

# ***PRIVATE GOVERNMENTS IN URBAN AREAS***

## ***Political Contracting and Collective Action***

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*Urban areas are increasingly populated by new organizations called private governments that are created within the boundaries of existing local governments. Examples include homeowner associations, community benefits districts, and business improvement districts. Citizens attempting to form private governments that supply public goods may encounter collective action problems. Utilizing transaction resource theory, the article examines potential collective action problems in forming private governments and explains how solutions to these problems emerge as a consequence of a political contracting process between stakeholders, where the rules of the resulting relational contract define expected cooperative behaviors. The article also applies transaction resource theory to a case study of the contracting process used to overcome potential collective action problems in creating a private government in Baltimore, Maryland. The case study demonstrates the complexities of the contracting process and illustrates how collective action problems might be intertwined in the prephase, negotiation phase, and postphase.*

**Keywords:** *transaction resource theory; collective action; private government*

**The urban landscape is increasingly populated** by new organizations created within the boundaries of existing cities or other local governments. Examples include such familiar organizations as homeowner associations and newer institutions such as community benefits districts (CBDs) and business improvement districts (BIDs). These private or quasi-governmental organizations play an important, if little noticed, role in urban governance. The focus of this article is the CBD, a private governance organization whose property owners, both residential and commercial, pay property taxes in addition to what the city levies to receive supplemental services such as safety, sanitation, and economic development. Although these various types of organizations are not monolithic in institutional form, Helsley and Strange (1998) characterize them as private governments with a number of common features and view their formation as a kind of secession because members withdraw from the civic whole and limit their interactions to other group members.

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Private governments, also referred to as nested governments, share the following key features:

First, they are formed by firms or households who are dissatisfied with the services provided by the public sector. In this sense, they are voluntary. Second, they provide additional services only to those who join the private government. In this sense, they are exclusive. Third, members continue to pay for and receive the services provided by the traditional public sector. In this sense, they are governments within governments, inherently supplementary in nature. Fourth, they pay for the services they provide with taxes and fees imposed on members, rather than with broad-based taxes imposed on firms and households who may not benefit from the services. In this sense they are self-financing. Fifth, private governments operate in a mixed system, where they must compete with the traditional public sector. In this sense, they are strategic. (Helsley & Strange, 1998, p. 282)

Although the five key features are fairly self-explanatory, the voluntary nature of private governments warrants further clarification. Helsley and Strange (1998) are speaking strictly in terms of why these organizations are formed when they cite their voluntary nature. In terms of the CBD organization under analysis in this study, its formation is voluntary under Helsley and Strange's definition in the sense that a supermajority of renters and property owners were dissatisfied with existing public services and, therefore, voted to create the CBD.

In this article we examine the collective action problems encountered by citizens seeking to form private governments to supply public goods to urban residents. The introductory section explains the debate between private government supporters and opponents. Utilizing transaction resource theory, the second section explains how solutions to collective action problems emerge as a consequence of a political contracting process between members of the collective where the terms of the resulting relational contract or constitution define expected cooperative behaviors (Heckathorn & Maser, 1987a; Maser, 1998). In the third section, we apply transaction resource theory to a case study analysis of the contracting process used to overcome potential collective action problems to create a private governance organization, the Charles Village Community Benefits District (CVCBD), in Baltimore, Maryland. The fourth section offers concluding remarks.

### **The Private Governments Debate**

The so-called voluntary nature of private governments is key to understanding the debate between their opponents and supporters. The formation of the Baltimore CBD is not purely voluntary in the manner that McConnell (1966) describes because the minority who voted against its formation in the referendum are still required to become members of and pay additional taxes to the CBD. In this sense, an element of coercion toward minority interests exists. Likewise, after the CBD is created a dissatisfied individual member does not have the right to resign from the organization.

On a practical level, during the creation process, an individual who does not desire to become a member of the CBD has the option through voice of trying to persuade enough individuals through the democratic process to vote against and defeat the referendum. Also, by design, the Baltimore CBD is not necessarily permanent. Every 4 years the Baltimore city mayor and city council hold one or more public hearings to assess whether the district will be terminated or continued for an additional 4 years (Baltimore City Department of Legislative Reference, 2004). Thus, a dissatisfied individual member in an already existing Baltimore

CBD has the alternative of attempting to form a coalition with other members to try to convince the mayor and city council to terminate the district. If the individual fails in either attempt and finds membership in the CBD to be unpalatable, he or she also possesses the option to exit the district's boundaries.

In addition, it is unlikely that a requirement of unanimity in forming a CBD for the purpose of protecting minority interests would be beneficial. A historical case, the Articles of Confederation, has demonstrated the failure of such a policy. Under the Articles' requirement for unanimity among states to enact navigation laws, for example, Rhode Island was able to veto each congressional initiative. Based at least partly on that experience, Madison proposed to enact the Constitution after ratification by nine states rather than require unanimity in the ratification process (Heckathorn & Maser, 1987a). The pitfalls in allowing a small minority to block the formation of a CBD and control its operation and status once formed are equally apparent.

Garreau (1991) also questions whether such shadow governments are truly voluntary and the desirability of exclusion. In speaking of homeowner associations as one form of shadow government he argues that membership in the association is not voluntary after a house is chosen. In addition, the homeowner must comply with the association's rules, and the covenants, conditions, and restrictions of the deed make obedience mandatory. Garreau also argues that shadow governments are only democratic to a degree; rarely utilize the one-citizen, one-vote principle; and instead tend to use "one-dollar, one-vote democracy" (p. 200). In contrast to Garreau's exclusionary notion of democracy, however, the Baltimore CBD did apply the one-citizen, one-vote principle. Using a referendum, a supermajority of both property owners and renters was required to vote in favor of the district's creation.

Other critics attack private governments as potential causes of interdistrict inequity because property owners in low-income areas may not be able to afford to pay the additional property taxes, fees, or dues needed to create a nested government and, therefore, will not be able to receive needed supplemental services. For example, Sandel (1996) asserts that city subdistricts exacerbate interdistrict inequality within a community. In his assessment of BIDs, Sandel reports evidence that residents and businesses in upscale districts may insulate themselves and receive private garbage collection, street cleaning, and police protection unavailable to the city as a whole. In this way the more affluent evacuate public spaces by retreating to privatized communities defined largely by income level (Davies, 1997).

Critics of small local governments in general find these units to be undemocratic and discriminatory, and their critique may be extended to private governments. For example, McConnell (1966) takes Madison's argument favoring a large republic and utilizes it to show the downside of small governments. Namely, the smaller the society the fewer diverse parties and interests likely composing it and, thus, the greater probability that a majority will be found that can more easily be oppressive toward the minority. McConnell further asserts that the majority will be much more cohesive in a small community, and the chance of developing effective opposition to the dominant interest is much less in a small than in a large community.

The work of other scholars provides support for private governments. These governments have been found to be consistent with the classic polycentric model of local governance (Baer & Marando, 2001). The term *polycentric* signifies many centers of decision making that are formally independent of each other. To the extent that the various political jurisdictions in a metropolitan area take each other into account in competitive relationships, enter into various contractual and cooperative undertakings, or have recourse to mediating

mechanisms to resolve conflicts, they work in a coherent manner with consistent and predictable patterns of interacting behavior (Oakerson, 2004; V. Ostrom, 1994).

The polycentric model of local governance helps to illustrate the advantages of small homogeneous units of government. Such units of government may in fact prove more beneficial in meeting service preferences than large diverse units. The creation of private governments formalizes service-level differences among residents and businesses within cities (Briffault, 1997, 1999), and these differences may allow services to be tailored to best meet the need of those within particular private governments.

Provision-side efficiency calls for the boundaries of a private government to be large enough to include the affected group of people and, at the same time, to not be so large as to include groups of individuals with very heterogeneous preferences (Oakerson, 1999). Individual preferences must be reconciled by creating suitable institutions in the contracting process. In terms of production-side efficiency, one finds that private government residents desire and receive those labor-intensive public services exhibiting diseconomies of scale such as safety, sanitation, and neighborhood revitalization. And small production units such as CBDs supply these services most efficiently. In contrast, larger production units with economies of scale supply capital intensive public goods most efficiently. This concept of production-side efficiency informs the discussion of nested governments and helps to explore how efficiency is related to the size of local organizations (Feiock, 2004).

The polycentric model includes both a demand and a supply component. On the demand side residents and businesses locate to those local units that best meet their public goods preferences (Tiebout, 1956). On the supply side, local government in metropolitan areas can be organized and reorganized to meet service preferences (Ostrom, Tiebout, & Warren, 1961). Much greater attention has been focused on the demand side of this model rather than the supply side.

On the supply side, empirical inquiry has focused on municipal incorporations and suburbanization (Burns, 1994; Lewis & Neiman, 2002; Schneider, 1989). The explosion of suburban jurisdictions during the past four decades has been taken as evidence of the efficiency of these jurisdictions in meeting the public goods and services needs of many metropolitan residents and businesses (Stein, 1987). This literature has paid limited attention to private governments that are nested within existing general-purpose governments.

Some also see private governments as a desirable solution to the fiscal dilemmas facing governments because firms and households who are willing to pay for needed supplemental services can get them (Baer & Marando, 2001). In this sense, the formation of private governments might be viewed as an exercise of *voice* rather than just *exit* (Hirschman, 1970; Parks & Oakerson, 1989; Williams, 1971). Private governments combine elements of voice and exit because residents and businesses act collectively to stay in place for the purpose of obtaining particularized goods and services (Briffault, 1996). In other words, the creation of private governments may provide a feasible and effective option for obtaining a different bundle of taxes and public goods without having to move to another jurisdiction.

In many respects creation of private or quasi-governmental organizations parallels the creation of government units. Each provides distributive as well as collective benefits (Feiock & Carr, 2001; Miller, 1981). Recent advances in our understanding of the circumstances surrounding innovation in local government (Schneider, Teske, & Mintrom, 1995) and the ability of citizens to overcome collective action barriers to the reorganization of governments direct our attention to the selective costs and benefits of private governmental organizations (Burns, 1994; Feiock & Carr, 2001) and the contractual nature of these governance organizations.

## TRANSACTION RESOURCE THEORY

“A contract is an agreement among two or more people stipulating: first, actions by each to be carried out or not carried out at some time in the future; and second, rewards or penalties to be meted out depending on compliance” (Heckathorn & Maser, 1987a, p. 143). Contracting mandates the expenditure of transaction resources or incurring transaction costs to solve three independent but interconnected problems of cooperation, including coordination, division, and defection. Transaction resources include the prerequisites for negotiating such as communication channels among participants and the prerequisites for enforcing contracts such as the ability to monitor compliance. The benefits of cooperation will not be realized if the transaction costs of searching for mutually beneficial agreements, bargaining over which of those agreements are chosen, and monitoring and enforcing the resulting contract are too high (Heckathorn & Maser, 1987b; Maser, 1998). Thus, collective action is more likely when the Pareto-benefits outweigh the transaction costs experienced by individual members of a group (Lubell, Schneider, Scholz, & Mete, 2002; E. Ostrom, 1999).

Extending transaction resource theory to encompass private governments, whether these organizations can form depends on the ability of actors involved in contracting to solve three problems of collective action: coordination, division, and defection. Each of the three problems might be discussed as corresponding with a distinct phase in the contracting process in theory, although transaction resource theory recognizes that the problems may be intertwined (Heckathorn & Maser, 1987a). As the subsequent case study also illustrates, in practice each type of problem may occur in any of the three contracting phases or in more than one phase. This section highlights transaction resource theory as generally described, and, therefore, it provides an account that may conflate collective action problems with particular phases in the contracting process. The case study of the formation of the CVCBD that follows attempts to tease out the complex relationship of problems and phases.

First, in transaction resource theory the coordination problem may correspond to the prephase in the contracting process. To prevent a coordination problem, the expected outcome of the contract must satisfy joint rationality. In other words, no participant will initiate contracting with another unless he expects an opportunity for both to gain (Heckathorn & Maser, 1987b; Maser, 1998). If people do not know whether coordination will be feasible, they extend their endogenous resources on search costs. In addition, “the *risk of incoordination* creates a demand for rules to promote *stability and decisiveness* in governance” (Maser, 1998, p. 541). Constitutional rules that generate stability and satisfy joint rationality guard against both rejecting outcomes that constituents jointly prefer and accepting outcomes constituents jointly dislike. A constitution can promote stability if its rules are clear and if the outcomes of political activity show predictability. Cooperation between parties occurs under contracts because each party realizes that there is stability in the rules to solve controversies and enforce the contract. This stability decreases the ability for parties to change the rules, however.

The division problem may arise in the contract’s negotiation phase, the time when the decision of how to contract is made. In this phase, parties decide the terms of the contract and specify the manner in which the gains resulting from the contract and the burdens of enforcing it will be allocated (Heckathorn & Maser, 1987b). The division problem occurs if parties possess opposing preferences regarding how to allocate the benefits and costs of the contract. If this is the case, the parties negotiate concessions, and the expected outcome is called concession rationality. The goal is to achieve an equitable agreement, and mitigating inequitable

divisions creates a demand for rules to promote responsiveness (Maser, 1998). Division problems can be eased through either a coalition or arbitrating third party that has the ability to allocate cooperation gains or is able to narrow the division range. However, an individual may inevitably refuse to accept a contract or constitution because he finds it unfair due to requiring excessive concessions (Heckathorn & Maser, 1987a).

In the postphase, each party decides to uphold or violate the contract and monitors the compliance of other parties. Defection, the third and most difficult contracting problem, occurs if one or both sides do not comply with the agreement. "Defectors enrich themselves at *greater* cost to the collectivity. They, so to speak, poison the common well from which they steal" (Heckathorn & Maser, 1987a, p. 159). This free riding manifests the troublesome nature of mutual trust and shows the necessity that contracts be efficient, enforceable, and hold people accountable to decrease defection and increase compliance. For a party to agree to a contract, its expected outcomes must satisfy individual rationality so that neither party is left worse off than the status quo (Heckathorn & Maser, 1987b; Maser, 1998).

### **Government Formation and Institutional Structure**

The institutional rules created by a private government may safeguard against the three risks for cooperation described above. For example, the charter of a CBD can provide constitutional rules to reconcile coordination, division, and defection. The costs of cooperation among next-door neighbors or residents on a single block may be small. Because identification of opportunities for gain from cooperation and information on preferences is known or inexpensive to gather, endogenous transaction resources may be adequate to secure cooperation. For transactions across entire neighborhoods at increasing distances, however, problems of coordination, bargaining, and defection are larger. Constitutional procedural safeguards in the form of a charter or contract for the CBD can minimize the barriers for cooperation at all phases of the contracting process.

The literature on local governance suggests a two-stage process in which a decision is first made to create a new government and, second, the institutional structures of the new organization are designed. Such a distinction is artificial and does not capture the politics of the formation of public or private governments (Carr & Feiock, 2004). Because collective action is more likely when the Pareto-benefits outweigh the transaction costs experienced by individual members of a group, the institutional arrangements or constitution of the organizations is central to overcoming barriers to collective action and forming the organization in the first place. From this perspective, solutions to collective action problems emerge as a consequence of a political process of crafting a relational contract among members of a collective.

A private government imposes institutional constraints on members as a mechanism to overcome barriers to mutually beneficial cooperation. Rather than relying on voluntary cooperation, nested organizations stipulate future actions of the parties and the benefits and cost of compliance or noncompliance by the parties. The effectiveness of relational contracts depends on the extent to which they alleviate barriers to cooperation by reducing the sum of uncertainty costs and avoidance costs. A decision to form a CBD can be framed as an effort to mitigate the risks of cooperation. The need for procedural safeguards to ensure stability, decisiveness, responsiveness, and efficiency gives rise to the need for a private government that can join citizens in a relational contract (Heckathorn & Maser, 1987a).

As the term implies, *nested* governance organizations are part of the intergovernmental system of sharing authority and delivering services (Hawkins, Percy, & Montreal, 1997).

The extent to which higher level governments regulate the creation and operation of such private governments varies by place and organizational form. Neighborhood residents typically cannot create a private government by themselves. A higher level local and/or state government is necessary for creating the organization. In other words, neighborhood interests for creating private governments need to be negotiated with representatives of city and/or state interests (Thomas & Hawes, 1999). The creation of a nested government organization is the result of a compact or officially sanctioned intergovernmental agreement involving not only the residents and businesses seeking to provide themselves a service but state and municipal governments as well (Briffault, 1997).

### **THE CASE OF THE CVCBD**

In this section of the article, a case study of the contracting process used to overcome potential collective action problems in creating a private governance organization, the CVCBD, in Baltimore, Maryland, illustrates elements of transaction resource theory. The case discusses the institutional arrangements or rules set up to create and govern the CVCBD. Again, a CBD is a private governance organization whose property owners, both residential and commercial, pay property taxes in addition to what the city levies to receive supplemental services such as safety, sanitation, and economic development. The CVCBD was the first district of its kind in the United States to assess both residential and commercial property owners (personal communication, May 12, 2004).

#### **Genesis by Tragedy**

The CVCBD was initiated at the grassroots level by a neighborhood business. The district's genesis was triggered by a random and deadly act of violence in Baltimore's South Charles Village community. According to a prominent member of the South Charles Village business community who made a strong contribution toward the formation of the CVCBD, the district's creation began on December 30, 1990, when two 15-year-old youths robbed and murdered an employee of the engineering and architectural firm Whitman, Requardt and Associates, LLP, in the firm's parking lot. The two teens then lingered in the neighborhood and attacked another person. After the murder, management at Whitman, Requardt questioned whether its 250-employee firm should exit, leaving South Charles Village and the city of Baltimore. It is natural for a company located in the inner city to consider whether to flee to a safer suburban location after one of its employees is murdered, as happened to the Whitman, Requardt employee (Baer & Marando, 2001).

Rather than exit the community, Whitman, Requardt instead decided to exercise voice to improve the safety of the area and, thus, remain in Charles Village. In doing so, the firm's executives initiated the contracting process required to create the CVCBD. The murder of the firm's employee was a random act of violence in that anyone who happened to encounter the two teens that day could have become their victim. The perception that everyone in the community was at risk of falling prey to violent offenders provided a common interest in collective action to increase safety and recognition of joint benefits from cooperation. Cooperative action by residents and businesses in the community also involved third parties because support from both the city of Baltimore and the state of Maryland was necessary for the creation of the district.

### The Relational Contracting Process

Maser (1998) describes a relational contracting process in three phases, including the prephase, negotiation phase, and postphase. Coordination, division, and defection problems may occur in each of these phases. Because the contracting process that created the CVCBD was filled with conflict there was a strong possibility that coordination, division, and defection problems would occur. In the case of the CVCBD, it is difficult to separate the three phases in the creation of a relational contract as completely distinct and occurring in sequence. Instead, elements of the three phases of the contracting process appear to overlap substantially and may proceed in a simultaneous or iterative fashion. The case analysis discusses the formation of the CVCBD as three phases that correspond to a generalized relational contracting framework but describes how the phases may occur simultaneously and how problems of cooperation may overlap these phases.

Under transaction resource theory, coordination problems may occur in the prephase of the contracting process. Joint rationality, the opportunity for all parties to gain, must occur to avoid coordination problems. Regardless of their circumstances, all residents and businesses in the community were at risk of random violence and had a joint interest in reducing that risk. Institutional rules generate stability and decisiveness in governance to satisfy joint rationality. The CVCBD rules ensured that all parties could gain from improving the neighborhood through the provision of supplemental services.

As this section explains, parties worked together to help overcome collective action problems and create the CVCBD. First, initiated by Whitman, Requardt, the 25th Street Task Force was created in 1991 and consisted of neighborhood business representatives, neighborhood residents, and city officials for the purpose of addressing the problem of neighborhood crime and violence. In the beginning, the task force originally studied a small 30-block section in the South Charles Village neighborhood between 20th and 26th Streets, a lower-income area. The population of this originally proposed district was quite small, having only about 3,000 residents. Determining the final population size and geographical boundaries of the CVCBD proved to be a contentious issue during the contracting process, as we will explain. Subsequently, the attempt to develop and locate the CVCBD in this lower-income area failed. Income inequality and population mobility also proved to be controversial issues in the CVCBD contracting process, as we will show.

The task force devised three institutional rules to help satisfy joint rationality and prevent coordination problems. These rules included the principle of fiscal equivalence: if everyone benefits, everyone pays for it; the rule that both residential and commercial property owners within the district would be required to pay an additional property tax in exchange for receiving supplemental services; and defining the scope of supplemental services: safety, sanitation, and economic development (Baer & Marando, 2001).

The task force agreed on and crafted these institutional rules after careful deliberation and communication with residents and businesses. The task force included a 23-member steering committee whose representatives served as ambassadors to their area in disseminating positive information about the proposed benefits district. The group also sought the support of local churches, particularly the five main congregations in the area, because an estimated 3,000 families worshipped there (25th Street Task Force, 1993). The task force held open meetings for residents and businesses and also held meetings with neighborhood groups to discuss and gain support for the proposed district.

Each of the three institutional rules responded to concerns about the allocation of costs and benefits, referred to by Maser (1998) as compensability. The fiscal equivalence rule

ensured that all property owners in the district would have to pay a cost—a supplemental tax—to receive a benefit—supplemental services. Requiring that both residential and commercial property owners pay a supplemental tax was an obvious cost to these individuals, but it also enabled them to receive the benefits of supplemental services. As noted earlier, neighborhood residents and businesses were largely willing to cooperate jointly to receive these benefits such as enhanced safety because of their perception that the neighborhood was unsafe. In other words, crafting an institutional rule requiring fiscal equivalence helped to create the political buy-in needed to successfully form the district.

Because of intense concern about crime in the area, supplemental safety services were emphasized at the time of the CVCBD's formation. However, from its inception, the CVCBD has always included all three supplemental services of safety, sanitation, and economic development. This is because of the fact that the district's founders believed that the perception of an orderly neighborhood enhances its safety, and they recognized that improvements in both sanitation and economic development contribute to a perception of order (personal communication, May 12, 2004). Thus, the founders felt that all three supplemental services would work together in a synergistic manner to increase the community's safety.

Other institutional arrangements created to overcome potential coordination problems included state-enabling legislation as a requirement to form CBDs, a first Baltimore city ordinance required to form CBDs in Baltimore and this ordinance's rules, and a second Baltimore city ordinance required to enlarge the boundaries of the CVCBD. These higher level rules defined the powers of the district and the constraints on its exercise of power. Maryland statutes required that a CBD first receive state-enabling legislation to tax property owners. Legally, the state's role was to pass legislation to enable CBDs to be established in communities in which the city gave its authorization. Moreover, with state-enabling legislation the Baltimore City Council needed to enact the necessary local ordinances for allowing a community to establish a district.

The first local ordinance creating the CVCBD also required a referendum in the proposed area as a prerequisite for adoption of the CBD. Specifically, it required a supermajority of 58% of property owners and renters in the district to support adoption of the district and its additional taxes. The additional tax rate levied on both residential and commercial property owners to pay for CVCBD supplemental services is equivalent and is currently 12¢ per \$100 of assessed valuation (personal communication, May 12, 2004). The city ordinance authorizing the CVCBD also required a sunset clause that mandated that the district would have to be reauthorized every 4 years. This sunset provision gave city officials an opportunity to abolish the district if political conflict arose or if residential or commercial support diminished. In essence, the provision served as a city administration escape hatch and not a precedent for a permanent city commitment to benefits districts (Baer & Marando, 2001). The task force lobbied for the enactment of both state-enabling legislation and this first city ordinance.

In addition, a second city ordinance required that the CVCBD's boundaries be enlarged from 30 to 100 blocks and its population size be increased from 3,000 to 14,000 residents. Although the originally proposed 30-block CBD was located in a lower-income area, the mayor, the city delegation to the general assembly, and several Baltimore City Councilpersons rather paradoxically expressed concern that by creating benefits districts the city would become balkanized with White middle-income neighborhoods becoming engaged in an elitist movement to obtain services that exclude lower-income neighborhoods. Several legislators were further concerned that such balkanized districts aimed to promote lifestyle homogeneity through subtle forms of gating. Perhaps they were concerned that future

districts might be located in White, affluent areas, thus creating balkanization by race and class. To safeguard against this, the city ordinance mandated that all districts, including the originally proposed 30-block, lower-income district, be relatively large in geographic scope and population and diverse economically and racially (Baer & Marando, 2001). Thus, the required, enlarged 100-block CVCBD was mixed income rather than low income in nature. State-enabling legislation and both city ordinances were enacted.

The city ordinance requiring larger CVCBD boundaries speaks to two characteristics addressed by transaction resource theory: population size and income inequality. Because city officials paradoxically feared that CBDs might balkanize the city of Baltimore by race and income, they mandated an ordinance that increased the geographic size of the originally proposed CVCBD that, as a result, increased its population size and racial heterogeneity and also created a district that was mixed income in nature. According to transaction resource theory, population size and income inequality hinder contracting. Thus, by requiring the second city ordinance as a method to prevent balkanization they ended up creating a district with attributes that might hinder the contracting process and might fail to get sufficient political buy-in from a more diverse group of constituents (Maser, 1998). However, without such an ordinance city officials would not have supported the creation of the CVCBD, and the contracting process would also have failed.

Another community characteristic that hinders contracting is population mobility. In the case of the CVCBD, this characteristic was central to the creation of the district. Concerns that local businesses might relocate from the neighborhood if public safety did not improve and that residents might also move if they were not satisfied with the services and safety in the neighborhood motivated the task force to identify ways to improve conditions in the neighborhood. The result was the creation of the CVCBD. If Whitman, Requardt—along with other key area businesses and residents—had instead decided to exit the neighborhood rather than seek ways to improve it, the contracting process needed to create the CVCBD might never have begun and, if started, would likely have failed.

In the negotiation phase the decision of how to contract is made. Parties decide the terms of the contract and specify the manner in which the gains resulting from the contract and the burdens of enforcing it will be allocated. Division problems occur if parties possess opposing preferences regarding how to allocate the costs and benefits of the contract. It appears that all of the institutional rules crafted to satisfy joint rationality and, thus, overcome coordination problems also specify benefits and costs. For example, the rules of fiscal equivalence, taxing both residential and commercial property owners, state-enabling legislation requirement, and mandated city ordinances all effectively safeguarded against division problems.

The CVCBD's governance rules were also products of efforts to safeguard participants from threats to cooperation and to gain support for the referendum creating the district. The larger boundaries of the district increased its heterogeneity. As a result, the founders formed a governing body for the CVCBD, a board of directors, with an elaborate system of representation in order for the diverse interests that are levied a supplemental tax to be represented and to address potential problems of cooperation.

The board meets monthly in a public meeting. At least two thirds of the board must be composed of owners or representatives of property owners who are subject to the additional property tax. Under existing CVCBD bylaws, between 14 and 27 board members must govern the CVCBD. The board originates from the community-at-large with members representing all four major neighborhoods within the CVCBD and is designed to be responsive to the community. These four neighborhoods include Abell, Charles Village, Harwood, and Old Goucher.

Under current CVCBD bylaws, board members must include at least eight representatives elected by each of the four neighborhoods, representatives from three business associations located within the district, four at-large members elected by the community, two representatives from nonprofit and religious institutions located within the district, one member appointed by the mayor, at least two members of the Baltimore City Council appointed by the president of the City Council, and four representatives from the neighborhood associations that border the CVCBD (Charles Village Community Benefits District Management Authority, n.d.). The representatives from neighboring areas are included in the system of representation because activities that the CVCBD undertakes are thought to impact these areas. Thus, those designing the board structure believed that representatives from the areas should be included, albeit as nonvoting members (personal communication, May 12, 2004). The board structure also ensures functional representativeness.

Additional governance rules include the following: A director's term begins on January 1 of the year following his or her appointment or election. The initial directors of the CVCBD had terms of 1 or 2 years as determined by resolution of the interim board of directors. All subsequent terms are for periods of 2 years except that the at-large voting members of the board have a 1-year term (Charles Village Community Benefits District Management Authority, n.d.). Members of the board of directors are eligible for reappointment or reelection, although no individual may serve as a director for more than 6 consecutive years. The board is able to remove a director. In this case, a majority of the remaining directors may fill the vacancy. Such a removal has not happened to date.

The board serves as the guiding voice of the CVCBD and makes final decisions regarding the district's budget allocation and program emphasis. It makes these decisions only after receiving input from district staff members, including an executive director. It, in fact, forms a selection committee to hire the CVCBD's executive director. The executive director then selects additional staff members, including a director of safety and an economic development coordinator. Finally, because state-enabling legislation is broadly phrased, the board can also make major changes in services or functions that would not require another referendum as long as the changes are intended to make the neighborhood more desirable.

Provision of a professional administrator in the form of the executive director provides a constraint on division and defection. Gary Miller (2000) argues that citizens benefit when professionally trained administrators are granted a certain degree of discretion in the exercise of public trust. The protective ideology of professional competence and a politics-administration dichotomy provide a credible constraint on the efficiency-undermining, rent-extraction activities of those holding electoral power (Miller, 2000).

In the postphase of contracting each party decides to uphold or renege on the terms of the contract. Defection problems occur if the parties do not comply with the agreement. In public or private governments defection can occur when leaders or constituents defect from the preferences of the community to pursue their own interests. The initial authorization process to create and make the district legitimate and the process for its reauthorization provide a powerful safeguard against defection.

During the initial authorization process to create the district the contract could be rejected by individuals voting no in the referendum needed to create the district, legislators voting against state or city legislation creating CBDs, or the mayor opposing legislation to create CBDs. Many of the institutional rules discussed previously that mitigated coordination and division problems also safeguarded the new private government against defection problems and generated the political support necessary to create the district. For example, the rule of

fiscal equivalence and the requirement that both residential and commercial property owners pay a supplemental tax guarded against defection and helped to win grassroots political support for the referendum.

### **Winning Community Support: The Referendum Campaign**

The effort to win grassroots support for the proposed CVCBD went into full force after Mayor Kurt Schmoke signed Council Bill No. 891 in July 1994, creating the CVCBD with the provision that a referendum occur before the district could begin operation (CVCBD, 1994a). An interim CVCBD board selected consultants to head the referendum election campaign, and the sophisticated campaign program appears machinelike in structure but at the sublocal level. In typical machine pyramidal style, the campaign program involved dividing the district into seven zones with seven zone captains. Under the zone captains were quad captains, and block captains were under the quad captains (CVCBD, 1994b, 1994c, 1994d).

The election campaign had two phases. Phase 1 involved the three i's: introduce, inform, and identify. The introduce component included distributing basic introductory literature about the CVCBD and referendum and inviting constituents to porch talks. In the inform component those hosting porch talks attempted to persuade attendees to support the referendum. Under the identify component the goal was to identify and obtain constituent support. Campaign workers conducted follow-ups of porch talk attendees and nonattendees with the goal being to determine if they were CVCBD supporters, opponents, or undecided. Supporters were asked to put up yard signs indicating their support (CVCBD, 1994b). In Phase 2, campaign workers contacted referendum supporters and those still undecided. They also contacted these individuals immediately prior to the referendum in a blitz campaign (CVCBD, 1994b). The ultimate goal of the campaign, of course, was to get out the vote and win the election. The campaign program to win constituent support proved successful because a supermajority of 67% of property owners and renters in the proposed district voted in favor of the CVCBD's creation.

As a result of the institutional arrangements explained previously, the various parties were able to secure a credible commitment to the benefits they sought. Thus, the crafting of the institutional arrangements themselves helped to win support for the creation of the CVCBD. In addition, a number of community meetings were held to win resident and business support for the CVCBD's creation, and a well-organized election campaign to win grassroots support in the referendum also occurred. In the end, both state and local officials' desires were largely fulfilled, and the CVCBD was created, thus satisfying the preferences of a supermajority of neighborhood residents and businesses.

### **The Reauthorization Process**

The CVCBD's reauthorization process provides a safeguard against defection similar to a recall provision, but in this case it is the entire government that is recalled. In this process that occurs every 4 years the city examines the district's performance. The CVCBD has taken the following actions prior to or during the reauthorization process to win constituent and city council support. It has performed or sponsored surveys and interviews to assess constituent satisfaction prior to reauthorization (Hyde, 2002). In addition, the CVCBD holds community meetings to attempt to persuade constituents to support reauthorization (personal communication, May 21, 2004). Also, the CVCBD has engaged in public relations that resulted

in news articles, published an annual report, published a newsletter sent to a wide audience, and met regularly with legislators. “These activities kept people informed and made people feel they were getting something” (personal communication, May 26, 2004).

In the formal reauthorization process, the City Planning Commission first makes a recommendation to the Baltimore City Council about reauthorization. Then, the city council hears from neighborhood residents and businesspersons concerning their views of the district. During the most recent reauthorization process, the Baltimore City Council went directly to the district’s constituents by holding a public hearing in the Charles Village community (personal communication, May 21, 2004). Individuals often stand in long lines to testify for or against the CVCBD’s reauthorization (personal communication, May 12, 2004). After hearing public testimony, the council makes its decision to either support or reject reauthorization. Although some detractors currently exist (personal communication, May 26, 2004), as they did during the CVCBD’s creation, public testimony and the district’s actions and performance have thus far persuaded the council to support reauthorization. In the next step of the process, the council presents a bill to the mayor either supporting or opposing reauthorization, and the mayor makes the final decision. The CVCBD was most recently reauthorized in 2003.

## CONCLUSION

This article has examined private governments and the formation of Baltimore’s CVCBD, a particular type of private governance organization. Extending transaction resource theory to private governments we find that whether these organizations form depends on the ability of actors involved in the contracting process to overcome problems of collective action, including coordination, division, and defection. Although each of the three problems of collective action might be commonly described as corresponding with a distinct phase, transaction resource theory recognizes that these three problems might instead be intertwined in the prephase, negotiation phase, and postphase. Illustrating elements of transaction resource theory, the case of the CVCBD’s creation supports this more complex view by showing that it is difficult to separate the three phases as distinct and occurring in sequence. Instead, as the case reveals, phases may occur simultaneously, and problems of cooperation may overlap these phases. As a result, the case analysis demonstrates the intricacies of transaction resource theory and its utility for studying the formation and structure of private governments.

Initially, the randomness of the crime that triggered the CVCBD’s creation galvanized the perception of joint benefits from cooperating to form the district. However, potential coordination, division, and defection problems did exist and presented significant barriers to collective action in creating the CVCBD. Specific institutional rules and provisions were crafted to address these problems. Of note, the task force devised three institutional rules for the CVCBD, including fiscal equivalence; taxing both residential and commercial property owners within the district; and defining the scope of supplemental services to include safety, sanitation, and economic development. Additional institutional arrangements crafted to create the CVCBD included state-enabling legislation, two Baltimore city ordinances, a referendum, governance rules, and a reauthorization requirement. The rules crafted proved successful in organizing collective action and winning stakeholder support necessary to create the CVCBD. The district was formed in 1994 and continues to operate today.

Future research might conduct more systematic tests of hypotheses based in this theory utilizing comparative analysis that investigates the numbers and types of private governments created for a sample of communities. By examining communities across different states it may also be possible to investigate the role that various state, local, and sublocal rules and constraints have on the formation of private governments.

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