URBAN FISCAL POLICY

FINANCE 230/730, BPUB 230/773, REAL 230/730

Fall, 2004

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Office Hours:Tuesday: 4:00-5:30; Wednesday: 3:30-5:00; or by appointment.

Course Outline and Reading List

(All readings are included in the course bulk pack.)

"My problem lies in reconciling my gross habits with my net income." Errol Flynn

This course will examine the problems of, and prospects for, financing the provision of public services through state and local governments. The course assumes a solid understanding of micro-economics and an ability to apply that understanding to solve *numerically* problems in property valuation, public budgeting, and fiscal design. The course is intended for three audiences: 1) students interested in the determinants of real estate market values and the influence of government activities on those values; 2) students interested in the financing and management of state and local governments, for its own sake or for possible application of the "U.S. model" in other countries; and 3) students interested in the pricing of municipal debt for the provision of public infrastructures. A mid-term and final examination are required.

To give you a sense for how the course materials will be presented, I view cities as economic organizations not unlike a publicly held corporation. There are "shareholders" called owners (or renters) of residential land. Shareholder voting rights are not, however, in proportion to the value of shares owned but rather are simply in terms of one person-one vote. The "Board of Directors" of the "corporation" is elected by the resident-shareholders and is called the City Council. The Chairman of the Board -- appointed by the elected directors or elected directly -- is the Mayor. The Mayor and the City Council appoints a management team -- Managing Director (COO), Finance Director (CFO), Commerce Director (Head of Marketing?), and a group of managers for the city's various "product lines" of the business: street cleaning and maintenance, safety, education, recreation, libraries. Each service has a production relationship requiring labor, capital, and materials. The corporation finances it capital with equity (taxes) or debt (municipal bonds) and pays it labor a negotiated (union) or competitive (non-union) wage. Labor may own "shares" in the corporation (live in the city). The city-corporation "sells" its services to "customers" who buy those services with a "yearly contract" (taxes) or perhaps with a per unit fee (user charges). The customers includes the resident-shareholders -- most of the customers *are* shareholders -- but it can also include non-shareholders, the most important of which is business. City-corporations have a competitive advantage called "agglomeration" economies in the provision of important residential and business services: for example, infrastructures such as roads, ports, and communication systems and services with significant consumer interdependencies such as safety, environment and (depending on what you consider to be an "appropriate education") school services as well.

Each city-corporation is in direct competition with other city-corporations. If a city does not provide its services efficiently, then customers (residents and businesses) leave the city and go elsewhere. This leads to a fall in land values (share prices) and if revenues are not sufficient to pay for fixed costs (prior debt accumulated), then bankruptcy.

Countries which design their systems of "city (corporate) governance" well will encourage efficient cities. Efficient cities attract businesses and residents. Economic growth follows. However, if the system of city governance is poorly designed, then cities in that country (or state) cannot compete, residents and businesses exit, and growth declines. For example, one inefficient system of "city governance" regulates the city-corporation to provide poverty services for which the city organizational form is not well-suited. Good rules of city governance are equivalent to a good national policy towards cities.

To use the "language" of finance, well run cities require good internal management, favorable (at least neutral) rules for city governance, and informed and diligent shareholders. To use the language of public policy, well run cities require honest and well-trained leaders, appropriate federal and state policies, and informed voters. Good management and good policy are one and the same when it comes to managing and financing cities.

As an investor/shareholder (owner of real estate), lender (banks and bondholders), worker (teacher), or customer (resident or business), you have a vested interest in ensuring your city is well-run. This is a course in how to finance and manage a city-corporation to maximize your consumption benefits and/or investment returns.

How to Use the Bulk Pack: Obviously I want you to read everything (!), or why did I go to the trouble to find the articles and put them in the pack? You will, however, find overlap between the articles and class lectures, so to that degree they are substitutes – but not perfect substitutes. Perhaps the best way to use to the readings is as a supplement to the lectures, and then when a topic strikes your fancy, read the articles more carefully. ***You will be responsible for readings not covered in class.*** In addition to the scholarly articles, I have also included in the bulk pack numerous "current events" articles so that you might appreciate that what we are doing here actually matters for consumers, investors, and taxpayers. Since many of the exam questions will be motivated by these current events, you might want to read – a think critically about – those articles.

Finally, I have included several *Class Lectures* of more technical material. You will be expected to bring those to class on the day we discuss the material. *I will not have extra copies in class* so if you do not have your copy from the bulk pack you will find the class rather a tough go. The Class Lectures are indicated below in *bold.*

O. **What are the Issues?** (September 9)

"Urban Discontent," Economist, June 15, 2002.

"Poverty in a Land of Plenty: Can Hartford Ever Recover?" NY Times, August 26, 2002.

"Principles of Good Budgeting," (Inman Notes)

I. **Introduction: Why Cities?** (September 11)

A. The Cultural City:

Lewis Mumford, "In Defense of the City," University: A Princeton Quarterly, Spring, 1965.

B. The Consumer City:

E. Glaeser, et. al., "Consumer City," Journal of Economic Geography, 2001.

"Guggenheim, Bilbao, and the Hot Banana," Financial Times.

C. The Producer City:

LECTURE NOTES 1: THE "ECONOMIC CITY"

Michael Porter, "Clusters and the New Economics of Competition," Harvard Business Review, November-December, 1998.

D. The City and the Region:

R. Voith, "The Suburban Housing Market: The Effects of City and Suburban Job Growth," Business Review of the Federal Reserve Bank of Philadelphia, September, 1996.

II. **Does Public Finance Matter?** (September 16, 18, 23, 25)

A. Facts:

R.P. Inman, "Do You Know How Much Money is in Your Public Purse?" Business Review of the Federal Reserve Bank of Philadelphia, August, 1995.

B. Causes:

R. P. Inman, " Anatomy of a Fiscal Crisis," Philadelphia Federal Reserve Bank Business Review, Sept/Oct., 1983.

R.P. Inman, "How to Have a Fiscal Crisis: Evidence from Philadelphia," American Economic Review, May, 1995.

"Schundler's Record: Taxes Down, but Debt is Up," NY Times, October 19, 2001.

Philippe Jorion, "Bond Basics and Repos," Big Bets Gone Bad: Derivatives and the Bankruptcy in Orange County, Chapters 3 and 4.

C. Consequences:

R. P. Inman, "Can Philadelphia Escape its Fiscal Crisis with a Tax Increase?" Philadelphia Federal Reserve Bank Business Review, Sept/Oct., 1992.

CLASS HANDOUT/LECTURE NOTES: "FISCAL CRISES AND VALUES"

M. Meyer and L. Masotti, "The Real Estate Consequences of a Public Bankruptcy: The Case of Orange County," Urban Land, September, 1995.

R. Smith and J. Booth, "The Risk Structure of Interest Rates and Borrowing Costs: The Impact of Major Defaults," J. of Fin. Res., Summer, 1985.

III. **Urban Public Finance: The Ideal** (September 30; October 2, 7, 9)

LECTURE NOTES 2: TIEBOUT COMPETITION

A. Technology and Public Goods

R. Fisher, "Costs and Supply of State and Local Goods and Services," State and Local Public Finance, pp. 302-308, 312.

H. Rosen, " Public Goods," Public Finance, pp. 62-72.

M. Boozer and C. Rouse, "Intraschool Variation in Class Size: Patterns and Implications," Journal of Urban Economics, 2001.

B. The Efficient Provision of Local Public Goods

B. Hamilton, "Zoning and Property Taxation in a System of Local Governments," Urban Studies, October, 1975.

C. Application: Capitalization

W. Stull and J. Stull, "Capitalization of Local Taxes," Journal of Urban Economics, 1991.

D. Application: Urban Sprawl

LECTURE NOTES 3: IMPACT FEES

J. Brueckner, "Urban Sprawl: Diagnosis and Remedies," International Regional Science Review, April, 2000.

“Paying the Price of Sprawl,” Philadelphia Inquirer, January 13, 2002

IV. **Urban Public Finance: The Reality** (October 16, 21, 23, 28)

O. Overview: How Public Finance Works in a Metropolitan Area

R. P. Inman and D. L. Rubinfeld, "Judicial Pursuit of Local Fiscal Equity," Harvard Law Review, June, 1979, pp. 1667-1689.

A. Role of Public Labor

R. P. Inman, "Wages, Pensions, and Employment in the Local Public Sector, Public Sector Labor Markets, 1981.

B. Role of Urban Poverty

W. J. Wilson, "The Underclass: Issues, Perspectives, and Public Policy," Annals, January, 1989.

Anita Summers and Lara Jakubowski, "The Fiscal Burden of Unreimbursed Poverty Expenditures," Greater Philadelphia Regional Review, Spring/Summer, 1997.

C. Role of Urban Crime

S. Freeman, J. Grogger, and J. Sonstelie, "The Spatial Concentration of Crime," Journal of Urban Economics, 1996.

D. Role of National Politics

Peter Eisinger, "Cities in the New Federal Order: Effects of Devolution," The LaFollette Policy Report, Winter, 1997.

E. Role of Leadership

The Leader's Problem:

LECTURE NOTES: SET 4 "DECISION TO EXIT"

The Economist, "America's Cities: They Can Yet Be Resurrected," January 10th, 1998.

"Old Style" Leadership

E. Fuchs, Mayors and Money: Fiscal Policy in New York and Chicago, pp. 273-279.

"New Style" Leadership

F. Siegel, "The Death and Life of American Cities," Public Interest, Summer, 2002.

MIDTERM EXAMINATION: Approximately the first week of November.

Previous Midterm Examination with Answers.

V. **Restoring the Ideal: Public Policies for Better Public Finance**

A. Improving Public Service Provision (October 30; November 4, 11, 13)

Technology of Service Provision (Education)

"Favorable Long-Term Effects of Head Start," NBER Digest, August, 2001.

R. Ehrenberg, et. al., "Does Class Size Matter?" Scientific American, November, 2001.

"Peer Effects in the Classroom," NBER Digest, November, 2001.

Managing The Technology

LECTURE NOTES 5: FISCAL MANAGEMENT OF SCHOOLS

Incentives for Efficient Management

"Top-Down:" No Child Left Behind

"How School Administrators Cheat Accountability" NBER Digest, 2003.

"Bottom-Up:" Parental Choice

Mark Sloan, "Initiating the Privatization Process: Identifying What Services can be Privatized and How to Take Them Private," ASP Wharton School, Spring, 1999.

"The Difference That Choice Makes," The Economist, 1/27/2001.

John Chubb and Henry Levin, "The Profit Motive: Will the Profit Motive Benefit Kids? " Education Matters, Spring, 2001.

B. Taxation (November 18, 20)

Efficiency:

LECTURE NOTES: "MEASURING EFFICIENCY LOSSES WITH CITY TAXES"

R. P. Inman and S. Mullin, "Tax Reform in the Delaware Valley," Report for the Governor's Tax Commission, 1981.

A. Haughwout, R. P. Inman, S. Craig, T. Luce, "Local Revenue Hills: Evidence from Four U.S. Cities," The Review of Economics and Statistics, May, 2004.

Equity:

Re-read R. P. Inman and D. L. Rubinfeld, "Judicial Pursuit of Local Fiscal Equity," Harvard Law Review, June, 1979, pp. 1667-1689. Understand Tables I and II.

W. Evans, et. al., "Schoolhouses, Courthouses, and Statehouses After Serrano," Journal of Policy Analysis and Management, Winter, 1997.

"New Jersey's Fiscal Plight Inspires Hopes for Change," NY Times, April 8, 2002.

R. P. Inman, "Should Philadelphia's Suburbs Help Their Central City?" Business Review: Federal Reserve Bank of Philadelphia, Summer, 2003.

C. Urban Poverty: The New Responsibility (November 25)

"Taxes, Welfare and Work by Single Mothers," NBER Reporter, Fall, 2001.

" Declining City Economy Leads to Rise in Welfare Roles," IBO: Inside the Budget, January 17, 2002.

"Living Wage Roulette: Bigger Paycheck or Pink Slip?" NY Times, May 19, 2002.

J. Heckman, "Doing It Right: Job Training and Education," Public Interest, Spring, 1999.

P. Huck, S. Rhine, P. Bond, and R. Townsend, "Small Business Finance in Two Chicago Minority Neighborhoods," Economic Perspectives: Federal Reserve Bank of Chicago, 1999.

LECTURE NOTES: "THINKING THROUGH ECONOMIC DEVELOPMENT STRATEGIES"

VI. **Investing in Public Infrastructure** (Optional Lecture or covered on your own.)

J. Carlino and E. Coulson, "Should Cities Be Ready for Some Football? Assessing the Social Benefits of Hosting an NFL Team," Business Review, Federal Reserve Bank of Philadelphia, 2nd Quarter, 2004.

A. Haughwout, "Infrastructure and Social Welfare in Metropolitan America," FRBNY Economic Policy Review, December, 2001.

S. Feldstein and F. Fabozzi, "Municipal Bonds," in F. Fabozzi, Handbook of Fixed Income Securities.

VII. **Financing Cities and Provinces in Developing Economies** (December 2 and 4)

A. Fiscal Decentralization Globally

R. P. Inman, "Fiscal Federalism in Developing Economies: Lessons Learned From Working in South Africa," APSA-CP Newsletter, Winter 2000.

C. Garman, et. al., "Fiscal Decentralization: Political Theory with Latin American Cases," World Politics, January, 2001.

B. Ensuring Fiscal Discipline: The Hard Budget Constraint

R. P. Inman, "Transfers and Bailouts: Enforcing Local Fiscal Discipline with Lessons from U.S. Federalism," J. Rodden, et. al. (eds), Fiscal Decentralization and the Challenge of Hard Budget Constraints, 2003.

"Argentina's Leaders Comes Begging, Burdened by More Bad News," NYTimes, November 8, 2001.

"Argentina's Provinces Struggle to Stay Afloat," NYTimes, November 17, 2001.
"Camden Recovery Bill Signed, But School Board Challenges It," NY Times, July 23, 2002.

FINAL EXAMINATION: The final examination will be given on the exam day scheduled for our course by the University calendar -- ABSOLUTELY NO EXCEPTIONS. Make your travel plans accordingly. Date: December 16.

Previous Final Examination