

Some years ago, the American Economic Development Council (AEDC), then the major professional association in the urban economic development field, defined economic development as “the process of creating wealth through the mobilization of human, financial, capital, physical and natural resources to generate marketable goods and services” (AEDC 1984, 18). For the public sector, over the years, this has meant an emphasis on the creation of jobs and wealth. More recently, an added focus has been to create jobs and wealth that benefit the local population. Thus local government’s role in economic development is to “facilitate and promote the creation of jobs and wealth by the private sector, and to ensure that it does so in a way that serves the short- and long-run interests of the broad population” (Bingham and Mier 1993, vii) [emphasis in original]. The economic development policies of local government are those designed to create private-sector jobs and wealth in the interest of the local population.

The systems approach provides an understandable framework for examining economic development policy. The systems model invites a look at the individual components of an allocative system and emphasizes their interconnections. This analytical approach to imposing order makes systems analysis highly compatible with empirical research. In certain respects it is like building a complex “black box.” The box serves the function of converting resources into outputs and eventually into outcomes. Economic development is presumably the system that converts resources like land, labor, and capital into gross state product and/or other outcomes.

Because systems analysis is allocative, it is also political. It requires answers to political questions. For example, how are land, labor, and capital allocated to optimize the growth of gross state product? Penetrating the black box of the relationship between the political process and the process of urban growth is the objective of economic development theories in a wide variety of disciplines.

**The Theory Problem**

The varied interests of disciplines in economic development and economic development theory are illustrated in a now somewhat dated book, *Theories of Local...*