

CHAPTER VII: GOVERNMENT and GOVERNANCE¹

1. Definition and Significance

In this chapter we examine how government and governance within metropolitan regions affect regional economies and regional economic growth. We focus on the organization of government and governance within metropolitan regions, on the taxing and spending activities of governments within a region, and on the culture of governmental institutions.

The collection of institutions and the culture they foster shape the economic activity that occurs in a region. While *government* is the predominant part of this institutional environment, it is only one piece of the puzzle of regional *governance* as carried out by a broader range of regional institutions. To clarify, *government* is a territorially based body that makes authoritative decisions (for which it has constitutional or legislative authority) that are binding on residents and businesses within its boundaries.

We define *governance* (admittedly a somewhat contested concept, see Appendix A) as the process of governing through which decisions are made that are intended to affect societal outcomes, including economic, social, environmental and other important outcomes. As Bradway and Shah (2009, p. 242) define it, governance is “the formulation and execution of collective action at the local level. Thus, it encompasses the direct and indirect roles of formal institutions of local government and government hierarchies, as well as the roles of informal norms, networks, community organizations, and neighborhood associations in pursuing collective action.” In this conception government (the public sector) is nearly always involved and usually plays a vital role, but other sectors - non-profit organizations, foundations, civic elite organizations, business leadership organizations, labor unions, social service organizations, and the inter-organizational collaboration among these various groups - may play important roles as well.

In the American system there is no general purpose unit of government at the regional level. Instead there are a variety of different kinds of local governments within a region, including counties, municipalities (and, in some states, townships), school districts, and various special districts. While there are no regional general governments, there are regional special districts in most metropolitan areas. Since local governments in the United States are creatures of their state government, the potential activities of local governments vary from state to state.

Regional governance is the process through which decisions are made that are explicitly meant to affect economic, social, environmental, and other important societal outcomes throughout the entire region or at least throughout parts of the region that extend beyond single governmental jurisdictions. Regional governance thus explicitly *excludes* decisions of a single unit of government such as a city or county acting on its own or a private firm pursuing its own

¹ The lead authors of this chapter are Hal Wolman, Alice Levy, and Diana Hincapie. The chapter draws upon both Wolman et al., *Economic Competitiveness and the Determinants of Sub-National Area Economic Activity* (2008) and Kosarko and Weissbourd (2010), *Economic Impacts of GO TO 2040*. Small segments of the text are lifted verbatim from these papers.

interests, even if these actions have an impact on societal outcomes throughout the region. Given the lack of regional governmental institutions (other than regional special districts and regional or multi-jurisdictional planning entities), regional governance usually requires cooperation among local governments and among other institutions with regional interests or missions.

Every region has some means of regional governance and we characterize these as regional governance regimes. These may vary from some regions where agreement is reached through ad hoc intergovernmental negotiations and agreements, to regions where governance is a product of decisions by regional special authorities, to other regions where there are formal systems of multi-purpose regional institutions.

Government plays a fundamental role in the economic development process. Economic development is largely a product of market forces, but market rules and operating procedures, including property rights and contract law, are set and enforced by government. Government plays a role in the economy through the provision of public goods that are collective in nature and through efforts to counter market imperfections such as externalities or poor information. For example, government at the state and local level, but often financed at least partially by the federal government, provides the public infrastructure that services economic activities. It also provides public services (e.g., police, fire, waste management) to both business and households. To finance its services, state and local governments impose taxes that are part of the cost of doing business and, since these taxes and the services they finance vary among states and among local governments, they are a consideration in business and household location decisions. Similarly, state and local governments impose regulations that affect business and economic activity. Furthermore, these decisions vary across states, metropolitan areas and local governments, rendering some more favorably poised to generate economic growth than others.

Determining how government can enable and improve the performance of the private sector – where wealth is overwhelmingly created – without displacing or unnecessarily distorting it, is one of the most complex challenges in driving regional economic growth. Economic theory is sometimes used as a rationale for limiting government’s role to a narrow set of functions related to addressing market imperfections. However, if as North and others believe, effective institutions can play a central role in facilitating economic progress, there is a strong case to be made for improving government (and other institutions) as a strategy for pursuing economic growth.

2. Local Government Structure and Regional Economic Growth

A. Discussion

Regional economic growth is highly affected by local governmental activity. However, as discussed in Chapter II, given the nature of the various regional systems that interact to produce regional economic growth, the real economy in a metropolitan area is regional in scope. Despite this, there are virtually no multi-purpose local governments at the regional level (the Twin Cities and Seattle are two exceptions). In other words, the regional governmental system operates at a

different geographic scale than does the regional economic system. Labor markets, housing markets, land markets, and the transportation network are all regional in nature. However, the formal political system is emphatically not regional in nature. This discrepancy has generated substantial challenges for policymakers interested in promoting economic growth and a substantial body of literature describing such challenges, which we summarize below.

The proliferation of governments within the typical American metropolitan region is frequently characterized as “fragmentation.” Fragmentation can be either horizontal or vertical. Horizontal fragmentation refers to multiple governments of the same type. Within a metropolitan area there are likely to be many separate general purpose governments, including large numbers of municipalities, often two or more counties, and in states with townships, several townships. In addition to general purpose local governments (which are responsible for multiple functions and have taxation and regulatory powers), there are a variety of special districts created to provide specific services. The most widespread of these are school districts, but there are many other types as well, some of which may even be region-wide, and most of which have revenue-raising powers.

In addition to horizontal fragmentation, fragmentation also exists vertically through the overlapping of many of these different kinds of governments. Thus, in most states, a resident will be served (and taxed by) a municipality, a school district (which may or may not be coterminous with the municipality), a county (of which the municipality, along with other municipalities, will be a part), and various special districts whose boundaries, unless the special districts are established by the municipality, are unlikely to be shared by the municipality. In short, these various levels of government overlap each other.

Why does this matter? What are the costs and benefits that result from this fragmented system?

We begin with the problems that horizontal and vertical governmental fragmentation of metropolitan regions pose for regional economies and regional economic growth.

- 1) *Incentive structure biases against regional decision making.* The institutional structure of US metropolitan areas is composed of many general purpose local governments, each of which is governed by officials elected by the voters residing within the local government jurisdiction. Elected officials respond to their electors and their concerns (indeed, this is the way representative democracy is supposed to operate), and this response is strongly reinforced by the possibility of being voted out of office at the next election if they fail to do so. Thus, to the extent that “acting regionally” or in the region’s interest is perceived by residents of a local government to be counter to local interests, local elected officials will be loathe to act regionally. However, there surely are situations that are “win-win,” i.e., where local interests coincide with the interests of the overall region in promoting regional economic growth. This should particularly be the case with respect to the location of employment; given that regional labor markets make it possible for residents of one locality to commute to jobs in another local jurisdiction within the region, a local jurisdiction concerned with employment for its residents should support new or expanded employment anywhere within the region. However, in practice,

we often see that local tax structures induce competition between local governments within the region instead of cooperation.

- 2) *Local tax structure within metropolitan areas encourages inter-jurisdictional competition rather than cooperation.* The property tax is the primary tax base for virtually all local governments. A local government is able to generate property tax revenue from a firm or household *only if* it locates within its boundaries. If the firm locates outside of a jurisdiction's boundaries, the jurisdiction is able to capture additional revenue from its residents who commute to work in the firm, *only if* the jurisdiction has a local income tax. In most states local governments are prevented by state law from imposing a local income tax, although several states with very large cities do permit these cities to levy such a tax. As a consequence, the incentive for elected local officials (who have to provide services to their residents paid for through local revenue), is to attract local development within the jurisdiction's borders. The economic development policies that are generated by this incentive are low tax rates and/or a series of tax breaks and subsidies provided to firms that locate in the jurisdiction. In the absence of a region-wide governmental body, regional economic development policy at its core often consists of a series of local government incentives designed to attract employment from one local government within the area to another rather than a coordinated effort to engage in activity to promote regional economic growth wherever it most appropriately might occur within the region. As Oates (1972) notes, the result is an erosion of the local tax base, lower tax rates, and the provision of services at a lower level than is optimally efficient. Regional planning or economic development organizations might engage in regional marketing efforts, promote cluster networks, and provide data, but they usually do not have the ability to *implement* a regional economic development strategy.
- 3) *Local government horizontal fragmentation and local land use regulation reinforce inter-jurisdictional competition.* Local governments control land use policy within their boundaries, virtually always without regional or state coordination or oversight. They thus zone land to produce their desired environment and to encourage positive fiscal outcomes, a process known as "fiscal zoning." Some suburbs, particularly the wealthier ones, engage in forms of exclusionary zoning (e.g., large lot requirements, restrictions on multi-family rental housing) that effectively prohibit low- and moderate-income households from living within the jurisdiction and thus reduces the high service costs relative to property tax contributions of such households. Others zone out commercial and industrial uses. Where local sales taxes are important, local governments may zone for retail development at the expense of other uses. All of these practices may have seriously adverse implications for regional spatial efficiency (see Chapter VI).
- 4) *Vertical fragmentation provides incentives for higher levels of both taxes and public services.* As Berry (2009) argues, while multi-purpose governments must make fiscal tradeoffs among competing priorities, single-purpose governments are budget maximizers with respect to the single function for which they are responsible. Furthermore, special district elections have lower turnout rates and are likely to consist disproportionately of voters with a strong interest in increasing the services that the special district provides. As a result, Berry concludes (p. 180), "the single function

politicians provide higher spending on each service, and the aggregate budget (for the geographic area) is larger than it would be if there were only one government. This is the fiscal equivalent of a common-pool problem.”

- 5) *Fragmented government imposes administrative and regulatory costs on businesses that operate in multiple jurisdictions within a region, requiring them to negotiate through additional layers of regulation and permitting requirements.*

The above discussion suggests that the institutional structure of local government in U.S. metropolitan areas, buttressed by the local tax structure, serves to discourage, if not prevent cooperation and collaboration on regional economic growth and development issues. Indeed, it is also argued that local government fragmentation prevents cooperation on a wide-range of activities. However, there are many issues where local interests do not compete with regional interests and/or where services or facilities for a local government can, for reasons of cost and logistics, only be provided regionally. These services and facilities are usually provided through a single-purpose regional authority (e.g., a regional water authority; regional airport authority, regional transportation authority). In other cases they are provided through consultation, informal cooperation or negotiated inter-local agreements among two or more local governments. Oliver Williams (1965) several decades ago observed that infrastructure decisions were politically relatively easy to deal with regionally, while “lifestyle” decisions involving social access or decisions directly affecting resource redistribution were politically dangerous and thus extremely unlikely to be undertaken. It is important to stress that fragmentation does not prevent regional governance; it is the structural context in which regional governance occurs and which therefore shapes the nature of regional governance.

It is also important to note that that the fragmented local government structure in metropolitan areas does not *always* adversely affect regional cooperation and collaboration and, indeed, may produce substantial benefits. Indeed, some economists argue (see Wallace, 2008 for a review of the literature, also Oates and Schwab, 1991) that fragmentation and the existence of many local governments may have some positive impacts. Following Tiebout, they contend that fragmentation and many local governments results in competition to provide services more efficiently and at lower tax costs. If a region can lower its average tax cost without lowering its level or quality of services, it will have a competitive advantage over other regions.

As this suggests, there are two schools of thought on the ideal level of centralization/fragmentation. Defenders of fragmentation argue that as the number of local governments increases, it spurs efficiency of operations in governmental units resulting in greater economic growth. This viewpoint is often traced back to Tiebout’s theory of local expenditures (1956), in which Tiebout argued that multiple competing local governmental units allowed “consumer-voters” (presumably including businesses) to select the communities that best satisfied their preference patterns. The greater the number of communities, the more likely the “consumer-voter” will be able to locate in a place that meets his/her ideal preferences. Further, the need to compete for “consumer-voters” provides an incentive for local governments to operate efficiently. In addition, some argue that tax competition among many local governments will result in driving down the cost of doing business throughout the region by

reducing the tendency of local governments to use taxes on businesses (who are non-voters) to cross-subsidize taxes on households (who are voters).

On the other hand, opponents of fragmentation (often called consolidationists) argue that large, multi-service governments achieve economies of scale and scope, resulting in more efficient operations and greater income growth for the region as a whole (Nelson and Foster, 1999). They argue that local government competition is a zero-sum game resulting in: corporate welfare, subsidies to land or property-based interests, levels of taxes and services that do not reflect resident preferences, and/or higher, unnecessary costs imposed upon communities and residents. Further, critics of government competition argue, such government interventions into the private market create economic rents distorting investment location decisions and creating inefficiencies in capital markets (Feiock, 2002). They also note that in a coherent, streamlined government, there is greater transparency, increased accountability of public officials to local constituents, and lower transaction costs.

B. What Does the Empirical Evidence Show?

To what extent is there empirical support for the proposition that fragmented local government retards economic growth or that regional government or governance promotes it? While the above discussion presents the powerful logic that underlies the presumed adverse relationship between fragmentation and regional economic growth (as well as the logic that underlies the contrary proposition), there is a relative paucity of empirical evidence.

Part of the problem results from the fact that measuring regional governmental fragmentation and regional governance has proven difficult and contentious. Different researchers employ different operational measures, making it difficult to compare research findings across studies² and helping to account for the diversity in the findings on its effects that we discuss below.

While measures of government fragmentation have a reasonably long history of use in empirical research, this is not the case for regional *governance*. Little systematic work has been done to specify the range of capacities for and degrees of regional action, and their relationship to successful regional development. Perhaps because the concept of regional governance is rather vague, there have been few efforts to attempt to operationalize and measure it (but see discussion in section 6 on a suggested research and development agenda).

There have been some efforts to develop typologies of regional government or governance (for a review of these typologies, see Millar, 2008, pp. 10-19). However, these typologies are

² Measures of fragmentation have included a count of all local governments in the metropolitan area (Hill, 1974, Dolan, 1990, Cutler and Glaeser, 1997), local governments per capita within the MSA (Hawkins, 1971; Hill, 1974; Zeigler and Brunn, 1980; Parks and Oakerson, 1992), a count of local *general* purpose governments or local *general purpose* governments per capita within the region (Lewis, 1996; Ellen, 1999), and more complex measures that attempt to account not only for the number of local governments, but for their relative importance or influence (Lewis, 1996; Mitchell-Weaver, Miller, and Deal (2000); Millar, 2002). Berry (2008, 2009) develops measures of *vertical* fragmentation measures, including special function jurisdictions per municipality and the number of *overlapping* jurisdictions per municipality in the metropolitan area.

conceptual only; with few exceptions³ they are not actually utilized to classify or describe specific metropolitan areas. Indeed, at present there is no data set on regional organizations and activity by metropolitan area available that would permit empirical development of regional government or governance typologies (see section 6).

Below we describe the research that has attempted to assess the relationship between horizontal and vertical fragmentation and economic growth. The results are ambiguous.

Several studies look directly at the effect of government and governance structure on regional economic outcomes such as employment, income, or firm births. Foster (2001) concludes that the theoretical and empirical evidence of the effects of regionalism in achieving metropolitan goals, like achieving equity, environmental sustainability and regional economic growth, provides a mixed and inconclusive picture. Swanstrom (2002) agrees, observing that, “the evidence that fragmentation hurts regional economic development is both weak and mixed. Some studies find that fragmentation reduces regional economic growth (e.g., Paytas, 2001; Hamilton, Miller, and Paytas, 2004), while Stansel (2005) finds that fragmentation increases regional income growth. Grassmuck and Schmucl (2010) find that the results are sensitive to the way that horizontal fragmentation is measured. When local governments per capita is used as the measure of fragmentation, the more fragmented a metropolitan area is, the lower its regional employment growth, whereas using a measure that adjusts for the relative importance of various local governments produces results that show that fragmentation increases regional employment (see also Nelson and Foster, 1999).

Looking at horizontal centralization, Paytas (2001) assesses the impact of fragmented local government on the economic competitiveness of metropolitan areas between 1972 and 1997. Economic competitiveness is defined in terms of income growth using a shift-share technique that calculates metropolitan income growth after accounting for both regional employment trends and national income trends⁴. He finds that between 1972 and 1997, fragmentation has been increasing⁵ and that there is a large negative statistically significant impact between the extent of horizontal fragmentation and metropolitan competitiveness.

³ Hitchings, 1998, classifies metropolitan areas into one of four categories: 1) ad hoc regions where governments work together but do not have a written regional plan, 2) regions where a regional plan exists, but there is no authoritative implementing mechanism, 3) regions where a regional plan exists and there is some supervisory mechanism responsible for implementing the plan, even if implementation means simply receiving compliance reports from local governments in the region, and 4) authoritative regions in which a regional plan exists and there is a regional body with the authority to enforce compliance with the plan by local governments.

⁴ Horizontal decentralization is measured using a Metropolitan Power Diffusion Index (MPDI) that the authors calculate. The MPDI is based on 24 expenditure categories and shows the relative power of various overlapping governmental institutions without obscuring the importance of small local governments⁴; a value of 1 indicates perfect consolidation and values increasing up to infinity indicate increasing decentralization. Vertical decentralization is measured using Stephens' State Centralization Index (SCI) which accounts for the services delivered by the state, services financed by the state but delivered by other units of government, and state government personnel. In addition to including both measures of centralization, Paytas includes an interaction term to the hypothesis that horizontal fragmentation matters less in centralized states. Mathematically, the MPDI calculates the sum of the square root of each municipality's percentage of metropolitan expenditures by expenditure category. The MPDI can also be calculated using revenues instead of expenditures.

⁵ Paytas argues that the increase is due to the creation of new governmental units (especially special districts and authorities) as a means of evading constitutional debt limitations. Paytas notes that much of this decentralization has been conducted under the auspices of increasing economic development but that this dispersion of authority may actually create additional challenges with respect to maintaining regional competitiveness.

Hamilton, Miller, and Paytas (2004) conduct an analysis very similar to that employed by Paytas (2001) assessing the determinants of metropolitan competitiveness in terms of the income shift share and characterizing metropolitan governing using both the MPDI and the SCI. They also find that fragmentation is negatively related to regional income growth.

Grassmueck and Shields (2010) look at the impact of government organization on MSA economic growth between 1992 and 2002. The authors measure governmental organizational form with the Hirschman-Herfindahl Index (HHI) and the metropolitan power diffusion index (MPDI), both of which rest upon the assumption that government units with spending authority are those with the political and economic power to influence economic growth⁶. When fragmentation is measured in terms of the HHI and MPDI for all local governments in the metropolitan area, Grassmueck and Shields find that horizontal fragmentation is associated with *increased* employment and per capita income growth. This finding is in direct contrast to the results reported by Paytas (2001) and Hamilton, Miller, and Paytas (2004) even though one of their measures of horizontal decentralization was identical to that used in the prior two studies. However, in addition to their measures of fragmentation using the HHI and MPDI, Grassmueck and Shields run a model with the number of governmental units per capita and find a negative coefficient in both the employment and population models suggesting the when government fragmentation is measured in this manner it has a detrimental impact on economic growth.

Carr and Feiock (1999) look at a specific type of regionalism, city-county consolidation, to test whether this rather extreme form of reducing fragmentation affects development patterns and efforts to attract new business to a metropolitan area. City-county consolidation is a form of regional governance in that a single government organization replaces several, theoretically resulting in reduced service delivery costs, clear lines of government authority, improved accountability, and regional cooperation. The authors employ a time-series research design from 1950 – 1993 for nine consolidated governments⁷, each of which is also compared to counties in its own state. Their measures of business attraction include the number of manufacturing establishments and the number of retail and service establishments in the county (both of which were obtained via County Business Patterns). They find that once both the time comparisons and cross-state comparisons are included in their models, there is not a significant impact of consolidation on the number of business establishments, suggesting that if economic development is the purpose of reducing fragmentation, consolidation is unlikely to induce the desired results, but that consolidation did not *reduce* economic growth in these areas either⁸.

⁶ The HHI is a measure often used to measure the market power of various industries (or companies) and in the present study, the authors measure governments' market share in terms of the ratio of local governments' unit's expenditures relative to all government expenditures in the metro area. The primary advantage to this approach relative to simple counts of the number of governments is that it distinguishes active and powerful governments from the inactive and weak ones. HHI scores range from 0 to 1, with 0 indicating high fragmentation and 1 indicating consolidation. The MPDI is a variation of the HHI, but is calculated in such a way that 1 indicates consolidation and values up to infinity indicate increasing levels of fragmentation.

⁷ City of Anchorage/Anchorage County, AK (merged 1975); City of Jacksonville/ Duval County, FL (merged 1967); City of Columbus/ Muscogee County, GA (merged 1970); City of Indianapolis/ Marion County, IN (merged 1969); City of Lexington/ Fayette County, KY (merged 1972); City of Houma/ Terrebonne County, LA (merged 1984); City of Butte/ Silver Bow County, MT (merged 1976); Carson City/ Ornsby County, NV (merged 1969); City of Suffolk/ Nansemond County, VA (merged 1972)

⁸ However, Carr and Feiock argue that it is possible that the increased professionalism, planning capacity, and legal, jurisdictional, and financial resources resulting from consolidation enhanced the efficiency of local development efforts, even if total development remained unchanged. The authors argue that the problem with local jurisdictions

Nelson and Foster (1999) look at the relationship between metropolitan governance structure and regional per capita income, one measure of regional economic outcomes across the 287 largest MSAs between 1976 and 1996. The authors find that existing case studies and aggregate studies provide inconsistent evidence. One of the limitations to much existing research, Nelson and Foster argue, is the inability to find appropriate measures of regional governance. For example, one of the most common approaches to assessing fragmentation is to use the number of governmental units (per capita or otherwise standardized) but such an approach treats all local government influences as equal which is not a valid assumption. Instead Nelson and Foster set forth a number of characteristics, each of which captures some aspect of fragmented metropolitan governance. These include:

- Central-city dominance (percentage of MSA population residing in central city)
- Central-city elasticity (ratio of central-city population in 1980 to 1960 divided by the ratio of land area in 1980 to 1960)
- Special-service district dominance (ratio of special-purpose governments excluding school districts relative to general-purpose governments)
- School districts per one million population
- General purpose elected officials per one million population
- Special purpose elected officials per one million population
- City-county consolidations
- Single-county, two-tiered federations
- Regional special purpose districts (limited to water and wastewater)
- Regional multipurpose districts (such as Minneapolis-St. Paul, Portland, and Seattle)

Using this approach to characterizing governance, Nelson and Foster (1999) find that as the percent of the MSA population residing in the central city increases (suggesting less fragmentation), regional per capita income decreases. The special-purpose government dominance variable (suggesting fragmentation) is negative (though marginally significant). Neither school district nor general purpose elected officials densities are significant, nor are city-county consolidations. Multipurpose districts are positive as are regional utility districts (though the latter are only marginally significant), while single-county two-tier federations are negative and statistically significant. Nelson and Foster (1999) conclude that central city inelasticity may hinder regional economic growth but that having at least a few thriving suburbs is also important to economic growth. They argue that although having numerous small governments does not lead to efficiency-producing competition between local governments, a minimum number of municipalities in competition with one another does enhance efficiency. Further, fragmented decision making (in the case of more elected officials and special purpose districts) leads to reduced per capita personal income.

competing for economic development is not these efforts but rather their costs, which increase with zero-sum completion while a consolidated local government could achieve similar results at a lower cost. Alternatively, the lack of findings may be attributable to the fact that consolidations typically leave sub-county units in place (such as school districts and municipal governments), rendering the consolidation much less meaningful in practice than it is in theory.

Stansel (2005) looks at the impact of horizontal decentralization (fragmentation)⁹ on metropolitan population and per capita income growth between 1960 and 1990. Decentralization is measured as (1) the per capita number of general purpose governments and public school districts, and (2) the share of the metropolitan population residing in the central city. Stansel found that the per capita number of governments was directly related to both population and per capita income growth, suggesting that horizontal decentralization improves economic competitiveness. Similarly, the central-city's share of regional population was inversely related to both population and per capita income growth, suggesting that horizontal concentration is related to reduced economic competitiveness.

There is also a substantial literature assessing the effects of fragmentation on service costs within the region, an important topic but only indirectly related to regional economic growth. Since higher-priced (or less efficient) public services will impact economic growth, the inference is that if fragmentation drives up the cost of public services, it will also result in decreased economic activity. Boyne (1992) and Hawkins and Ihrke (1999) conduct literature reviews of these studies; both find inconclusive results.¹⁰ However, in a review of over 2000 articles and books, Dowding, John, and Biggs (1994) conclude that public expenditures *decrease* as the number of governments increases, i.e., fragmentation reduces per capita spending on public services in a region. Berry (2009) examines the extent of *vertical* fragmentation within metropolitan areas and finds that such fragmentation is positively related to levels of taxation and spending within the region.

Taken together, the diversity of findings provides some, but not unambiguous, support for the conclusion that fragmentation causes adverse effects on regional economic outputs. The same is true with respect to the effect of fragmentation on regional economic efficiency, though the evidence here provides somewhat stronger support. However, Howell-Moroney (2008) argues

⁹ Stansel notes the discrepancy between their findings and those of Nelson and Foster (1999) and suggest that one explanation is that they used all metropolitan areas while Nelson and Foster used only large areas and there may be critical differences between metros of different sizes. For example, mass transit is likely to be in higher demand as population increases, and mass transit creates significant externalities across local jurisdictions that are best rectified with coordinated action. Indeed, when the analysis is conducted separately for the largest metros, Stansel finds that the relationship between decentralization and economic growth is weaker for such metros and stronger for the smaller metros.

¹⁰ Boyne conducts a meta-analysis of studies in the U.S. exploring a relationship between fragmentation and concentration in government and spending. In 20 tests between spending and horizontal fragmentation (measured as number of local governments or number of local governments per capita), 11 find a negative relationship, 5 find a positive relationship, 1 finds a non-linear relationship, and 3 find an insignificant relationship. The type of relationship found is related to the type of government studied. For example, studies using multi-purpose governments tend to find that spending decreases as fragmentation increases while those looking at single-purpose governments are more likely to observe a positive or insignificant relationship. With respect to vertical fragmentation, Boyne (1992) finds that the evidence is much thinner and due to measurement problems is unable to provide convincing evidence one way or another. Hawkins and Ihrke (1999) conduct a literature review that includes 30 studies of the effect of metropolitan government fragmentation and 25 studies of the effect of city-county government consolidation that illustrates the diversity of findings regarding these issues. Of the 30 studies of fragmentation, 21 showed that fragmentation was either cost-neutral or *lowered* the costs of public services, while 9 showed increasing costs. Of the 25 studies of consolidation, 16 found that consolidation did not produce the hypothesized benefits, while 9 of them did show a positive relationship.

that any efficiency gains may be insufficient to offset some of the costs associated with horizontal fragmentation which include urban sprawl and concentrated poverty. Thus, while decentralization may offer some increased efficiency benefits, it is not clear whether they are worth the equity costs.

3. Local Government Taxes, Public Services and Regional Economic Growth

A. Discussion

The role of local government taxes is one of the most misunderstood areas, particularly in public debate, in the area of government and governance. Since local government taxes are indisputably an element of firm operating costs, it is argued that lower local taxes promote growth and high local taxes hinder it. Later in this section we discuss the empirical literature on this question. Here we examine its logic.

Taxes fund public services. While taxes are indeed an operating cost to firms, if they result in public services of equal or greater value to firms, then taxes are a promoter of growth rather than a deterrent. Local taxes provide infrastructure construction and maintenance, police and fire protection, water, sewer, and waste disposal, all of which are services that most business establishments make use of. Taxes also provide support for labor force skill development through funding the elementary and secondary education system. The value of these services will vary among different kinds of firms, but the calculation is still the same: if the value of the services produced equals or exceeds the taxes paid then the taxes are not a deterrent to growth. It is the case that if the same level of services can be provided at lower tax cost in one jurisdiction relative to another, then that jurisdiction, *ceteris paribus*, will be more attractive as a location of economic activity.

What are the conditions under which taxes *are* a deterrent to growth? First, if services are not provided efficiently, then taxes will be higher than they need to be to provide a given service level. As noted above, this is a deterrent to economic growth. Secondly, if taxes on businesses are used to cross-subsidize services to households, then the value of taxes on business will exceed the value of the public service they receive and jurisdictions that do not cross-subsidize in that manner will be more attractive as a location of economic activity.

In general, however, taxes constitute a relatively small percentage of business operating costs and thus are not likely to be a very important consideration in a firm's decision to locate in one region relative to another. Indeed, empirical research shows that the importance of taxes pales relative to labor quality and cost and transportation concerns in *inter-regional* location decisions.¹¹

However, it is true that within a region, given that regional labor markets and transportation connections to external markets render these costs relatively similar, differences in local taxes, while small relative to other operating costs, may affect decisions on where firms will locate *within* the region. Thus, as noted above, given the property tax returns for locating within a

¹¹ For a review of this voluminous literature, see Wolman et al., 2008.

jurisdiction, local governments engage in competition to attract businesses. This competition, which passes for local economic development policy in many local governments, mostly just redistributes economic activity within the region and does nothing to promote regional economic growth.

From the point of view of regional economic growth and development, there is no regional tax system, and the “average tax” for the region is largely an irrelevance. A business or household doesn’t locate in an average jurisdiction, but on a specific tract of land in a specific jurisdiction that has its own tax system. Unless a firm is unable to find a suitable jurisdiction whose taxes and public services are to its liking, there should be no tax/service barrier to deter a firm from locating somewhere within the region and contributing to regional economic growth. (However, wherever they locate within the region, assuming the region is completely within one state, the firm will be subject to state taxes and if state taxes do not provide services of value to the firm, the region as a whole may be less attractive than regions in other states.)

While a firm pays taxes only to local governments that have jurisdiction over the land on which the firm locates, firms rely on services throughout the entire region – e.g., the regional infrastructure, labor market skills that are a product of education systems throughout the region, etc. Thus, the average quality of public services throughout the region may affect inter-regional location decisions of firms and therefore the region’s economic growth. There are some public facilities and infrastructure components that are particularly important to business location, since they serve to link the region to the national and global economy. Probably the most important is an airport that has frequent direct service to national and international centers or to regional hubs that provide such services, and a well-maintained regional highway system with links to major interstates, both east-west and north-south. In addition, the quality of the intra-regional transportation system, both public and private, affects a firm’s ability to induce workers to commute from throughout the entire labor market area, thus increasing the labor pool, and, if commuting is relatively easy and inexpensive, moderating worker wage demands.

As the above discussion suggests, understanding and creating the best tax-value proposition for a particular local economy is a critical issue for regional growth strategies.

B. What Does the Empirical Evidence Show?

The considerable literature assessing the impact of taxes and public spending on economic development can be summarized as follows: when the quality and quantity of public services are held constant, tax increases deter economic growth; when taxes are held constant, increases in the quantity or quality of public services attract economic growth. However, the magnitude of these effects is subject to considerable debate. In a meta-analysis of the literature on the effects of taxes, Bartik (1992) found a small, but statistically significant and negative relationship between tax rates and economic growth¹².

¹² Bartik estimated an elasticity in the range of -0.1 to -0.6, with the magnitude very sensitive to model specification and data source. Noting Bartik’s conclusion, Wasylenko (1997, 38) remarks, “The range of the elasticity is not estimated with much precision, and it matters a great deal to policymakers whether the elasticity is -0.1, -0.6, or somewhere in between.”

Most of the literature finds negligible or small effects of state taxes on business location decisions or state economic growth¹³. However, studies suggest that impacts are generally more pronounced within metropolitan areas. For example, Mark, McGuire, and Papke (2000), Bartik (1994) and Wasylenko (1997) have each independently estimated that a 10 percent reduction in local business taxes will increase economic activity in the community by around 20 percent – *assuming all other communities leave their property tax rates unchanged and there is not an offsetting decrease in local spending*. However, it should be noted that both the assumption of unchanged quality and quantity of public services, and the assumption of constant tax rates in neighboring jurisdictions are seldom likely to be met.

As noted above, both the level of taxes and the quality and quantity of public services impact economic growth. On the service side, government services may either reduce a firm's operating costs or provide a desired amenity (or both). Not surprisingly, not all public services provide an equal inducement to firm locations. Of the public services covered in his literature review, Fisher (1997) finds that only for transportation are there consistent findings of a positive relationship, while other services – public safety, education, and public capital – have different effects across different studies. However, in a review incorporating more recent literature, Thompson (2010) concludes that, “public infrastructure investments increase productivity and decrease costs of private sector firms,” thereby leading to greater economic growth. He also observes that, “in the short-run, spending on education is effective at generating jobs because it is such a labor intensive industry.... Numerous studies on the long-term economic impacts of spending on education show that it can boost employment and incomes in a state or region. Several studies suggest that transfer payments have a negative impact on economic growth.”¹⁴

In addition to the impacts of taxes and spending, governments may undertake endeavors specifically designed to draw economic activity into the region; yet the extent to which these endeavors achieve their aims is a major source of disagreement within the field of economic development. Tannenwald (1996) notes that fiscal competition between sub-national governments is a 350-year-old practice in the U.S., and that in moderation, it can promote efficiency in state and local government. Opponents argue that competition between local governments rewards businesses for actions they would have taken anyway and redistributes economic activity within the region without creating any new economic activity. In a review of the impact of specific tax abatements, Malpezzi (2001) notes that virtually all state and local governments provide some such incentives and that in some cases, these incentives matter at the

¹³ Two literature reviews, Lynch (1996) and Kusmin (1994), find little evidence that the level of state and local taxation figures prominently in business location decisions. Lynch, in particular, stresses that there is no evidence that state and local tax cuts stimulate economic activity or create jobs. Tomljanovich (2004) examined the effect of various taxes on state economic growth and also concluded that sales tax rates, corporate income tax rates, property tax rates, and income tax rates have little or no effect on state growth rates. This result is generally consistent with the findings above. However, Yamarick (2000) found that both personal income and marginal property tax rates have a negative impact on growth in state economic activity, whereas the sales tax rate is insignificant.

¹⁴ For example, Modifi and Stone (1990) estimated the effect of state and local taxes and expenditures on manufacturing employment and investment for all 50 states and found that while transfer payments had a negative impact on economic activity; spending on health, education, and public infrastructure produced a positive impact. In contrast, Dalenberg and Parttridge (1995) found that total metropolitan employment was positively related to education spending but negatively related to highway spending.

margins while in other cases, they simply reward firms for actions that would have been taken anyway. However, Bartik (2009) finds that customized job training by community colleges is more than ten times as effective in creating jobs as are tax incentives. Surveys such as those by Rubin (1990) often find that firms do not cite specific incentives as the determining factor in their location decisions. As is the case with taxes and spending, empirical literature generally shows that such incentives are much more likely to impact firm decisions at the *intra-regional* level than at the *inter-regional level* (Anderson and Wassmer, 2000; Bartik, 1992; Haughwout and Inman 2002). Thus, it appears that for taxes, public services, and specific incentives aimed at attracting firms, government activities are much more likely to affect the distribution of economic activity within the region than they are to impact overall growth levels.

4. Local Government, Business Climate and Business Culture

The competence of local government – its ability to provide services and manage its resources efficiently, to administer its regulatory and permitting systems fairly and without delays, to operate transparently and without corruption – are factors affecting the willingness of businesses to locate within the jurisdiction and/or to operate efficiently within it. Surveys of business executives (see Cohen, 2000) generally find that an area’s business climate is an important determinant of location decisions. While cited as important in qualitative research, the attributes of business climate that attract firms are difficult to define and even more difficult to measure, but may include cultural attitudes towards businesses, state and local laws restricting business activity and governing labor relations, and inefficient government bureaucracy resulting in permitting and licensing delays.

In addition to local government basic competence, local government ethos may also affect business and the economy. A political culture of corruption and favoritism may impose a real cost on businesses located within the jurisdiction and deter other firms from locating there. Indeed, recent changes in the economy suggest similar changes may be necessary in governance in order to facilitate economic growth. The speed of change in today’s economy explains the growing emphasis on innovation as a central component of economic development. The challenges of the modern economy demand flexibility, quick detection and solution, as well as the willingness to start from scratch when the first solution fails or the next problem pops up.¹⁵ Innovative, open and flexible places may be better equipped to confront the ever-changing challenges presented. Many successful firms have recognized the significance of the changes in the economy and have modified their organizational cultures and structures to be flatter and less top-down oriented; more responsive and open to new people and new ideas; more flexible and willing to embrace change; and less afraid to take big risks. These new approaches allowed the firms that implemented them to better innovate, adapt and compete.

We suspect that similar changes in governance may allow regions, too, to be more innovative, adaptive, and competitive. The traditional machine politics of favoritism, old-boy networks, and bureaucratic inefficiency do not fit well with the needs of modern economies. More broadly, the institutional environment of a region (including governments, universities, corporations and

¹⁵ See Singer and Paluso, “When the Trend Is Not Your Friend,” Executive Agenda, AT Kearney Consultants, 2009, for examples of companies whose great success depended on adapting quickly to changing circumstances with innovative and risky ideas.

organizations) may support, or hinder, the pursuit of a flexible, open, innovative and entrepreneurial region.¹⁶ In addition to the explicit policies, rules and regulations that make up the institutional environment, cultural values also contribute to the creation of productive places. These difficult-to-quantify characteristics include the celebration (in the press and by public officials) of entrepreneurs and innovators; cooperative networks and coordination within and between sectors; openness to new people and ideas; flexibility and adaptability; tolerance of failure; and enthusiasm for taking risks.¹⁷

Although government is not the only institution whose culture impacts the economy, it is uniquely positioned to extend its influence to other sectors (see Visser, 2002, for development of a cultural model of inter-local relations). A government that uses technology to streamline processes and diminish bureaucracy, and is sensitive to the unintended consequences of regulation, removes barriers to entrepreneurship and innovation. By being more open and transparent, governments can provide businesses, citizens and institutions with the key data and information that reduces market entry and transaction costs. Greater willingness to collaborate across sectors -- creating public-civic-private partnerships -- creates more access for firms. Flexibility and adaptability allow governments to address arising problems (in the economy or otherwise) more quickly and effectively. Governments that are willing to take risks may find new solutions for long-standing inadequacies in education, health care and transportation. Each of these cultural and structural changes has its own intrinsic value for a successful region, but their primary importance is the effect they have on economic actors and the regional economy.

5. Policy Recommendations for Consideration

A. Bringing about more effective regional governance within metropolitan areas to bolster regional economic growth

The organization of governments within U.S. metropolitan areas has been a controversial issue for more than 50 years. The early debate centered upon problems of coordination and planning that were thought to result from a fragmented local government system. Fiscal equity concerns were also seen to result from fragmentation: without the ability to redistribute across the entire region, some local governments were faced with low property tax bases per capita, while luckier ones had a much more robust tax base.

¹⁶ See, e.g., Mikel Landabaso and Benedicte Mouton, *Towards a New Regional Innovation Policy: 8 Years of European Experience Through Innovative Actions*, Draft for Publication (Brussels: European Commission Directorate-General for Regional Policy, 2002).

¹⁷ See, e.g., Bart Van Looy, Koenraad Debackere and Petra Andries, "Policies to Stimulate Regional Innovation Capabilities Via University-Industry Collaboration: An Analysis and an Assessment," *R&D Management* 33 (2) (2003): 209-229; Stephan G. Goetz and David Freshwater, "Determinants of Entrepreneurship and a Preliminary Measure of Entrepreneurial Climate," *Economic Development Quarterly* 15 (1) (February 2001): 58-70; Annalee Saxenian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128* (Boston, MA: Harvard University Press, 1996); Robert Atkinson and Scott Andes, "The 2008 State New Economy Index," The Information Technology and Innovation Foundation, November 2008; and Jill S. Taylor, "What Makes a Region Entrepreneurial?: A Review of the Literature," (Cleveland, OH: Center for Economic Development, Cleveland State University, September 2006).

The policy solution proposed was some form of general purpose regional government. However, except for Seattle, Portland, and the Twin Cities, there are virtually no instances of multi-purpose regional government in the United States, and all three of these are quite limited in scope (city-county consolidations are more common, but while many may have served as multi-purpose regional governments when the consolidations occurred, in most places population growth in the region has moved considerably beyond the original county).

Over the past two decades “regional governance” has superseded regional government as the preferred solution for problems affecting regional areas. The focus of regional governance is not on creating a single regional government, but on inducing cooperation and collaboration among local governments and other sectors and actors, with formal government being only one player. The expectation is that metropolitan areas with strong regional governance, i.e., with multiple organizations and actors interacting to address regional problems, will be more successful in addressing problems and bringing about regional economic growth than those regions engaged in lower levels of collaboration and activity.

The shift of focus from government to governance is manifested in increasing efforts at regional planning, including regional visioning exercises held in regions such as Salt Lake City, Sacramento, Denver, Chicago, and Washington (see Knapp and Lewis, 2010). However, while regional planning and goal setting is now occurring with increasing frequency, implementation of these sometimes heroic efforts is still extremely difficult. Virtually all of the recommendations require action by actual governments, and, since there still is no viable multi-purpose government at the regional level, this often requires voluntary cooperation among many local governments. How can coordinated action among local governments within metropolitan regions to bring about higher levels of regional economic development be encouraged?

The fundamental problem hindering collaborative regional activity to bring about greater levels of regional economic growth is the incentives for localization that characterize US metropolitan areas. From the broad macro-economic point of view of the region it may matter little where within the region economic activity locates (although there are both equity and spatial efficiency concerns). However, it matters deeply to individual local governments, since they receive no property tax yield unless the activity locates within their boundaries. The result is a form of prisoners dilemma that can only be broken through structural reform that is extremely unlikely to be forthcoming (i.e., some form of multi-purpose regional government), through a cooperation pact (whether formed regionally or, more likely, imposed from above), or through locally generated activity that serves regional interests as well, what Feiock (2007) terms, after Eleanor Ostrom, the Institutional Collective Action approach (ICA).

Thus, the current structure of local governments and local fiscal institutions provide local governments with strong incentives for pursuing their own rather than regional interests except in those cases where local self-interest and regional (or at least inter-local) collaboration clearly coincide. However, even when local and regional interests coincide, the frailty of regional institutional frameworks often imposes substantial transaction costs on efforts to engage in collaborative activity (see, for example, Kwon and Feiock, 2010). How could incentives be changed to promote local government behavior that would also be in the region’s interest and

how can institutions be strengthened or created to reduce transaction costs of arranging such behavior?

1. Restructuring incentives to promote more effective regional governance.

Since the incentives that mitigate collaborative regional behavior with respect to economic development are rooted in the structure of local fiscal institutions, i.e., the fact that property tax receipts are tied to the locality in which a business or household locates, the most direct solution would seem to be metropolitan tax-base sharing such as exists in the Minneapolis-St. Paul region to mitigate the localization incentives. Metropolitan tax-base sharing in the Twin Cities region requires localities to contribute 40% of their growth in commercial-industrial tax capacity to a regional pool. The resulting funds in the pool are then redistributed to local governments within the region with municipalities with a lower-than-average tax capacity receiving a higher per capita share (Orfield, 2002, p. 107). The system resulted from state legislative action.

Meeting the revenue needs of competitive local governments within a region through visible redistribution of general tax resources is a hard sell politically for local governments and makes voluntary tax-base sharing schemes unlikely. However, regional support for specific purposes may be more politically feasible. Millar (2002) points to several instances where regional voters have supported “cultural asset districts,” adopting a regional tax to support cultural assets that are regional in scope but located in the core city.

A more effective way of meeting these needs is through the state fisc, i.e., through state taxing and spending decisions that, in aggregate, provide greater resources to fiscally strapped local governments. The most direct means of accomplishing this is through a state equalization grant that provides money to local governments based primarily on their tax capacity and which can be used by the recipient as revenue sharing for any purpose. The United States is one of the few advanced democracies that does not have some form of general equalization grant at either the federal or state level, although state education equalization grants are routine in most states. A less visible approach is to redistribute through individual state programs for specific purposes such as state highway grants, housing and community development grants, or police and fire grants to local governments.

Another means for reducing inter-jurisdictional competition within metropolitan areas is through state changes in the local tax structure. Michigan, for example, now funds education largely out of the state sales tax and has removed the local property tax as a major means for raising local revenue, thus reducing the incentive for local governments to compete against each other for rateables.

Local governments can also be leveraged (or even required) to engage in cooperative activity. State governments could provide incentive funding for localities in regions that develop *and implement* regional economic development plans. State governments (or the federal government) could also provide funding for regional visioning exercises with citizen input that result in regional plans with recommendations for implementation. Or, states could require intergovernmental collaboration within metropolitan regions as a condition for applying for

federal grant programs¹⁸. At a minimum, state governments could make sure that their laws do not hinder or prevent regional collaboration from occurring among local governments. More proactively they could provide incentives to encourage regional collaboration, as some states have done (see Millar, 2002), even if they don't require it.

The federal government could also use its federal aid as a lever to encourage greater local government collaboration and in regional economic development. It could, for example, provide economic development assistance to local governments within metropolitan areas only if there is a regional economic development plan and evidence that the plan is being implemented. Or, it could cease providing economic development assistance to local jurisdictions at all and provide aid only to a regional economic development body that presented an application signed off on by the central city and a majority of other jurisdictions in the region.

2. Strengthening institutions to promote more effective regional governance.

Local governments already engage in a substantial amount of inter-local (and sometimes regional) activity, even though the transaction cost of doing so is often quite high. Kwon and Feiock (2010) point to several different types of transaction costs:

- Information costs: the cost of a local government obtaining information on problems faced by other local governments with whom collaboration to mitigate the problem might be possible, the range of possible solutions, the resources of other local governments, and their preferences over possible outcomes.
- Agency costs: the extent to which agents – i.e., local government officials – engage in activities that depart or might depart from the preferences of the principals they represent, i.e., their residents.
- Negotiating and bargaining costs: the time cost of arranging agreements that are acceptable to the potentially collaborating local governments.

How can these transaction costs be reduced? At the regional level a first step is to encourage greater regional activity by creating, supporting, or facilitating networks that bring together the potential actors concerned with economic growth in the region, including local governments, voluntary organizations such as COGs, foundations, non-profits, and civic organizations to discuss regional problems and how they might be addressed. Indeed, regional organizations of some sort (both formal and informal) abound: a 1999 survey by the national Association of Regional Councils (Atkins et al., 1999) of 80 regions found an average of 15 regional organizations per metropolitan area.

¹⁸ However, this approach may be too similar to the one tried at the federal level during the 1960s and 70s through the A-95 program and which proved unworkable. OMB circular A-95 required proposals from a local government within a metropolitan area to be certified by a regional planning agency within the area (usually a COG) that the proposal was consistent with an existing regional plan. However, the COGs, voluntary organizations consisting of local governments within the region, were too weak a reed on which to hang this requirement. The process that ensued was one of logrolling – I won't oppose your proposal if you don't oppose mine – with the threat of withdrawal from the COG as the ultimate weapon for a local government whose application was not approved.

Olberding (2002) argues that while strategies to “regionalize” a broad range of activities, either through formal institutions or through collaborative networks, have generally proven very difficult, collaborative efforts around one or a small number of functions have proven more successful. She conducted a survey of all metropolitan areas from 1980-1997 and identified 191 regional partnerships for economic development in 147 metropolitan areas. The classic argument that collective action or prisoner dilemma problems can only be addressed through authoritative action by government has been questioned by Ostrom (1998), Axelrod (1997) and others. Olberding cites both to suggest that such organizations are more likely to form when cooperative norms already exist in a region. She writes:

Scholars have long recognized the difficulty of achieving and sustaining voluntary cooperation among a large number of individuals with no central authority – the so-called “dilemma of collective action.” Axelrod... argues that, in situations with large numbers of individuals or groups, the solution to this dilemma is cooperative norms – or the extent to which parties usually act in a collaborative or coordinated manner or are expected to act in such a manner.”... Other scholars have also concluded that cooperative norms – or something conceptually similar – are critical for shifting from competitive to cooperative behavior. For example, in her comprehensive review of the cooperation literature, Ostrom (1998) concludes that the key determinant of cooperation is “norms of reciprocity.”

Olberding’s empirical work with respect to regional economic development partnerships supports this. Using a variety of measures of the existence of cooperative norms such as business and civic associations per capita, she concludes that the existence of such norms is positively related to the existence of regional economic development partnerships. In terms of public policy the major concern is how to promote such norms where they do not currently exist. Axelrod’s empirical research (1986) suggests that norms of trust arise after repeated interactions among individuals and groups where trust can be experienced (see also Feiock, 2004, who posits a theory of “institutional collective action.” This suggests that even efforts to create a venue or network for discussions of regional economic needs and concerns may have later payoffs¹⁹.

Feiock, Tao and Johnson (2004) make the same argument and buttress it with empirical support. In the context of governance, they contend that trust and social capital among governments is built when local governments engage in cooperative agreements aimed at improving regional outcomes. These agreements allow for resource exchange and other commitments; when commitments are honored, trust is built and social capital created. In fact, in their empirical work they find that the greater the number of inter-local agreements involving revenue transfer among local governments within a metropolitan area (implying the existence of cooperative action), the more likely the region is to have a metropolitan economic development partnership (implying the ability to act on a regional basis).

More elaborate efforts such as regional visioning and community planning efforts may flow from (or possible stimulate) collaborative regional economic growth activity. As noted above, these

¹⁹ Note that there is nothing in Olberding’s work (or anyone else’s) that shows that the existence of regional economic development partnerships result in greater regional economic growth. Indeed, Carr and Feiock (1999; 2003) present evidence that governmental consolidation does not enhance economic development.

kinds of activities rarely result in direct implementation. However, they can set up constituencies and interest groups that can continually press local governments to engage in cooperative activity to accomplish at least some of the recommendations (see Knapp and Lewis for a discussion). Creating or bolstering networks of regional actors might stimulate regional collaboration on some issues. Development of metropolitan mayors' coalitions as has occurred in Denver and Chicago provides a good forum for mayors to discuss their common regional interests and to serve as a body to consider implementation of regional activity.

B. Tax and spending recommendations

The most important challenge with respect to taxes and spending is to get local government within a region to understand that their economic policy needs to consist of more than tax reduction or subsidization. Low taxes are not always good if they produce inadequate levels of public services required by businesses. High taxes are not always bad if they produce high-quality public services. It *is* true that high taxes supporting high-quality public services may embody locational disincentives if the public services delivered are not those that meet business needs (e.g., welfare or public assistance payments) or if the same quality of public services is being provided elsewhere in the region at lower tax costs.

The financing of regional activities is a constant concern in nearly every region where such activities take place. The most direct means of financing regional activities (and the one most consistent with economic theory) would be through a tax imposed upon residents and businesses in the area that benefit from the activity. Indeed, there are many examples of such regional taxes for specific purposes such as regional transportation systems, airports, regional parks and recreation, etc. There are very few examples of regional taxes for multi-purpose use other than those in Minneapolis-St. Paul and Seattle. However, in general, we know very little about how regional activities are financed.

With respect to spending, Williams (1965) was the first of many to observe that there is much less political and public opposition (and even support) for regional infrastructure activity than for purposes that involve what he called "life-style" activity or that involve substantial social interaction (particularly among racial groups, e.g., regional school catchment areas), or visible redistribution among income classes, racial/ethnic groups or local governments. Regional economic development activity would seem to be closer to the former set of activities than to the latter, although, as we have seen, local governments are likely to be the primary roadblock. If regional activity does build upon itself, as suggested by Axelrod (1986, 1997), this suggests the "low-hanging fruit" approach of attempting to encourage regional activity where there is some support.

Absent some enforceable (and unlikely) agreement among local governments not to engage in what is almost always, from a regional perspective, non-productive competition to provide tax incentives to attract businesses within their boundaries, local governments are likely to continue to engage in these kinds of activities. If they are compelled to do so, however, they at least should do so strategically, focusing tax incentives on sectors tied to the locality's existing base and growing clusters. In addition, incentives should be designed with clear performance requirements (e.g., local jobs created) and with clear "clawback" provisions if these performance

outcomes are not met or if the firm moves out of the local government jurisdiction within a specified period of time. Since local tax incentives are usually provided under state law, these provisions are likely to require changes at the state level.

C. Modernizing Local Government and Local Government Business Culture/Climate

As discussed, the institutional environment of a region (including governments, universities, corporations and organizations) may support, or hinder, the pursuit of a flexible, open, innovative and entrepreneurial region.

Although government is not the only institution whose culture impacts the economy, it is uniquely positioned to extend its influence to other sectors. Potential actions might include:

- Streamline processes and reduce governmental delays by concerted efforts to rationalize procedures (particularly permitting procedures) and by using technology to remove barriers to entrepreneurship and innovation
- Promote greater transparency and engage in increased efforts to combat local government corruption since corruption (grafts, kickbacks, payoffs) serves to impose an invisible tax on firms located within the area.
- Focus on efforts to provide a given level of services more efficiently (i.e., at least cost) through efforts to eliminate true waste and to engage in identifiable and validated best practice techniques.
- Provide higher-quality and more timely data to businesses, citizens and institutions, in an effort to be more open and transparent and empower them to make better decisions
- Increase collaboration across sectors to catalyze beneficial public-private partnerships
- Engage firms, citizens and civic sector institutions more readily in the work of government (from community health to public safety)
- Champion flexibility and adaptability to enable emerging problems to be addressed more quickly and effectively
- Take calculated risks in considering new solutions for long-standing inadequacies in education, health care and transportation

Each of these cultural and structural changes has its own intrinsic value for a successful region, but their primary importance is the effect they have on economic actors and the regional economy.

6. Government and Governance Research and Development Agenda.

We have noted that regional governance is complex and that regional regimes vary considerably across regions. However, we have also noted that very little is known about how much regional activity exists by region, of what kind, through what kinds of structures, involving which sectors as participants, and with what results. Unfortunatley, at present there is no data set on regional

organizations and activity by metropolitan area available that would permit empirical development of regional government or governance typologies. Constructing such a data set would require a survey of regions designed to gain information on the formal and informal regional organizations and activity. Such a data set is a foundational requirement for characterizing metropolitan areas by the nature of their regional governance and employing the result as a variable.

Clarifying the variation that exists from one region to another in regional development capacity and action is baseline work that would then allow addressing many other questions, especially concerning when and to what extent regional governance arrangements account for differences in regional economic development among regions.

Conceptually each metropolitan area could be characterized by its regional governance arrangements (or “regime”), with regions differing according to their degree of fragmentation (both horizontal and vertical) of formal local governments, the nature and extent of single purpose regional governments, the existence and mix of regional cooperation among formal governments on an ad hoc basis, the presence of voluntary local government organizations such as councils of government (COGs) or informal mayors organizations, and the presence of collaborative networks as well as non-governmental regional organizations and actors who engage in systematic interaction, and specific regional initiatives. Each metropolitan area could be characterized in terms of its regional arrangements. The result would be a regional governance regime variable for which each metropolitan area could be assigned a value and which could then be used in empirical research to test propositions about the effect of regional governance on regional economic growth.

We thus suggest a multi-stage research program focused on regional activity and its effect on regional economic growth.

1) Regional Activity and Regional Economic Growth

- A. Develop and gather data on measures of the key attributes of regions.** To identify the circumstances under which desired regional economic development outcomes are most likely to be achieved, we would begin by defining the independent variables: regional attributes such as regional governance structures, collaborative networks or specific initiatives that indicate the degree to which the region exhibits regional capacity and regional action. This would involve identifying the most relevant attributes, based on literature and case studies, as well as the range of values that can be observed for each attribute. For example, different types or degrees of regional organizational structures and governance, local government fragmentation, tax base sharing, coordinated activities, land use planning, and so on. The next step would be to collect data on these attributes, largely through survey research.
- B. Develop a typology of regions (likely using hierarchical clustering statistical analysis).** Using the attributes and data collected in “A,” as well as perhaps some basic distinguishing characteristics with respect to economic structure, it would then be possible to create a typology that groups regions into different categories with respect to

their capacity for and action at a regional level. Differentiating types and degrees of “regionalism” is useful for its own sake, but more importantly creates the foundation for analyzing what types are most successful in specific circumstances for particular outcomes.

- C. **Develop measures of important regional economic development outcomes.** Serious conceptual work needs to be done in terms of the dependent variable as well: what we mean by regional economic development and how we wish to measure it, particularly with respect to equity, sustainability and regional spatial efficiency. Traditional measures need to be updated and supplemented both to add inclusiveness and sustainability goals, and with measures of the underlying systems and system performance, so we know not just the results, but what accounts for them (and can be improved).

- D. **Model the effects of regionalism on economic development and related outcomes.** With the foundational work from A through C, we can then analyze what “types” of regions and what specific regional attributes and activities are most effective for achieving which economic development goals.

2) **Financing Regional Activity**

- A. **Survey metropolitan areas to determine how various kinds of regional activity are financed.** We know very little about regional financing mechanisms or how these mechanisms are related to results. Since financing is critical for many kinds of regional activities, this kind of knowledge would be extremely useful for many regions contemplating regional activity.

- B. **Why are regional taxes successfully imposed in some regions and for some purposes while rejected in others?** What kinds of circumstances, framing, and political campaigns are more likely to result in success? What kinds of regional financing mechanisms are more likely to be successful, under what circumstances, and why? These research questions would be pursued both through a set of case studies and, if possible, through multivariate analysis.

3) **Government and Governance 2.0**

As mentioned, a great deal of promising practice is emerging with respect to government becoming more transparent and efficient, better engaging citizens and firms, and fostering cross-sector networks and partnerships. These practices range from making more data and analytic tools available to using web-based applications to enable reporting problems or getting services to fostering cross-sector targeted development organizations. Systematic identification and assessment of these practices, and development of materials to guide policymakers in how to successfully design and implement them, is needed to enable governments to more broadly transition to and support the open, flexible, entrepreneurial culture which supports regional economic growth in the current economy.

Appendix A.

Defining governance

One of the challenges in defining governance—no matter at which level one is talking about—is the wide variety of definitions used by those examining the issue, or the fact that some writers do not provide a definition even when criticizing about other authors not doing so. Writing in 1997, Rhodes counted six different definitions of governance in use. Writing about the changes in British government during and after Margaret Thatcher’s reign as prime minister, Rhodes (1997) ultimately defines governance as “self-organizing, interorganizational networks” (p.53) and notes that “The phrase *local governance* is now used in the place of *local government* to capture the range of organizations, drawn from the public, private and voluntary sectors, involved in delivering local services” (p. 8, emphasis in original). This is similar to Savitch and Vogel (2000), who find that “*governance* [emphasis added] conveys the notion that existing institutions can be harnessed in new ways, that cooperation can be carried out on a fluid and voluntary basis among localities and that people can best regulate themselves through horizontally linked organizations” (p. 161, as cited in Norris 2001). Meanwhile Stoker (1998) includes the fact that “Governance identifies the blurring of boundaries and responsibilities for tackling social and economic issues” (p. 18) as one of his five principles of governance.

Some attempt to distinguish between various forms of governance. Oakerson (2004) offers the idea of regional governance as polycentrism as “a process of decision making whereby multiple independent actors interact to produce an outcome that is commonly valued” (p. 21) in contrast to monocentrism, where “a single actor (or cohesive set of actors) provides direction to others” (p. 21). He distinguishes them because “Polycentrism describes a pattern of governance that emerges from the interactions of multiple independent centers of authority, whereas monocentrism describes a pattern of governance by a single center of authority” (p. 21). Lewis (2004) also considers the polycentric model, linking it to Charles Tiebout’s theories on regional diversity.

Hooghe and Marks (2003) take a different approach in their work, outlining two types of multi-level governance²⁰ that they label Type I and Type II. They analogize Type I governance to federalism in that “every citizen is located in a Russian Doll set of nested jurisdictions, where there is one and only one relevant jurisdiction at any particular territorial scale” (p. 236). In Type I governance, jurisdictions are general purpose, at a few levels, and do not have overlapping memberships. In contrast, Type II governance “is composed of specialized jurisdictions ... [and] is fragmented into functionally specific pieces” (p. 236). There are benefits to both types of governance, according to Hooghe and Marks, and “Type I and Type II governance are not merely different means to the same end. They embody contrasting conceptions of community” (p. 240).

Characteristics of governance

While there are still disagreements over the exact definition of governance, there usually is some general agreement over its characteristics. First and foremost, governance includes actors

outside the sphere of government—these actors are from the private and nonprofit sectors. Wallis (1993) notes that, “The capacity of all three of these sectors to act out of enlightened self-interest in pursuit of the betterment of the region constitutes the *civic infrastructure* of the region” (p. 132, emphasis in original) and that “Effective governance must fully employ the civic infrastructure of the region” (p. 133). Likewise, Stoker (1998) argues that governance brings recognition of the range of groups that have taken over some of the traditional tasks of government” (p. 21).

Even as these non-governmental actors play a larger role in governance, there is usually still a role for government in governance. Oakerson (2004) argues that “Governance structures ... require access to governmental authority (to prescribe, invoke, apply, and enforce rules) but need not be confined to governmental institutions. Governments are a necessary condition of governance, but not a sufficient condition” (p. 20). Similarly, Peters and Pierre (2001) find that:

We have been witnessing a development from a “command and control” type of state towards an “enabling” state, a model in which the state is not proactively governing society but is more concerned with defining objectives and mustering resources from a wide variety of sources to pursue those goals (p. 131).

Practically speaking, in its examples of regional governance in the United States, the Alliance for Regional Stewardship (2006; hereafter “the Alliance”) shows how many governance structures are the creation of regional governments and ultimately must work with those governments to accomplish their goals. Formal government also can provide the coercion sometimes needed to affect change, but Oakerson (2004) notes that “the actual use of coercion through command and control is a highly ineffective instrument for undertaking many of the activities on which governance depends” (p. 20). There are those, however, who do argue that governments are unnecessary to governance—as noted above, Oakerson writes that “Governments are a necessary condition of governance” (p. 20) but also that “that metropolitan *governance* can and does occur without metropolitan *government*” (p. 17, emphasis in original); in the same volume, Post (2004) notes that “‘regional governance’ refers to the policy decisions made by existing governments” (p. 68)—but this seems, in general, a minority viewpoint.

The structure of governance can take many forms, and this is partly due to the differing definitions of the term “governance”. Sometimes, governance is a formal government arrangement such as a special purpose district, an intergovernmental compact, or an intergovernmental agreement. However, Norris (2001) cites a 1997 study of special district government in Southern California by Bollens that found “but a faint connection to the true potential of regional governance” (as cited in Norris, p. 560). More often, governance takes the form of multisector compacts or networks, often with a formal structure but a more diffuse structure that, in the words of the Alliance (2006), “avoids the false choice between top-down directives and bottoms-up initiative by offering an adaptive system that can produce innovative solutions” (p. 8). Generally, formal city or city-county consolidation is not a method of governance—Oakerson (2004), for example, argues would be to the “detriment” of governance (p. 41). However, these differing structures of governance all lead to concerns of accountability; as Stoker (1998) notes:

The dilemma suggested by the blurring of responsibilities is that it creates an ambiguity and uncertainty in the minds of policy-makers and public about who is responsible and can lead to government actors passing off responsibility to privatize providers when things go wrong. Worse still is the enhanced possibility of scapegoating raised by more complex governance systems (p. 21-22).

The Alliance, however, argues that mutisector compacts are one attempt to create an accountability mechanism (2006), but it still seems likely that there will be accountability issues with the involvement of large numbers of outside-government actors present in these organizations.

Often, the structure of regional governance leads to a decentralized system in which power is more diffuse and flexibility is greater. Both the types of governance defined by Hooghe and Marks (2003) offer decentralization and more flexibility, compared to conventional government, even as the different structures provide different methods of operation and different roles for various actors. This decentralization is necessary, Stoker (1998) argues, “Because no one single actor, public or private, has the knowledge and resource capacity to tackle problems unilaterally” (p. 22). Likewise, Post (2004) argues that flexibility is present more in governance versus government structures because “Changing regional government often requires a significant change in the existing political structure of local government, whereas changing regional governance maintains existing local governments and simply requires a shift in the behavior of these governments” (p. 68).

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