A Quasi-Market Theory of Local Development Competition

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This paper describes and elaborates a quasi-market framework to integrate the diverse perspectives on local government development competition found in the economic development literatures. Within this framework local governments seek to obtain positive externalities associated with economic growth through provision of services and inducements to private firms in exchange for commitments of employment and investment. Business provides an enhanced tax base to provide services, employment and income growth as a consequence of private development location decisions.

This quasi-market for development is limited by market failures, such as failures of competition, externalities, information asymmetry, and high transaction costs. Several government failures are also likely to result. These include preference aggregation failure, moral hazard problems, and bureaucratic failure. Given the social inefficiency of development competition that can result when these market and government failures are present, we investigate various paths that might be taken to correct these failures. The alternatives we examine include prohibitions or limitations on competition, metropolitan government, arrangements for regional cooperation, and reform of political and administrative institutions to reduce the divergence between governmental and community demand for growth. Better understanding of how the quasi-market for economic development works promises to enhance our understanding of the relationships between economic and political demands and local development with important implications for evaluation of local growth policy and development competition.

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The role of cities in promoting local economic development has been the subject of controversy and acrimonious debate among scholars of local government. The literature on economic development might easily be characterized as a hodge podge of conflicting perspectives that do not speak to or with each other (Cheshire and Gordon 1998). Nowhere is this problem more evident than with efforts to evaluate the causes and consequences of government competition to attract economic development. Welfare economics based work contends that state and local economic development competition among state and local governments creates economic benefits for local residents and the rest of society (Dye 1990; Bartik 1991; Kotler et al. 1993). Peterson (1991) and others argue cities operate under an economic imperative to provide development policies.

Critics of development policy reject efficiency arguments for development promotion and employ several different conceptual frameworks and languages to evaluate development competition. Some scholars contend that development incentive competition is destructive. Competition is deemed irrational because local provision of incentives for development spurs zero-sum or negative sum competition. State and local development programs have been characterized as corporate welfare (Howard 1994). Other commentators on urban development depict development policy as driven by, and principally benefitting, a small set of land or property-based interests (Molotch 1976; Logan and Molotch 1987), or a governing coalition or regime that supports growth interests (Stone and Saunders 1987; Stone 1989). The literature on growth management further contends that new development imposes substantial, and often uncounted, costs on the communities and their residents (Turner 1990).

Relying on a different conceptual framework, public choice work is also critical of development competition. While this approach embraces markets, it views development competition as an inefficient government intervention into private markets. Development programs create economic rents that distort investment location decisions, inducing business to choose locations that would not minimize production costs. This produces a geographic distribution of new capital investments that is less efficient for regional or national economies (Burstein and Rolnick 1995).

This balkanization of the development literature, and fundamental disagreements over the causes and consequences of local development policy, suggest a need for an integrative theoretical structure to organize our
thinking about development and direct attention to solutions for problems of development competition. This framework needs to employ a common language equally conducive to understanding the arguments of all of the many sides of the debate over local economic development policy. In this article, we draw the outline of a quasi-market among governments. We demonstrate how this ideal model of development competition can be extended to incorporate the various perspectives on and criticisms of development competition. Our analysis draws on the framework Lowery (1998) applied to examine the quasi-market for local public goods. We first identify the assumptions necessary for a competitive market for development incentives to lead to socially efficient outcomes. We then identify how the problems with local development policy described in the above literatures can be recast as market failures. Next, we critically examine the public choice criticisms of local development as government failures. Diagnosing the market and government failures that arise in a quasi-market for economic development leads us to a set of alternatives to correct these quasi-market failures. After critically evaluating several alternatives, we discuss how the quasi-market framework integrates the findings of empirical work carried out from different theoretical perspectives and how this can inform program evaluation and future research on development politics and policy. We conclude with a discussion of the consequences of institutional reform for quasi-market failure.

COMPETITION, MARKETS, AND ECONOMIC DEVELOPMENT

Because spatially distributed social benefits and costs of growth are excluded from private investment decisions, local development policy can internalize these externalities thus improving efficiency (Peretz 1988). In a development quasi-market, individuals act collectively through government to induce desired economic changes in a specific geographic area. In other words, voice, rather than mobility, is the primary mechanism to satisfy citizen development demands. Social welfare is enhanced by governments’ ability to produce changes in economic growth that match the expressed preferences of citizens. Of course, tax dollars are not directly exchanged for economic welfare gains; changes in income, employment, congestion, and pollution are spatial externalities of the location of private investment. Governments can induce changes in community welfare that result from economic growth by stimulating or impeding private development.
The Quasi-Market for Economic Development

Cities can be thought of as unitary actors seeking to maximize their economic and status interests. Local policymakers pursue the economic interests of a city though policies that alter the rate of economic growth in the community. This is similar to Peterson’s (1981) conception of city interest in which developmental policy benefits the median taxpayer. We depart from Peterson's notion that cities have a uniform incentive to pursue economic growth irrespective of economic needs and political demand. Peterson (1981) contends cities promote growth regardless of economic need because the marginal benefit of developmental programs to the median taxpayer exceed the marginal cost. This assumption, that growth promotion always enhances the median taxpayer's benefit cost ratio, is unfounded. Instead, we assume that communities will place differing values on additional development based upon citizens perceptions of the impact of additional growth on income and lifestyle values.

The benefits of growth, and thus, the willingness to pay for economic development, vary between communities and, in some instances, will be less than the costs. The median taxpayer might benefit from restricting urban development through growth management rather than from the promotion of additional development under existing conditions of rapid growth. In addition to increased service costs, growth changes qualitative features of a local area including congestion, crime, and environmental pollution. The economic benefits of development may not offset the median taxpayer’s loss from negative qualitative changes to the community.

Investors of new capital supply development in a particular jurisdiction in exchange for services or financial assistance. A community’s factor endowments ensure some level of new investment will occur absent any direct government initiatives. These private investment location choices influence economic opportunities and the physical character of the communities where firms choose to invest or not invest. Where labor mobility is constrained and economic problems give rise to demands for additional growth, governments incentives can increase the returns on investment in a particular jurisdiction. Some policies, such as tax abatements, loans, specific infrastructure provision, and subsidies that target benefits can significantly reduce private costs for particular firms. Other programs, such as an incentive available to all firms meeting eligibility requirements,
information provision, general infrastructure, workforce development, and promotion of entrepreneurship can have marginal effects on production and transaction costs for many firms. Below we outline ten assumptions that are necessary for a development quasi-market to operate efficiently:

1. There are a large number of local governments.
2. The boundaries of local governments are fixed and residents are not highly mobile in the short-term.
3. Cities act rationally to maximize their economic interest by pursuing a level of development at which the marginal value of new development to the median taxpayer equals the marginal cost.
4. Cities have capacity to induce or impede development by directing resources to economic development or growth management efforts.
5. Cities pay for development actions from their own resources and receive all the economic benefits of their efforts.
6. Cities have prefect information regarding a) effects of development efforts on obtaining changes in economic growth; and b) impacts of growth on the median taxpayer.
7. There are large number of firms or entrepreneurs that might invest in a particular location.
8. Firms act rationally to maximize returns on investment.
9. There is perfect mobility of new investment capital.
10. Firms have perfect information on returns on investment at various locations.

Under these conditions a quasi-market would operate in an economically efficient manner as local governments pay to induce development up to the point where the marginal benefit of the last dollar spent on development programs equals the marginal benefit of the growth induced. Cities compete for development until the marginal benefits of growth to the median taxpayer in each community equal its marginal economic and social costs. This equilibrium point is different for each community since taxpayers are willing to pay more for development in some communities than others (Rubin and Rubin 1987). The benefits of additional development increase with the severity of economic dislocations suffered by cities. In communities with low incomes and high unemployment, demand for additional economic development will be great and own-source revenues will be limited. Conversely, the benefits of additional development will be minimal or even negative in the context of affluence and full employment. In this situation, growth controls can serve as a pricing mechanism that discourages additional growth.

Figure 1 remaps the simple price/quantity axes in micro economic theory to depict the relationship between supply and demand for additional development for a single community at a given point in time. The downward sloping development benefits demand curves (DB) reflect the median taxpayer’s marginal benefits from, or willingness to pay for, additional units of new development under different economic conditions. The upward-
sloping supply curve (S) indicates that the marginal incentive costs of supplying additional new development increases as lower cost opportunities for development are first exploited.

**FIGURE 1 HERE**

In Figure 1, DB₁ represents a city's demand for development under conditions of economic distress, DB₂ is the demand for development under conditions of moderately high income and low unemployment, where the level of new growth absent any government intervention approximates the preference of the median taxpayer. The curve DB₃ represents growth demand under conditions of existing affluence and rapid development. The benefits of additional growth to the median taxpayer are greatest when there are severe problems in the local economy. This reflects the high marginal social benefit of economic expansion in that context (Blair 1984; Feiock, Dubnick, and Mitchell 1993). Without local government development incentives (or growth control disincentives), a city would attract Q units of new investment or jobs, this is the point where the supply curve intersects the horizontal axis. This point falls well below demand for new development under conditions of economic distress (DB₁). If informed public officials seek to maximize development benefits to the median taxpayer, they would respond to unmet development demand by providing development incentives to level C to stimulate growth to X, where the marginal costs of promoting additional development equal the marginal benefits. Public officials could maximize benefits to the median taxpayer by offering zero incentives in the context of adequate growth and low unemployment (DB₂). This results in new development at point Q. In the context of rapid growth and tight labor and housing markets (DB₃), the median taxpayer is made better off by providing disincentives for additional development.

Where cities compete for new development based upon their demand for its economic and social benefits, the outcome would be, in economic terms, efficient. These results emerge from a model that shares many of the strengths and weaknesses of the perfect competition model of the private market. This characterization of development competition thus provides a useful benchmark to examine the influence of political and administrative factors on development and to evaluate the descriptions of economic development politics found in the literature discussed earlier.

In our quasi-market formulation, development incentives only result in welfare improvements over an
unregulated market if capital is more mobile than residents and the boundaries of local government are fixed (or costly to alter). Even though American labor is highly mobile, some groups of people, especially older, less-skilled, or minority workers are relatively immobile (Fisher and Peters 1998). Moreover, even for skilled, younger, and non-minority workers, mobility is quite limited in the short run. On the other hand, new investment capital approaches perfect mobility as funds can be electronically transferred around the globe in seconds. To the extent that boundaries can be changed by annexation, consolidation, the creation of special districts, or incorporation of municipalities, boundary adjustment might provide an alternative to either a Tiebout market or a development quasi-markets for urban residents to pursue the benefits of development. Nevertheless, state laws and other constraints on local action limit the ability of citizens and governments to use of these instruments for development purposes (Feiock and Carr 1997).

Criticisms of development competition is often directed at the types of policy instruments that are used in this competition. In particular, the use of targeted subsidies or tax incentives that are directed to specific firms has met substantial objection. Development policy runs on a continuum from one-time deals tailored to a particular firm that is the object of a bidding war, to broad scale policies available to all (but valued by some more than others). Non-targeted development programs and incentives, human capital development, and fostering entrepreneurship have each been advocated as more effective in generating economic benefits (Clarke and Gaile 1998). Competition does not mean that the more targeted incentives will be used to the exclusion of other policy instruments. In our model, communities seek to maximize their economic interest by pursuing a level of economic growth at which the marginal value of additional development to the median taxpayer equals the marginal cost. In doing so they would take into account the opportunity cost of using any particular instrument. Absent the market and government failures discussed in the next section, the use of more targeted incentives would indicate that the marginal social benefits from employment of those instruments exceeded the marginal social benefit of alternative instruments.

Concern is often expressed regarding the capacity of local government inducements to affect the location of mobile development capital. Several widely cited studies of firm location decisions reported government taxes and incentives were not important factors in the determination of location choice. But more detailed and
sophisticated studies in the last decade provide strong evidence that state and local development policies stimulate investment and economic growth (Plaut and Pluta 1983; Feiock 1991; Brace 1993; Bartik 1991; Fisher and Peters 1998). In fact, it has been asserted that state and local economic policymaking has been central to the resurgence of the U.S. economy in the 1990s (Feiock, Dubnick, and Mitchell 1993).

An often voiced criticism is that government sponsored economic development programs result in zero-sum competition. While development policies that lure mobile resources can result in economic losses that offset the gains to communities offering incentives, the zero-sum argument is not applicable if development actions create expanded economic opportunities, rather than moving investments around. Even if we assume no additional investment is created, competition among governments for economic development does not lead to zero-sum results if growth creates significantly greater positive externalities in the area were business relocates. The zero-sum outcome is a special case (Feiock, Dubnick, and Mitchell 1993). The lower the mobility of labor, the greater the likelihood of economy-wide gains from development competition that moves jobs to people. Positive-sum results for the economy as a whole are particularly likely where there is surplus labor in declining regions and the economic and social costs of movement give rise to rigidities in the labor market (Bartik 1991).

**MARKET FAILURES**

When a large number of informed buyers and sellers are brought together in a situation in which the costs of exchange are minimal, private markets operate efficiently. This situation does not typically characterize a market for economic development. In fact, the most prominent criticism of growth politics in the literature can be incorporated into our analysis by recasting them as market failures. In the following sections, we identify failures of competition, information asymmetry, and high transaction costs in the development quasi-market.

**Failure of Competition**

Competition among governments for new investment, and competition among firms for the services and incentives provided by government are necessary for social gains to be realized from these exchanges. While there are typically a substantial number of jurisdictions that might want to attract new investments, often there is a lack
of potential entrepreneurs seeking to start or expand business operations that might benefit from local government development programs. A failure of competition among firms to supply development can allow private interests to exercise monopoly power in their exchanges with governments.

The number of potential entrants to a community depends on both market conditions and the characteristics of communities. Cities will attract some firms to invest without any resources being transferred from government to private interests. Natural endowments, such as the physical and geographic characteristics of a community and existing economic base, influence whether the area is a potential site for investment and entrepreneurship. Where a city provides a potential market for products and there is a diverse industrial base, opportunities exist for development programs to influence production costs for many firms.

The extent to which a market for cities’ development assistance can be generated depends on the type of development sought. Where development needs are specialized to a particular size, industry, or technology, the number of potential takers is limited, sometimes to one. Where communities seek investments from only one potential supplier, the monopoly supplier may be able to extract development concessions from government that exceed the competitive equilibrium in Figure 1. For this reason, the extent of market failure is related to the policy instruments that are used to pursue economic growth. Where development efforts are highly targeted, monopoly power may be exercised. This is particularly true if a the city does not have some natural advantage in the targeted sector which would enhance it bargaining power with firms. Conversely non-targeted development efforts, or those directed to small firms, and business expansion can have numerous potential takers. While some of the benefits of these programs may be negotiable and programs may be customized to certain businesses, each recipient has little market power.

**Externalities**

To the extent that the costs and benefits of development spill over jurisdictional boundaries, development competition results in externalities. Spillovers do not occur for the tax benefits resulting from new development because only the tax base of the specific jurisdiction in which investment occurs is enhanced. While the employment gains from development may go primarily to citizens in the jurisdiction in which development occurs,
they can also be captured by residents of neighboring jurisdictions and migrants to the area. The resurgence of the concept of regionalism in the study of local politics in recent years is based on the notion that suburbs and central cities are economically linked (Savitch and Vogel 1996; Barnes and Ledebur 1997). The social and environmental costs of growth are particularly likely to cross jurisdictional lines. If spillovers are more likely to occur for the costs of development, than for the economic benefits, it creates incentives to over-promote growth.

**Information Asymmetry**

Information failure is also a problem in a quasi-market for economic development. Typically an asymmetric distribution of information exists in quasi-market exchanges which gives private firms a systematic advantage in negotiating with local governments. Unlike private firms, government officials cannot make policy and implement decisions in secret. Moreover, citizens’ “willingness to pay” must be communicated to public leaders in an open and public forum. This information is available to private interests seeking to benefit from development policies. On the other hand, private firms have little incentive to reveal the true value to the firm of the services and incentives offered by governments (Jones and Bachelor, 1986). Because information advantages can be most fully exploited in the context of limited competition, once again market failure is most severe when targeted development is pursued.

**Transaction Costs**

A development quasi-market is also distinguished by high transaction costs. Several distinct types of transaction costs are evident. These include measurement costs, contracting costs, and costs arising from asset specificity. Measurement of the effectiveness of development programs has consistently been a problem in the field of economic development (Reese and Fasenfest 1997). It is difficult for local governments and their residents to evaluate or measure the economic and social gains that would result from the level of resources or the choice of instruments used to pursue economic growth benefits. The potential of development evaluation studies remains unrealized. Many observers have called for more systematic evaluations by individual governments as well as rigorous multi-site evaluation of various economic development programs and policy instruments (Bartik 1994).
Contracting costs are a second type of transaction cost in the development quasi-market. These costs include the resources employed in negotiating an agreement, specifying its terms and obligations, and defining mechanisms for enforcement of the agreement. Contracting costs can be substantial because of the complexity of the exchange and the possibility of reneging on agreements. A third type of transaction cost can arise from asset specificity. While investment capital is highly mobile, it becomes fixed once invested. Large capital investments, like production facilities, become fixed assets. The value of these assets in the future can be influenced by a local government’s environmental, regulatory, land use, and tax policies. When development requires investment in fixed capital, concerns about state and local “business climate” may be more than symbolic. Uncertainty about future policy actions can increase the risk of investment in a particular community because it affects the future value of specific assets.

GOVERNMENT FAILURES

The public choice literature suggests that government failures result because political leaders substitute personal political preferences for the community interest. Several types of government failures can occur in a quasi-market for economic development (Weimer and Vining 1999). Most of the government failures identified here are drawn from public choice critiques of government. Nevertheless, the perspective that development politics is dominated by a land-based elite, which in a central tenant of the urban growth literature, can also be framed as government failure. The first government failure we identify is preference aggregation failure in which groups with greater resources to overcome collective action problems are more influential in the political process. As a result, the expressed demand on which development decisions are based differs from the preference of the median taxpayer. Second, moral hazard problems result where political benefits to government leaders do not correspond to economic benefits to citizens. In this situation, local officials’ pursuit of individual interest conflicts with collective interests in promoting or managing growth. Third, bureaucratic failures result from opportunities for agencies to use information advantages to expand programs and responsibilities. Each of these failures results in a departure from the equilibrium described in Figure 1.

Figure 2 compares the median taxpayer’s demand for development benefits (DB) with public officials
demand for the political benefits (PB) of growth. New development provides visible benefits that officials can
claim responsibility for and provides elected officials with resources to direct to specific groups, geographic
constituencies, or political supporters. In Figure 2, the socially efficient level of development incentives is at C,
where DB intersects S. The level of growth that maximizes political benefits exceeds the socially efficient level.
City officials may actively pursue growth where it will yield significant political benefits, even if there is little
demand for, or social benefit to the median taxpayer.

FIGURE 2 HERE

Failure of Preference Aggregation

The organization of interests has obvious implications for the aggregation of demand for growth
promotion and growth management. In the case of programs to promote growth, a substantial literature documents
business elites exert substantial influence on economic development activities (Stone and Sanders 1987). Growth
is the essence of local politics; scholars point to a land-based elite that legitimates the ideology of growth and
manipulates local public policy to promote growth (Molotch 1976). Collective action problems (Olson 1965) are
central to why aggregated development demand reflects the demands of business and land based interests. The
benefits of growth are often captured by land and capital interests. These benefits create incentives for certain
political actors to organize to promote growth even when the community is not experiencing economic and
employment problems. In fact, land and capital interests capture a larger share of the benefits of growth in the
context of a tight labor market (Bartik 1991).

Collective action problems pervade the aggregation of citizens’ growth preferences because small groups
receiving concentrated benefits from growth have an incentive to bear the costs of influencing government action
while larger, more diffuse interests do not. In addition, it is less costly for individuals represented by existing
organizations to influence policy than for unorganized individuals to do so. Small groups of highly interested
individuals, like developers and retail businesses, have strong incentives to organize around the benefits of growth.
In cities in which civic and business groups are already active and organized, the likelihood of collective action
promoting growth is enhanced.

While the benefits of promoting growth may be concentrated and selective, slowing or managing growth is likely to produce diffuse benefits such as reduced pollution, lessened highway congestion, or protection of environmentally sensitive lands (Calavita 1992). In this context, it is often difficult to generate collective effort to restrict growth; hence, it will be in the interest of groups and individuals to free ride, with the end result a tendency toward inaction.

Moral Hazard Problems

The incentives of self-interested public officials to maximize personal political benefits, such as re-election, is fundamental to understanding inefficiencies in the development quasi-market. The political incentives of mayors and council members to gain re-election can result in growth policies which depart from the level which would maximize the median taxpayer's interest. Typically the costs of development are diffuse or are borne by groups that are not politically mobilized. On the other hand, the benefits of economic development are often highly visible and provide politicians opportunities to claim credit and reward specific constituents or supporters that provide instrumental political resources. This can give local officials an incentive to pursue growth even when the economic costs exceed their benefits (Clingermayer and Feiock 1990). Reese and Fasenfest (1997) explicitly link this moral hazard problem with development competition:

An increasingly intense and destructive competition results in incentive packages that become remarkably similar. As in any auction market, the highest bidder wins. Because it is the community (defined as its residents), not the actual bidder (the local government officials or planners), who pays, the scope for moral hazard is wide. Elected officials “buy” jobs at any price with other people’s money, because this is both the scientifically recommended course of action and the self-interested means to retain their own jobs (1997:200).

Bureaucratic Failure

Development bureaucracies and the information they produce directly and indirectly shape local officials' development choices. Economic approaches to bureaucracy suggest that bureaus use information asymmetries to their advantage to maximize program size. Niskanen (1971) contends bureaucrats seek to increase their control of
public resources, often independent of societal needs. Bureaucratic capacity to augment demand derives from a monopoly on information regarding the true costs of programs and responsibility to assess the private supply and public benefits of growth. This information control is reinforced by development agencies’ strategic institutional position relative to the council, and by their technical expertise.

The notion that development bureaucracies have incentives to over-promote development is not confined to economics. Rubin (1989) found that economic development practitioners become advocates for expanding business and counted all business expansion as success, regardless of the expense the city incurred. Most scholars regard the Niskanen model’s assumption of a bureaucratic monopoly on information as unrealistic and, instead, have argued for a less restrictive specification in which over-production of agency outputs is a function of the relative capacity and authority of agencies, and their independence from control and monitoring by elected officials (Moe 1984; Bendor et al. 1987).

CORRECTIONS FOR MARKET AND GOVERNMENT FAILURE

Given the social inefficiency of development competition that can result when market and government failures are present, we need to identify the various paths that might be taken to correct these failures. Our diagnosis suggests three approaches to correcting quasi-market failure. The first is intergovernmental regulation of the development quasi-market. Intergovernmental intervention by states or the federal government could take several forms including actions to prohibit or limit development incentives, requirement for information provision, constraints on boundary change, and elimination of intergovernmental subsidies for local development.

The second approach is to shift the development market to the metropolitan or regional level. This might entail efforts to establish metropolitan government or to foster regional cooperation on development issues. The third approach would direct attention to the political and administrative institutions of local governance in an attempt to reduce the divergence between governmental and community demand for growth. The quasi-market framework provides a structure to guide our examination and evaluation of these alternatives.

Intergovernmental Regulation of the Development Market
**Prohibit or Limit Competition.** State or national government might intervene in order to correct several of the quasi-market failure we identify. One option is to restrict or prohibit development incentive competition. Calls for this solution are based on the assumption that government intervention distorts the market and results in inefficient outcomes. The preceding analysis argued that this assumption does not always hold. Nevertheless, the development quasi-market only enhances the efficiency of development investment patterns when the private development market creates spatial externalities and labor is not highly mobile. This suggests that limited intervention to constrain local actions might be justified.

Many states restrict the types of development incentives available to local government. Unfortunately, intergovernmental restrictions do not always work, particularly if there are incentives to cheat or to circumvent the rules. The incentive for local government to circumvent restrictions placed on them by higher governments is powerful. For example, Sbaragia (1996) details how attempts by states to limit and restrict local borrowing to promote development led to the creation of new debt instruments (revenue bonds) and new institutions (authorities) designed to circumvent these rules. Attempts to ban development programs would lead to more indirect, and very likely less efficient, methods of subsidizing development. Nevertheless, because competition targeted to specific firms exacerbates market failures, certain restrictions, such as limits on the use of targeted instruments like tax abatement, might enhance the efficiency of the development quasi-market and strengthen the link between citizen demands and policy choices.

**Information Disclosure Requirements.** Intergovernmental intervention may take several other forms. Local governments could be required to provide information that would reduce uncertainties and asymmetries of the market and better inform citizens of the consequences of development programs. The preceding analysis highlights the importance of reasonably accurate knowledge of the real costs of economic development and the importance of conveying that information to citizens. Rather than an outright prohibition on certain incentives, states might require systematic analysis of the subsidy costs per job created. For example local governments in Ohio are required to project and report the tax expenditure costs and the value of jobs created though certain types of tax abatements (Byrnes, Marvel, and Sridhar, 1999). Recent changes in governmental accounting standards require valuation of local government infrastructure. The enhanced capacities required for this task might also be
directed to valuing subsidized investments.

**Limiting Boundary Changes.** One of the assumptions of our idealized development market was that the boundaries of local governments are fixed. To the extent that boundaries can be changed by annexation, consolidation, the creation of special districts, or incorporation of municipalities, boundary adjustment provides an alternative to the development quasi-markets for urban residents to pursue the benefits of development. By restricting boundary change states facilitate competition. State laws defining the procedures for and limitations on the creation and expansion of local government boundaries limit the ability of citizens and governments to use of these instruments for development purposes (Feiock and Carr 1997).

**Eliminate or Target Intergovernmental Development Subsidies.** Recent work by Anderson and Wasmer (2000) demonstrates that, when intergovernmental development programs are not targeted to need, communities that do not have great economic need offer development incentives. They prescribe state-based encouragement or regulation of incentives that targets communities with high unemployment and underutilized infrastructure (Anderson and Wasmer, 2000). Intergovernmental subsidies reduce the cost of attracting growth. Cities compete for development until the marginal benefits of growth to the median taxpayer in each community equal its marginal economic and social costs. If intergovernmental subsides are available to all communities, development demand may no longer reflect the variation in the value of new development across communities. For example, the tax benefits of industrial revenue bonds were taken advantage of by affluent growing communities as often as communities experiencing economic decline. The amount of development incentive extracted by firms and the level of economic growth occurring with intergovernmental subsidies will exceed the equilibrium point defined in Figure 1. Subsidies that are targeted to communities with severe economic problems and therefore greater demand for growth will result in less distortion to the quasi-market than programs available in all communities.

**Regional Governance**

A second approach to correcting quasi-market failures is to shift development competition to a metropolitan or regional level. This change could enhance the bargaining position of government actors to counteract the market power of firms. It also reduces intergovernmental externalities and reduces information
costs. Approaches to regional governance include both consolidation of existing governments and cooperative efforts among local governments in a metropolitan area.

*Metropolitan Government.* One approach to regional governance is to centralize or consolidate development policymaking at the metro level. Metropolitan government, particularly city/county consolidation, has been linked to economic development on several grounds. Regional government can internalize development spillover effects. Recommendations for creation of regional level government are based on the assumption that fragmentation creates incentives to provide unnecessary subsidies to business. Regional governments might enhance development efficiency through enhanced planning capacity. Comprehensive planning on a metropolitan-wide basis under a single authority has been viewed as a necessary condition for attaining coordinated development. Hawkins, Ward, and Becker (1991) directly assert consolidated government can better address problems of multi-jurisdictional economic decline and geographically uneven development.

Consolidation may facilitate public/private cooperation in addressing development problems and reduce the costs of gaining approval for new developments. Metropolitan government provides a mechanism to streamline the regulatory and development approval process. This may be especially important for manufacturing firms which have complicated siting decisions that can be influenced by regulatory uncertainty. Studies of growth management regulation confirm that confusion, delays, and uncertainty result from the need to gain development approvals from multiple departments and agencies (Feiock 1994).

The creation of metropolitan governments to eliminate development competition is subject to a number of limitations. Most important, metropolitan government has proved exceptionally difficult to achieve in practice. Moreover, even in the few examples we have of city/county consolidations a significant number of subcounty units are left in place. The Lexington/Fayette consolidation, for example, did not result in the merger of existing city governments, but instead simply prevented the creation of new units in the future. Empirical support for the proposition that metropolitan government enhances economic development is limited. Savitch and Vogel (1996) reviewed evidence of economic interdependence between cities and suburbs and conclude that efficient local development programs need to be implemented at a regional level.

Other empirical studies have drawn opposite conclusions. Morgan and Mareschal (1996) examined
political fragmentation and economic conditions in 77 large MSAs and concluded that decentralization promoted economic growth. Most recently, in an analysis of development outcomes over time in nine consolidated governments, Carr and Feiock (1999) reported no evidence of a link between consolidation and economic development. Manufacturing, retail, and service sector growth were not significantly different in consolidated counties.

Voluntary Cooperation Among Competing Jurisdictions. While structural consolidation of governments is rare, cooperative development efforts by governments in a region are more common. Bowman (1988) explains that jurisdictions are likely to cooperate in the pursuit of goals from which they can each derive benefits. Compacts among jurisdictions in a region not to compete for development have long been urged by critics of development competition. More recently, regional reform organizations or citizen leagues have been advocated as a mechanism for regional governance (Pierce 1993).

At times, private sector organizations engage in cooperative relationships with competitors in order to reduce environmental uncertainty or to exercise control over another organization and its resources (Schoorman et. al 1981; Oliver 1990). Cooperation provides a means to exert influence or control over organizations that possess scarce resources (Oliver 1990). Applied to the quasi-market for development, cooperative strategies provide a mechanism to counteract the market power of relocating firms.

Recent work points to a revitalization of councils of government as viable institutional arrangements facilitating intergovernmental cooperation (Lindstrom 1998: 328). Lindstrom examined the economic development activities of sub-regional councils of government in the Chicago region. She found these COGS played an important role in setting the economic development agenda. A common interest in economic development is a prerequisite for regional cooperation. Cooperative action may not be possible where the growth interests of communities are not uniform. Lindstrom found COGS to be effective at the subregional level because of the social and economic homogeneity of those areas. At the regional level this consensus breaks down as growth interests diverge (Lindstrom 1998: 341).

Even when cooperation would be in every member’s interest, there are incentives to free-ride on the actions of others. As a consequence, voluntary action is difficult. One solution to the collective action problem is
the emergence of an entrepreneur or patron to promote cooperation. Entrepreneurial strategies are particularly effective if the entrepreneur is able to provide selective incentives to local governments that commit to cooperate rather than compete. Lindstrom (1998) found membership services such as technical assistance and training and intergovernmental insurance pools or bond banks were more likely to be used by COGS that attempted to address economic development issues.

Another solution to the collective action problem is the availability of an existing organization that can be used as the vehicle for promoting regional economic development. The organizational problem has already been solved, and the indigenous organization can then be retooled as the organizational base for the new collective action. Organizations that promote regional development are typically established for other purposes. For example, some federal programs like the Transportation Equity Act for the 21st Century (TEA-21), require regional cooperation on environmental or transportation issues.

Problems of monitoring and enforcing agreements severely limit the viability of cooperative approaches. Whether or not cooperation is in the collective interest of all jurisdictions, voluntary agreements are likely to fail. The non-competition compact between New York, New Jersey, and Connecticut, for example, lasted just four days (Ellis and Rogers, 1999). Because most of the economic benefits, and all of the tax benefits, from property development are retained by a single jurisdiction, the rational strategy is for each member to defect from the agreement. In this context, the costs of monitoring and enforcement can easily dissipate any net gain from cooperation. From the perspective of a quasi-market for development, agreements to not compete or to limit competition might also reduce the competitiveness of the region within the national economy. This action could make all parties to the compact worse off. Moreover, unless there are mechanisms to share the benefits in a way that corresponds to the differing demand for development by citizens in the individual jurisdictions, allocational inefficiencies result.

Structural Reform of Local Government Institutions

A third approach focuses on how the institutional structures of local governments shape the incentives of public decision makers. The study of institutions has interested scholars of urban politics and administration for
decades (Salisbury 1969; Lineberry and Fowler 1967; Welsh and Bledsoe 1988; Ostrom, Bish and Ostrom 1988; Stein 1991). While institutional variables have generally been included in most social science models of development policymaking (Sharp and Elkins 1991; Fleischman and Green 1992), structural reform of local government institutions has not been a central consideration for dealing with the problems of economic development practice, either theoretically or practically.

**Political Institutions.** Political structures are important in several ways. First, institutions determine importance of the political benefits of development to elected leaders by influencing their time preference and risk aversion. Second, institutional powers shape the ability of local officials to bargain with private actors and make credible commitments. Third, institutions affect the responsiveness of political choices to economic conditions and the divergence of growth policy from economic demand. Much of the theoretical underpinning of this role for institutions is derived from the study of structural reforms introduced by the municipal reform movement. Government structure may also interactively influence responsiveness to community economic and political demands (Lineberry and Fowler 1967).

The shorter the time horizons of local leaders and the greater the level of political risk from failure to attract development and the more likely cities will over-pay for new development. Anette Steinaker (1999) provides a simple Nash bargaining model to illustrate how players time preference and political risk aversion result in discounting the costs of development incentives. When local officials are faced with political uncertainty, their time horizons can shorten considerably. Recent work (Feiock and Clingermayer 1999) attributes intertemporal shifts of fiscal burdens to the time horizons of local officials who incur future obligations and commitments of future revenue. In this way, credit may be claimed for public benefits delivered (or at least promised) in the short-run, while the costs of the projects may be deferred until later or placed on future taxpayers. When there is short tenure in office local officials are faced with electoral threats and political uncertainty that can make time horizons shorten considerably and increase political incentives to incur obligations. It is difficult for local leaders not to support development actions, even if they are costly and unlikely to succeed, when they face political demands to reverse decline in a city’s population or economic base. Where tenure of elected office is short we would expect short time horizons and politically risk averse behavior. The upshot is a greater divergence between the median
taxpayer’s demand for development and that of elected officials.

The structure of electoral representation can have similar consequences. Under partisan, district-based electoral systems, local officials seeking election or reelection might maximize political support by symbolically supporting development actions that provide short-term political benefits. District electoral systems create political incentives for targeted growth. When the costs of growth policies are diffusely distributed, self-interested politicians elected from districts may pursue benefits from growth for their constituencies even when the total costs exceed benefits for the median taxpayer. Benefits of development projects are often geographically concentrated, and thus provide excellent opportunities for distributive policymaking (Clingermayer and Feiock 1995). This suggests that electoral structures will have consequences for the development instruments chosen and the extent of quasi-market failure.

A second way that institutions affect the operation on the development market is by influencing the bargaining power of local leaders. The institutional powers of office, particularly local executive office, shape the ability of local government to bargain effectively with private actors and to make credible commitments. The ability of a local executive, either a city manager or a mayor, to “speak for the city” and commit resources is critical to consummating development deals (Clingermayer and Feiock 1990). The power and authority of local executives affects the ability of a municipality to negotiate contracts, make credible commitments to developers, and faithfully uphold and enforce contracts or agreements with potential investors. Exchange is most likely when both parties to the exchange—the city and a business firm—consider the arrangement to be in their best interest. The exchange is less likely to take place when either side suspects that the terms of the deal or agreement will not be upheld. This suspicion may prevent exchange that otherwise would be mutually advantageous. The incentive price that private interests demand from government will increase when there is great uncertainty and the commitments that local leaders make lack credibility.

Executive institutions can also create incentives for innovation and entrepreneurship to correct preference aggregation failures. Government failure can be self-correcting if divergence between the community and government benefits from development create incentives for public entrepreneurs that can mobilize support for more efficient alternatives. Schneider, Teske, and Mintrom (1995) identify pro-growth entrepreneurs who
advocate new approaches and policy instruments to pursue growth and anti-growth entrepreneurs who seek to restrict or manage growth. The benefits available to potential entrepreneurs, and therefore, the incentives for action, are largely a product of institutional powers of office. The presence of both full-time mayors and city managers was related to the emergence of pro and anti-growth entrepreneurs (Schneider, Teske, and Mintrom 1995).

Political institutions influence how community development demands are aggregated. Examination of the effect of government structure on preference aggregation failures directs our attention to how governing institutions condition the relationship between economic needs and economic development activity—an interactive relationship. The council-manager form of government has long been viewed as a means to insulate local decisions from political demands and community pressures (Lineberry and Fowler 1967; Lyons 1978). Elaine Sharp (1991) identified that the link between fiscal stress and the number of financial incentives a city offered was conditioned by local institutions; the greater the dependence upon non-reformed structures the stronger the linkage. She found that pressure to respond to fiscal stress with financial incentives was negligible in reformed settings and substantial in unreformed settings (Sharp 1991: 142).

Institutions and Collective Action. The mobilization of political and economic interests in a community are also shaped by institutions. Political institutions and rules determine which interests are granted access, shape incentives to organize, influence the magnitude of the free rider problem, and create incentives for the emergence of a pro-growth or no-growth entrepreneur (Schneider, Teske, and Mintrom 1995). Many communities require citizen participation in planning and development decisions. Responsiveness to neighborhood demand has been linked to decision making arrangements (Sharp, 1984). To the extent that institutions diminish the propensity for public involvement, one may expect greater insulation from popular demands and fewer neighborhood-based development confrontations (Elkins and Sharp 1998). One way to expand the scope of conflict is to encourage and institutionalize input from citizens and citizen organizations in formal decision processes, typically through open meeting, public hearing, or community representation requirements.

Institutions for direct democracy in local government can be especially important for growth management and efforts to curb development incentives because they provide community groups with a mechanism to bypass the
entrenched power of elite interests (Calavita 1992). Nevertheless, it is difficult to craft institutional fixes to quasi-market failure because the same structures that reduce one type of failure can exacerbate others. For example, public meeting, participation, or referenda requirements that expand participation and public input in development decisions may also create uncertainty regarding future action which makes city commitment less credible resulting in higher transaction costs.

**Institutional Arrangements and Bureaucratic Failure.** Operational arrangements for implementing growth promotion shape development choices and opportunities to manage, rather than promote, growth. Government-based development programs result in a fundamentally different institutional logic for development than market based approaches that delegate authority to a private or quasi-public organizations (Clarke and Gaile 1998). Reliance on development authorities contributes to quasi-market failure because authorities pursue business expansion with little public oversight (Kantor 1988).

Where development is implemented within government, its organizational location and structure may have consequences for the attention given growth issues by elected officials and the influence of bureaucrats and elite interests on decisions. A single line agency devoted exclusively to economic development and growth promotion provides a tightly coupled framework that may facilitate elite access and input. It has been asserted that such agencies are likely to act as an advocate for pro-growth policy (Fleischmann and Green, 1992). Nevertheless, Kim and Feiock (1996) suggest that this organizational arrangement facilitates a more rational and considered development decision process by institutionalizing professional planning values, rather than leading to capture by development interests. Professional development organizations can promote full disclosure, strict accountability, and improved cost benefit analysis. Sullivan and Green (1999) asset that economic development professionals “have a greater ability to impose controls on business subsidies as a way to ensure that the their municipalities investment in a select number of firms will increase economic development outcomes within their jurisdiction” (Sullivan and Green, 1999: 271)

**Institutions and Market Failures.** Institutional structures that reduce government failures might also reduce the severity of market failures. As was explained earlier, the pursuit of targeted development exacerbates the problems of monopoly, information asymmetry, and transaction costs. Reliance on policy instruments such as
direct incentives and subsidies to firms can be a consequence of the political benefits they generate for public officials. Institutions that redirect the incentives of elected government officials and bureaucrats toward the growth preferences of the median taxpayer are likely to reduce reliance on targeted assistance and to encourage alternative approaches to development. This, in turn, is likely to reduce distortions resulting from failures of competition and information asymmetries. Bureaucratic institutions that promote professionalization of development administration but provide access to wider publics may also create incentives for better evaluation of development proposals. This can reduce transaction costs resulting from the inability to predict or measure development benefits. Finally, the power and structure of executive office has implications for transaction costs. A strong executive, either in the form of a city manager or mayor, plays a central role in growth policy. A strong leader can reduce market transaction costs by acting as an agent for the city as a whole in dealing with community groups, private interests, quasi-governmental authorities, and higher level governments (Clingermayer and Feiock 1990).

DISCUSSION

The quasi-market framework for economic development outlined here promises to enhance our understanding of the relationships between economic need, political demands, and local development policy in several ways. This framework provides a means to integrate and reconcile conflicting approaches and empirical findings regarding local development. Casting development problems as market and government failures leads to several specific policy solutions. These include intergovernmental regulation of development competition, shifting development competition to the regional level, and promoting institutional structures that provide incentives for government actors to pursue the development interest of the median taxpayer.

This framework can also inform program evaluation. A better understanding of the role of political and administrative institutions in a quasi-market for development has both theoretical and applied importance for the evaluation of local growth policy and development competition. Recent studies provide evidence that local economic development policy can be both efficient, in the sense of achieving positive-sum economic gains, and progressive in that disadvantaged groups disproportionately benefit (Bartik 1991). A critical assumption of
evaluations that reach these conclusions is that economic development programs are supplied by communities suffering economic distress because there is high demand for the spatial externalities produced by additional development. If incentive offerings are not linked to economic demand, then they will result in an inefficient allocation of new jobs and investment. Research that more systematically examines the relationship between economic demands and the employment of development programs is necessary to evaluate the performance of the quasi-market for economic development. Political systems which respond to economic hardship with development incentives can produce economic outcomes that are both more efficient and progressive. On the other hand, even if development programs may attract new investment, if development is a response to political forces, rather than community economic demand, it create allocational as well as economic inefficiencies and directs development benefits primarily to land and capital interests.

This framework also provides a guide for empirical inquiry into urban politics and the growth policy choices of local government. Focusing on the role of political structures in development choices highlights the implications of growth politics for study of institutions and institutional change in local government. The choice of institutional arrangements is linked to development preferences of local political actors because of the "path dependent" nature of local political systems (Woodlief 1995). Individual and group preferences for particular institutions may be shaped by a belief that those institutions will increase the probability of reaching particular development policy ends. The politics of institutional choice may then be viewed as a continuation of the politics of development policy choices. William Riker (1982) argued that, at any given point in time, institutions represent the "congealed tastes" for the specific policies that they encourage. This suggests that institutions may be modified to improve the chances of reaching new policy ends, and that groups and interests will mobilize to support or oppose institutional change based upon its perceived development consequences.
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Figure 1: THE MARKET FOR GROWTH UNDER DIFFERING ECONOMIC CONDITIONS
Figure 2: GROWTH POLICIES MAXIMIZING COMMUNITY BENEFITS AND POLITICAL BENEFITS