Greetings policymakers,

Governance structure is not something the average American spends much time thinking about, but it has impact on the outcomes of our lives, shapes the cities we live in, and affects the health and vitality of our economy in many ways. While there is much debate in the United States regarding the structure of the federal government, as well as the philosophy of federalism and delegation of power between the federal and state governments, there is relatively little discussion about the structure of local and metropolitan governance, outside of a few select areas. We think that this lack of discussion is unfortunate, and we hope this issue brief can be the start of a healthy and robust debate that brings about positive change.

The American system of governance is built on a principle of federalism, or the division of powers between two levels of government of equal status (in the United States, this would be between the Federal government and the State governments). The Tenth Amendment of the United States Constitution provides that "all powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." Inherent advantages of this decentralized system include individual States acting as “laboratories of democracy,” where, being that there are 50 semi-autonomous states, different policies can be enacted and tested at the state level without directly affecting the entire country. As a result, a diverse patchwork of state-level government practices is created, allowing for innovations in public policy. If any one or more of those policies are successful, they can be expanded to the national level by acts of Congress.

Additionally, this decentralized approach follows a general Jeffersonian maxim of “the government closest to the people serves the people best,” emphasizing the American cultural belief in the greater transparency and accountability of lower levels of government. An individual is generally more likely to be able to get a few minutes to discuss an issue with their local representative in their state legislature than they are with, perhaps, their federal representative, for example. By and large, Americans tend to have greater levels of trust in lower levels of government.

Finally, this approach allows for competition between individual governments, which can increase economic freedom. As summarized by the Mercatus Center, many individual governments enable each of us to choose the one that best matches our preferences for government goods and services. If a city or state raises taxes but doesn’t use the money to improve services, citizens will leave for a better-managed city or state. More generally, the threat of exit by people, firms, and entrepreneurs creates competition among governments that limits governments’ ability to exploit its citizens.

However, there can be discrepancies between local, regional, state, and national interests, and policymakers must use caution when deciding which level of government is suitable for which task. While competition can breed innovations, under certain conditions competition can encourage “race to the bottom” or “free-riding” behavior. In the context of governance, race to the bottom behavior often occurs when different levels of government, often competing to lower taxes, end up cutting public services (such as education) in such a way that the region would be significantly better off if each maintains those public services. Free-riding behavior is a related concept, where one local government may benefit from regional public services but fail to contribute to the funding of those public services. While there are many sources and examples of such deleterious behavior, the genesis that most often comes up in the context of metropolitan governance stems from the spatial nature of many benefits, costs, externalities, and taxation policies. In such instances, state legislatures may justifiably intervene.

Within the constitutional framework of the United States, state legislatures are uniquely positioned to solving these types of problems. Many local powers are generally delegated by state governments to local governments to implement and enforce, and how and at what level of government those authorities are implemented is at the sole discretion of the state government, unless a state's constitution declares otherwise. While it may not be a well-known case to much of the American public, the Supreme Court case *Hunter v. City of Pittsburgh* (1907) makes clear the authority of states over their local governments or other lower political jurisdictions:

> *"Municipal corporations are political subdivisions of the State, created as convenient agencies for exercising such of the governmental powers of the State as may be entrusted to them… …The number, nature and duration of the powers conferred upon these corporations and the territory over which they shall be exercised rests in the absolute discretion of the State… …The State, therefore, at its pleasure may modify or withdraw all such powers, may take without compensation such property, hold it itself, or vest it in other agencies, expand or contract the territorial area, unite the whole or a part of it with another municipality, repeal the charter and destroy the corporation. All this may be done, conditionally or unconditionally, with or without the consent of the citizens, or even against their protest. In all these respects the State is supreme, and its legislative body, conforming its action to the state constitution, may do as it will, unrestrained by any provision of the Constitution of the United States. Although the inhabitants and property owners may by such changes suffer inconvenience, and their property may be lessened in value by the burden of increased taxation, or for any other reason, they have no right by contract or otherwise in the unaltered or continued existence of the corporation or its powers, and there is nothing in the Federal Constitution which protects them from these injurious consequences. The power is in the State and those who legislate for the State are alone responsible for any unjust or oppressive exercise of it."*

As such, states have a wide latitude and clear responsibility to intervene to promote the general welfare, particularly in cases of misalignment between local government behavior and regional and state needs. Generally, consistent with the maxims and ideas laid out at the beginning of this issue brief, such interventions should only be applied where there is a clear and logical case for improving overall societal welfare and efficiency by altering, reorganizing, or preempting local government authority. However, the remainder of this brief will give examples of when such interventions may be warranted.

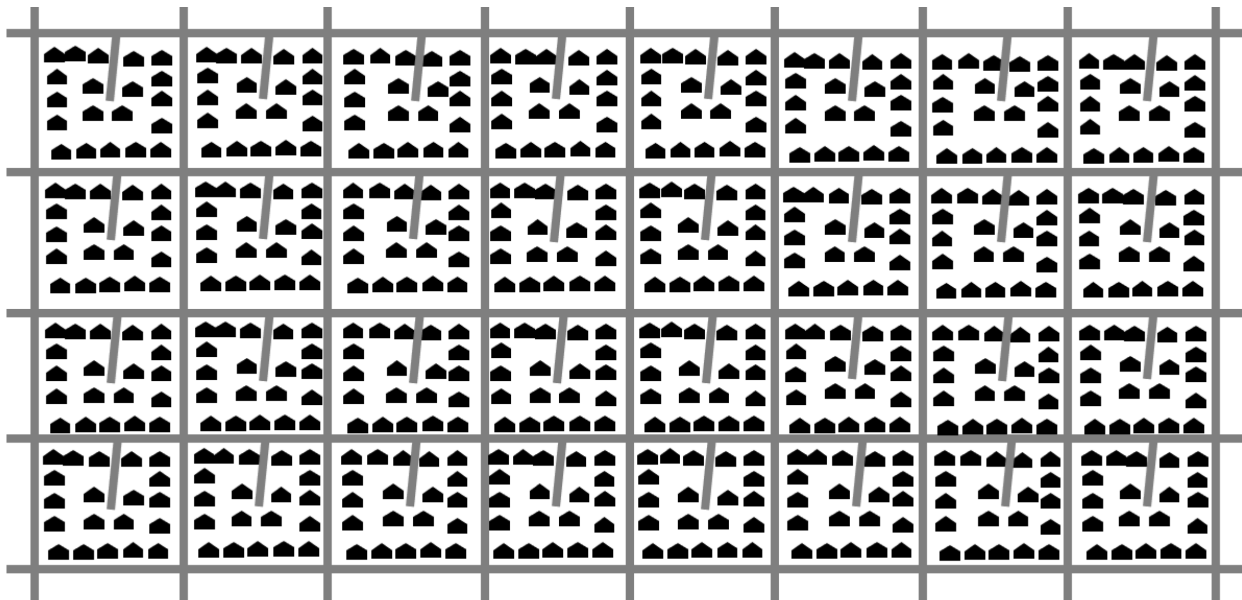
Zoning Examples: "Not In My Backyard"-ism, or NIMBY-ism, and its relationship to zoning, housing, and land use policies is one of the most straightforward examples for understanding this concept. To illustrate this, consider two general facts about increased development intensity and density:

(1) Many of the **benefits of additional density** and development intensity are **broadly distributed regionwide**, such as more housing units putting downward pressure on regional home and rental prices, more space for businesses putting downward pressure on regional commercial rents, more efficient use of existing infrastructure and transportation facilities meaning less need for regional expenditures on new infrastructure, higher farebox recovery ratios on mass transit systems (meaning less need for taxpayer subsidies), lower transportation costs per capita and improved regional air quality stemming from reduced vehicle miles traveled per capita.

(2) Many of the **costs or dis-benefits of additional density** and development intensity are **highly localized**, such as more challenges for local residents finding on-street government-provided parking spaces, higher levels of local traffic congestion (even as density reduces vehicle miles traveled globally), aesthetic concerns about changes to neighborhood character, light, shadows, or open space, or a perception of increased burden on local government services such as schools (notwithstanding of course that new development also helps fund local government services through property taxes).

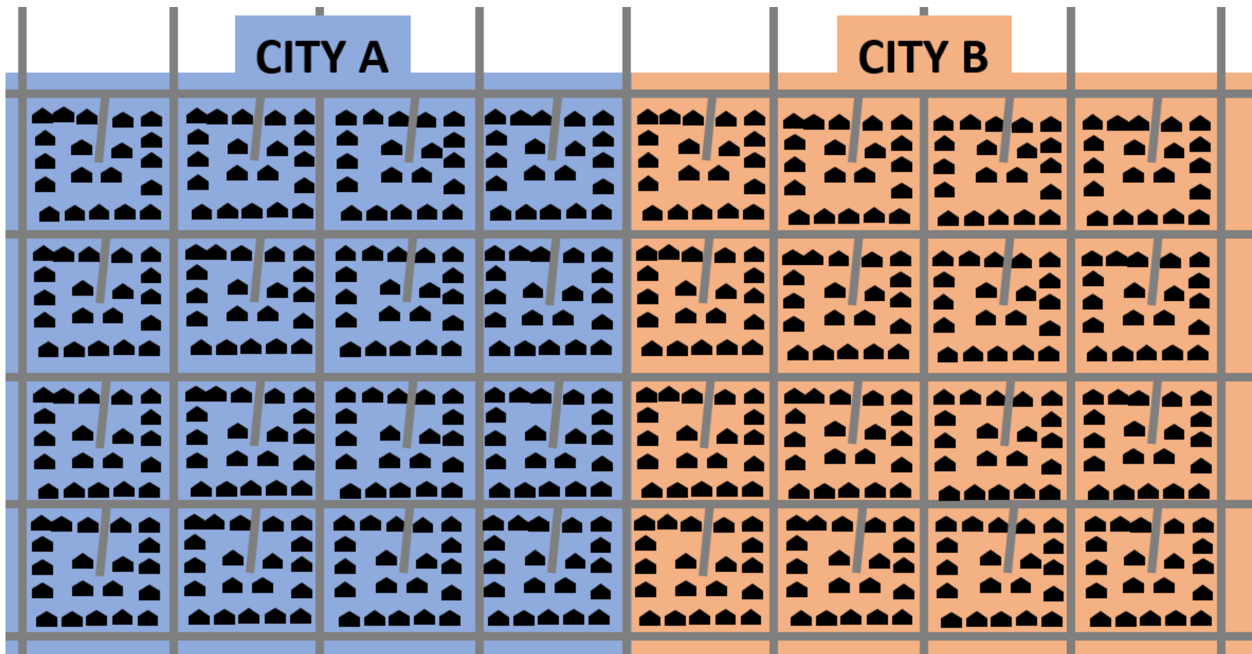
This dichotomy between regionally distributed upsides and highly localized downsides means that local neighborhoods, and likewise smaller local governments, are going to nearly always be more resistant to new development, housing, businesses, or other intensification of land uses than is socially optimal and economically efficient for the region (unless a local government is desperate for investment). For some countries, such as Japan where land use regulations are administered at the federal level, this isn't a problem. In the United States, however, land use regulations are a state police power that has generally been delegated, all or in part, to local governments to enact and enforce.[1] This means that the level of government least able to achieve an efficient outcome for the metropolitan region or the state is often tasked with decision-making power over land use regulations.

To illustrate why this can be an issue, imagine a simplified metropolitan area, where the entire area is made up of only single unit rental houses. The metropolitan area is a simple 4x8 grid (32 squares total), with each square containing 20 rental houses (640 units total). For simplicity, let's assume each rental house has only one person.

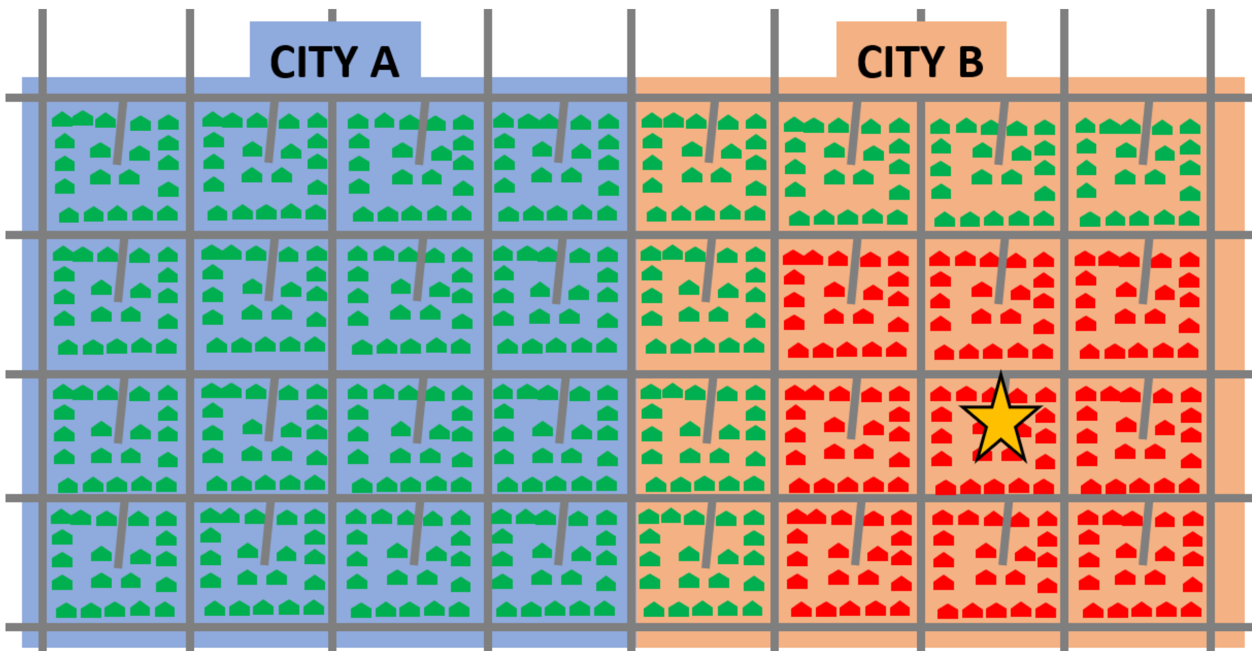


Now let's assume the metropolitan area is split in half, with City A on the left and City B on the right, with each city controlling land use within its own borders:

[1] A police power is the capacity of a state to regulate behavior and enforce order within their territory for the betterment of the health, safety, morals, and general welfare of their inhabitants.

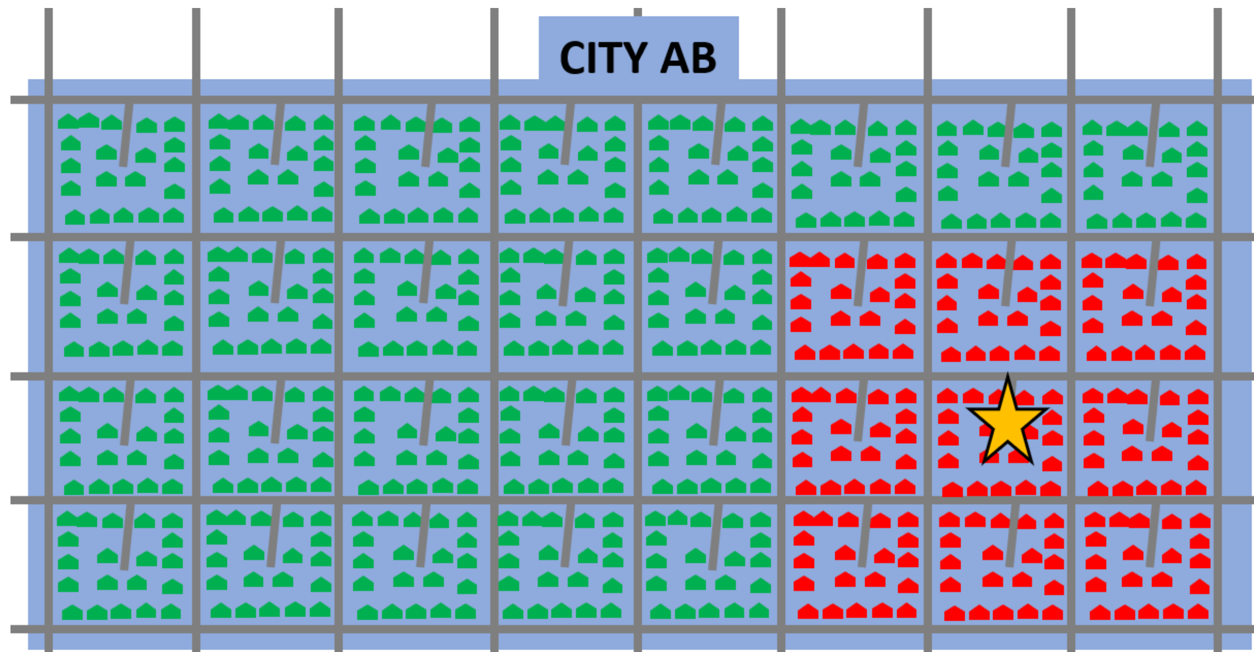


Now assume a rezoning proposal (signified by a yellow star) is under consideration near the center of City B. Assume people in both cities believe the metropolitan area should build enough new housing units to accommodate new residents and keep down regional rents (we'll color those residents **green**). However, because the downsides of additional density are localized in nature, assume residents near a development proposal will come out against the new development project due to concerns about local traffic, parking, neighborhood aesthetics, etc. (we'll color those residents **red**).



As you can see, within City B, **180 residents are against** the rezoning, and **140 residents are in favor**, and thus **the rezoning fails**. In City A, all 320 residents are in favor of the rezoning within City B, but they

have no say in the land use decision that City B makes, even if they are harmed by higher regional rents as a result of City B's choice. Now imagine the metropolitan area is only one city, we'll call it City AB:



Now, in City AB, the same **180 residents are still against the rezoning**, but **460 residents are in favor**, and **the rezoning passes**. The real world is obviously more complicated, residents' views on development and the planning process are more complex, cities and metropolitan areas are generally larger than a handful of blocks, zoning decisions are usually not decided by simple citywide vote, and concerns about increased development can extend over a larger area than a one-block radius. Nevertheless, this simplified example illustrates part of why, at least in the abstract, smaller municipalities and more fragmented metropolitan areas can have added difficulty in allowing enough new development to keep up with population and job growth, and to keep business and residential rental rates in check. Some empirical evidence also supports this effect when looking within cities.

The example also illustrates a useful lesson about delegation of authority in governance structures. **In any area of public policy or regulation where the dis-benefits of decisions are highly localized and the benefits of the decisions are highly disbursed or regional in nature, it makes sense to delegate that authority to the lowest level of government that can effectively and efficiently weigh the *full* benefits and costs of those decisions.** If the regulatory or policy behavior of a local jurisdiction, such as a single municipality or other sub-entity, is likely to have a deleterious effect on the metropolitan area or region as a whole, it makes sense to instead delegate that regulatory or policymaking authority to a higher level of government such as a metropolitan or regional government.

Transportation Planning Examples: Similar to land use policy, transportation planning and investment in the United States suffers from similar coordination problems. There are three general areas in which this manifests itself:

1. Transportation planning and investment in the United States is generally characterized by a highly decentralized approach, with many overlapping jurisdictions and separate entities having authorities in the process and decision-making. Metropolitan planning organizations, or MPOs,

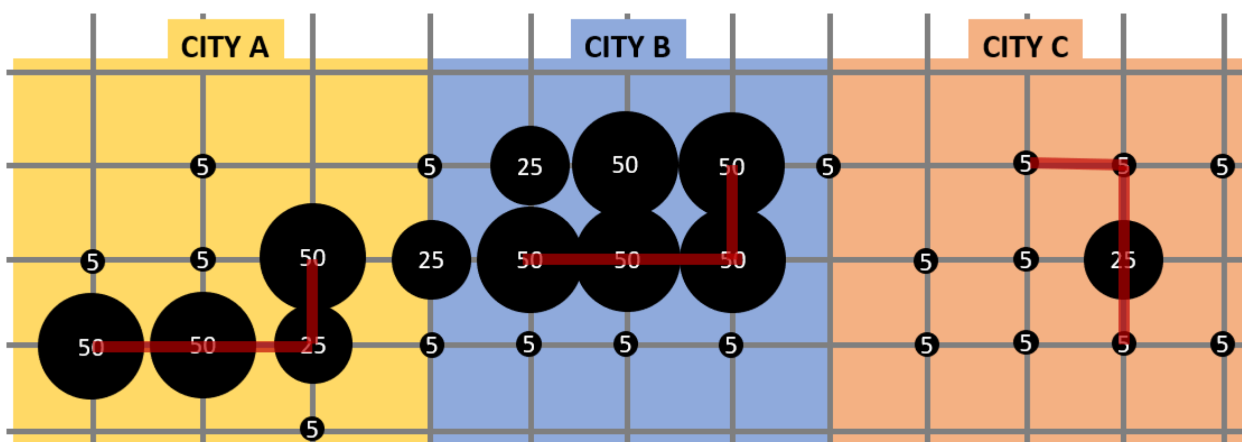
were created with the intent of rationalizing transportation investment in metropolitan areas, though their effectiveness at doing so has varied substantially. While a few MPOs play an active role in decision-making, have a high technical capacity, and improve the efficiency of regional investment outcomes, many remain relatively low-resourced with limited in-house technical capacity, acting more as “pass-through” entities for transportation funds that simply “rubber stamp” transportation plans created by local governments, rather than harmonizing or focusing a regional strategy.

2. Transit agencies themselves often vary wildly in their ability to efficiently provide transit service or to build and sustain mass transportation infrastructure. Some transit agencies are simply a department of a local municipal government, while in other regions transit agencies serve a large portion (though usually not all) of the metropolitan area. A few are even entities of a state government, though this is still relatively rare in the US. More common still, many regions have multiple overlapping transit agencies, with some agencies serving portions of the region overlapping with local city- or county-provided transit agencies. Additionally, local transit agencies almost never have direct authority over zoning and land use regulations near transit stations, even on land that they own, irrespective of the tantamount importance of station area land use to transit ridership and transit agency financial performance.
3. Lastly, infrastructure ownership varies widely by jurisdiction. In some areas local roads are owned by local governments, with a few major roadways owned by state governments. In others, all but the smallest roads are planned, constructed, and maintained by state governments, and local governments have varying levels of authority over the design of such facilities. Transit agencies, with their buses usually relying on such roadways, almost never have decision-making power over the design of the infrastructure that they operate upon.

All of these features of local governance, how transportation investment and decision-making is organized and executed, how transit agencies are organized and what authorities they have, and what entities control and own infrastructure, can hinder the development of efficient metropolitan transportation systems. Many metropolitan areas in the US have highly balkanized, overlapping, and sometimes competing transportation agencies and investment portfolios, leading to significant coordination problems and inefficiency.

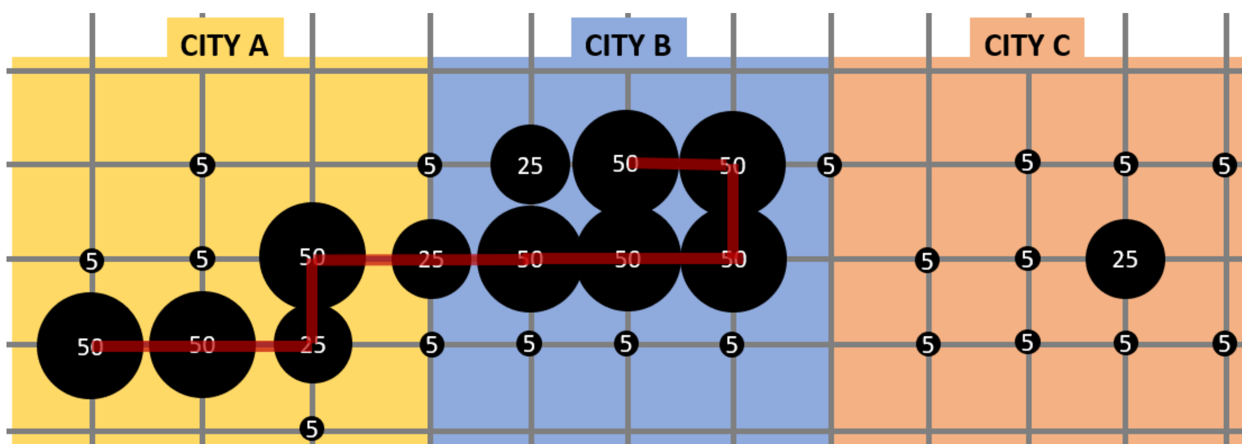
To illustrate the issues with metropolitan coordination, imagine a metropolitan area with three separate cities, with each having various nodes that are given a certain number of points for ridership potential:

Now imagine each of the three cities has a separate transportation budget and its own planning process, and let's say each city has enough money to buy three "segments" worth of mass transit (for simplicity, assume they can only be built under the roads). Imagine each city gets "points" for each node it connects, corresponding to the number on the node, and the entire region gets extra points for the longest chain of nodes connected. Within each city, residents and planners decide on the following transit lines meant to maximize their individual point totals, signified here in **red**:



In the above example, the optimal strategy for each city when not taking into account the benefits beyond their own borders when making investment decisions produces 175, 200, and 40 points for Cities A, B, and C, respectively, for a total of 415 points. The longest chain is four nodes (we'll say four points), so the grand total points for the region is 419. Let's say the MPO for the metropolitan area simply "rubber stamps" each individual city's transportation plan, leading to this overall outcome.

Now consider an MPO that takes a more active role in transportation planning, and imagine the transportation funds are given to and controlled by the MPO directly, rather than the individual cities. The MPO looks at regional needs, and after analyzing different investment options, decides to maximize the total points for the entire region by investing as below shown below in **red**:



In this example, with the same amount of "transit segments" available (i.e. the same cost) the MPO connected nodes worth 450 points, with the longest chain being 10 nodes long, so 460 points in total. In

fact, the optimal choice given these conditions actually precludes any mass transit segments being allocated to City C, even if residents in City C are contributing taxes to the regional mass transit system. This example used that edge case to illustrate the fact that the most efficient allocation of mass transportation infrastructure in a region could very well mean that some parts of the region paying for the overall system may not receive *any* service (again, purely on efficiency grounds, of course). Not all parts of a metropolitan area are necessarily well-suited for mass transportation investments.

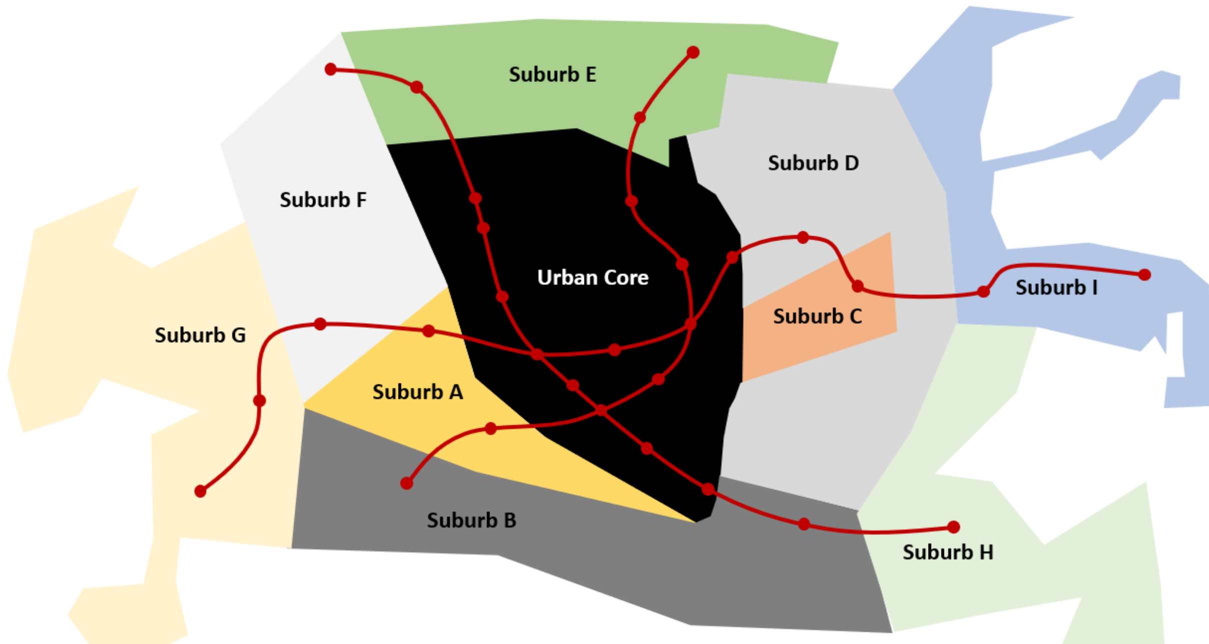
Now, one could reasonably make the argument that, absent an MPO or regional/metropolitan government, the three cities could have negotiated amongst themselves to plan and build the second more efficient alternative that serves more riders (or, gets more “points” in this illustrative example). In some situations, this could certainly be true, especially in the case of three similar cities. However, the reality in many parts of the United States is that metropolitan areas are fragmented into multiple counties, and sometimes hundreds (or even thousands) of cities, villages, towns, or townships. This type of coordination and negotiation becomes far more difficult with increasing numbers of local governments, compounded by the fact that local governments will have a strong incentive to “free-ride” and not pay into projects that benefit the region as a whole (i.e. they prefer to get the benefits of regional infrastructure without paying the costs of it). Additionally, similar to land use policy, the optimal transportation investment portfolio for each individual city is likely to be quite different from the optimal transportation investment portfolio for the entire metropolitan area. Thus, there is little compelling reason to expect that the ability of local governments to coordinate and negotiate would lead to the optimal regional outcome, even if such coordination were easy and costless (and it usually isn’t). Lastly, the more fragmented the metropolitan area, the more likely that each independent jurisdiction will want their “slice of the pie” in exchange for the regional taxes they pay in, causing further deviation from the infrastructure provisioning that would be most efficient for the region as a whole.

Transit agencies in the United States are often on the receiving end of substantial criticism, but not all of these criticisms are warranted when taking into account governance structures. In fact, given how we’ve structured most transit agencies, some of the poor outcomes are quite predictable. Oftentimes there’s a negative sentiment towards mass transportation investment because transit agencies “don’t make money” or require subsidies to operate. Setting aside for a moment that **something paying for itself directly through user fees and being cost-beneficial to society are *not* the same thing**, and that other modes of transportation also don’t pay for themselves directly via user fees (see Exhibit 6-1 here), financial sustainability is still a legitimate concern when attempting to provide a public service to help the most people possible at the lowest societal cost. For mass transit systems, this financial sustainability is called a “farebox recovery ratio,” or the percentage of operating costs that are recovered via passenger fares. High ridership is a key element to high farebox recovery ratios, and substantial (and walkable) commercial and residential density in a station’s walkshed is crucial for achieving high ridership (with a few key exceptions, including end of line termini stations which draw from outlying markets, stations at major intercity rail or airport facilities, or major transfer facilities).

However, as discussed in the earlier example on zoning, the fragmented governance structure in metropolitan areas creates barriers to the allowance of additional density, hampering ridership the financial viability of mass transportation investments, devaluing investments by higher levels of government, and burdening taxpayers at large with higher levels of taxes to subsidize the capital and

operating costs of said systems. Misplaced incentives from governance structure decisions may add additional challenges.

To illustrate the issues of misplaced authorities, imagine we have a metropolitan region of an urban core city and several suburbs, served by a regional transit system with 30 stations. Assume any system operating costs above and beyond the fare revenue collected by the system is paid for by a regional tax, a practice common in many metropolitan areas.

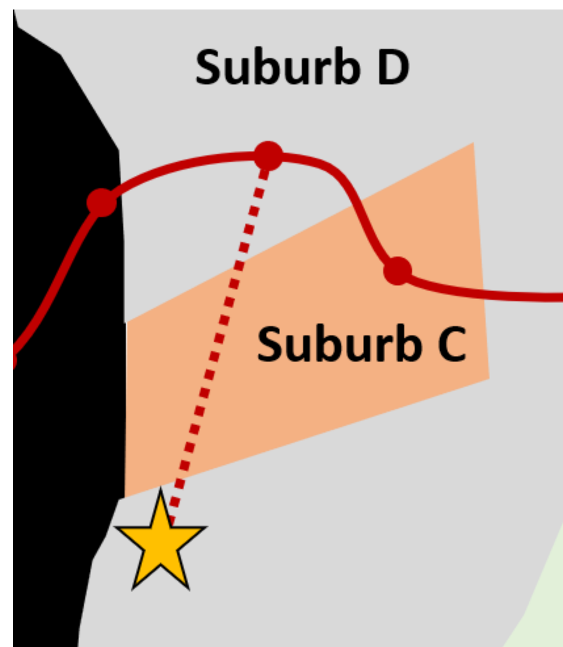


Assume Suburb C is doing station area planning around its transit stop, and assume, being just outside the urban core, there is demand for enough residential and commercial development in the station walkshed to produce an average daily ridership at that station of 20,000. Assuming a flat $1 fare for simplicity and a two-way trip, that yields $14.6 million in annual fare revenue for the transit system. However, given the relatively small geographic size of Suburb C, assume the land use planning process around the station is more easily swayed by those living near the station who do not want more development, similar to what is shown in the first example of this piece. Thus, the zoning that is ultimately adopted for the station's walkshed only allows enough residential and commercial development such that the average daily ridership at that station is 2,000, yielding $1.46 million in annual fare revenue for the transit system (for simplicity let's assume the headways of trains that run on the line is the same in both scenarios, and thus no change in operational cost). Thus, the transit agency loses $13.14 million annually in fare revenue due to the zoning decision implemented by Suburb C.

But herein lies the key issue: Suburb C only pays for a small fraction of that cost because the transit system is funded by regional taxes. Thus, Suburb C is able to offload most of the cost of its regulatory decision onto the other municipalities in the metropolitan area. Every other municipality in the region would be better off if Suburb C allowed more development near its transit station, as it would reduce the subsidy need for the transit system and lower regional tax burdens, but none of them have any say in Suburb C's decision to prevent most development. Moreover, if Suburb C had to pay the *full costs* of

its decision, it's very possible that it would have allowed more development around its station. If the entire metropolitan area had been a single city, that entity would been much more likely to allow the maximum amount of development possible around the transit stop, since it would pay the full costs of not allowing it. Similarly, if the transit agency itself had land use authority over station-adjacent land, it too would have likely allowed the most development possible to increase its fare revenue and farebox recovery ratio.

This example illustrates another useful lesson about governance structures. **To the extent possible and practicable, governance structures and fiscal policy should ensure that each sub-entity with decision-making power bears the full costs (and reaps the full benefits) of their behaviors, thus ensuring that their decision-making is as close to optimal as possible for the region and society at large.** This is analogous to economic theories about how to deal with externalities, ensuring the actor making the decision internalizes the full costs of benefits of their decision.



This idea can also be illustrated in our third example on infrastructure jurisdiction. Imagine there is a job center in Suburb D, designated by the star. The job center is large enough that the regional transit agency runs a connector bus from a nearby rail stop, passing along the dashed arterial through Suburb D and Suburb C. Imagine this roadway facility is four lanes and mostly serves local traffic. Let's say this bus route costs $2.0 million annually in fuel and labor to run, and the route receives $1.0 million in fare revenues each year (a farebox recovery ratio of 50 percent, requiring a subsidy of $1.0 million annually that gets paid by regional taxes).

Assume in this scenario Suburb C has jurisdiction over all the roadways within its municipal limits. Imagine the arterial roadway in question experiences heavy peak period congestion, which dramatically slows down the buses that the regional transit agency runs between the job center and the rail stop in Suburb D. Roadway expansion is not feasible nor desirable, given the already built-up nature of Suburb C. Given this, the regional transit agency asks that, during the next routine street reconstruction, Suburb C designate the center two lanes on the arterial as bus-only lanes to ensure bus speeds are not dramatically reduced by peak period traffic congestion (for simplicity let's assume that reconstruction needed to occur anyways, and thus there is no extra capital or maintenance cost to adding the bus-only lanes). However, given that most users of the bus route do not reside in Suburb C, the local elected officials in Suburb C have very little interest in speeding along non-residents to their jobs in Suburb D. As such, the speeds on all buses on the route drop by half, requiring double the amount of buses to keep the same headways than would be needed in free-flow conditions, raising the regional transit agency's cost to $4.0 million annually for the route. At the same time, the longer travel times for riders on the slowed buses results in some riders opting to drive to their workplace instead, lowering fare revenue to $0.5 million annually. These two factors together lower the farebox recovery ratio on the bus route to 12.5 percent, and raise the annual subsidy need to $3.5 million, paid via regional taxes.

Again, here we see an example where Suburb C's jurisdiction over an infrastructure decision leads to higher costs for the entire region, yet Suburb C bears only a small fraction of those costs (only to the extent it pays the regional tax for the regional transit agency). If Suburb C were directly charged the $2.5 million in added subsidy needs owing to its decision, it may make a different decision about its infrastructure. Let's say the arterial in question was instead owned by a State DOT rather than Suburb C. While the political and economic interests of a state-level agency may better-internalize pressures to ensure efficient metropolitan-scale transportation systems, the state government would also not directly bear the cost of not allowing the regional transit agency to have bus-only lanes on the arterial (unless of course the regional transit agency was part of the state government or run by the State DOT). Given this, even a higher level of government would not directly bear the cost of its decision. Only when the agency that runs the regional transit system is **the same agency** with infrastructure decision-making authority can it fully internalize the costs and benefits of its decisions.

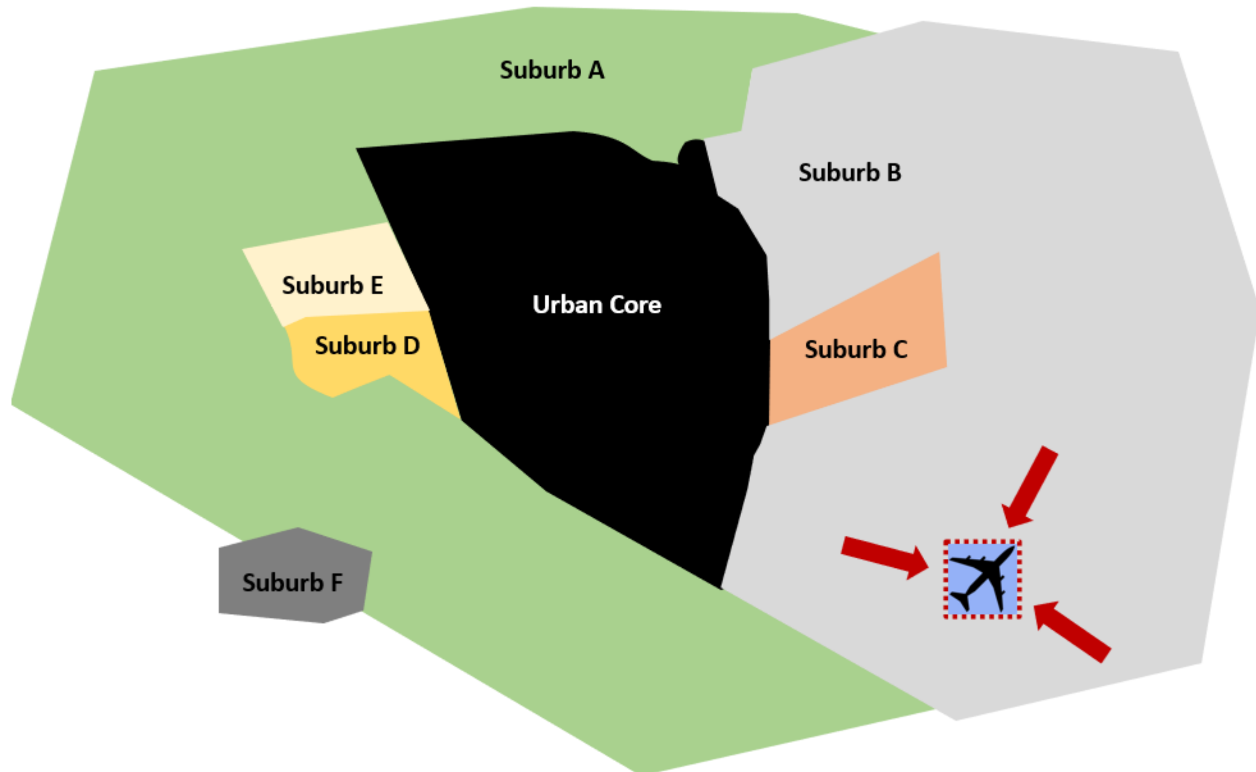
In summary, throughout most of the United States, **transit agencies often (1) inherit systems created through a balkanized transportation planning process that almost guarantees sub-optimal infrastructure provisioning, (2) don't have authority over station area land use, even on land that the transit agency itself owns, a key deficiency given the tantamount importance of station area employment density, residential density, and walkability as generators of ridership, and (3) run buses on roads over which they do not have decision-making power to ensure designs that allow buses to move quickly and independently of congestion to lower operating costs, increase ridership, and lower subsidy needs, nor do they generally have a say in making areas around their bus and rail stops actually "walkable," with sidewalks, street trees, full crosswalks, and other features to encourage transit compatible streetscaping, urban design and land use.** In nearly all cases, these infrastructure planning, infrastructure design, and land use authorities and decisions lie with separate entities that do not directly internalize most of the short- or long-term costs of poor station area or transportation planning. Given these governance structure deficiencies, it's a miracle that transit agencies are able to operate effectively at all!

Taxation and Equity Examples: Carefully designed metropolitan governance structures can preserve the benefits of local competition while preventing some of the predictable downsides. Fragmented local governance, common in the United States, creates unique challenges for taxation and equity, with numerous openings created for free-riding, race to the bottom, and opportunity hoarding behaviors. Metropolitan governance is focused on preventing several common behaviors, which often occur simultaneously, that tend to damage overall societal welfare:

(1) **"Free-riding behavior**," a common concept across the economics field, occurs in the metropolitan governance context when smaller units of government benefits from regional public services but fail to contribute proportionately (or at all) to the funding of those public services.
(2) **"Race to the bottom behavior"** occurs when different levels of government, often competing to lower taxes and poach one another's firms, end up cutting public services (such as education) in such a way that the region would be significantly better off if each maintains those public services.
(3) **"Opportunity hoarding behavior"** occurs when lower levels of government with high opportunities (high job access, excellent public services such as schools, etc.) effectively "wall themselves off" from new entrants through the use of local authorities.

In the metropolitan governance context, **free-riding behavior** occurs when smaller units of government benefits from regional services but fail to pay into them. Without taxation authority and public goods provisioning of a higher level of government, such as a metropolitan government or a state government, many metropolitan areas are forced to fund regional goods using loose agreements and negotiations between major municipal governments within a metropolitan area. However, smaller (and often wealthier) local governments will refuse to enter such agreements if they know that the largest government (or group of largest governments) in the region will still agree amongst themselves to finance major regional infrastructure. They can do this because they know that citizens of these local governments, and the taxable value of assets in the local government's borders, cannot be easily excluded from the benefits of major regional improvements (such as a regional airport or mass transportation system expansion).

To illustrate, imagine a metropolitan region is contemplating the creation of a new airport, located in Suburb B below:

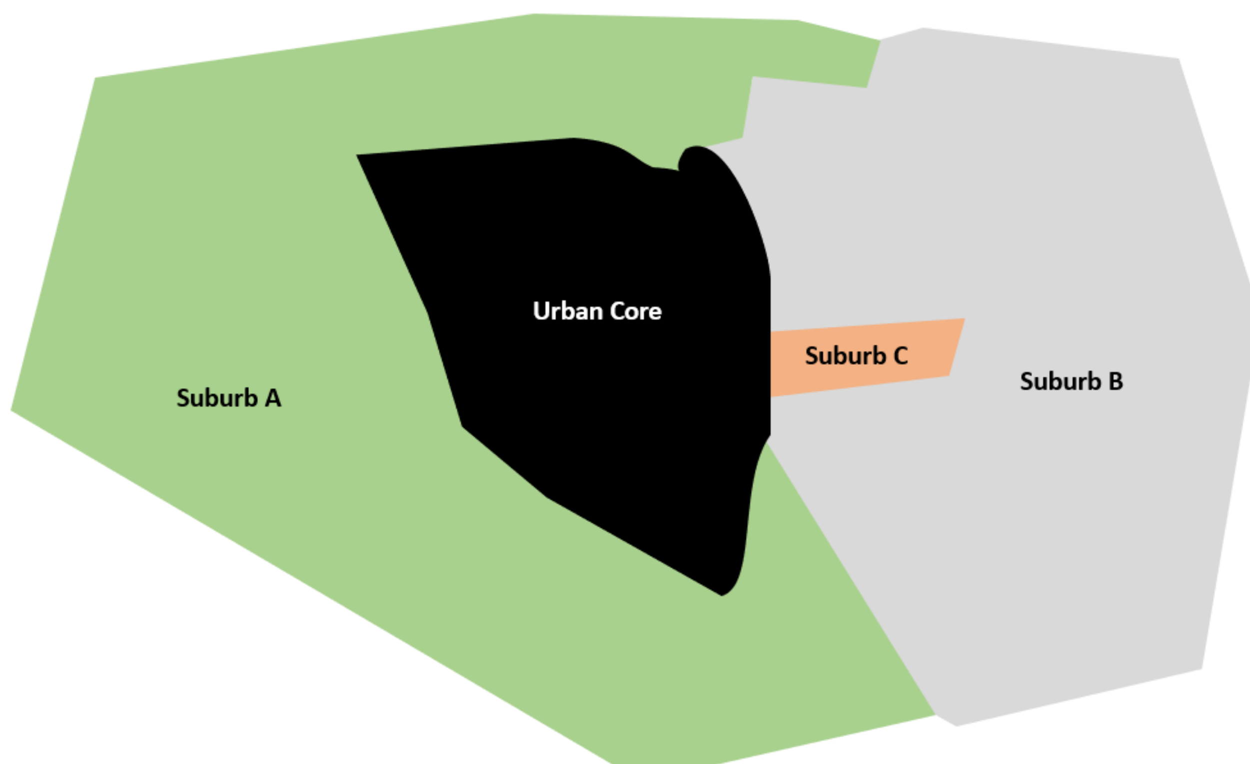


To pay for the initial capital construction cost, the municipalities in the region begin to negotiate on a regional tax. The urban core jurisdiction and Suburb A supports the negotiations, as major stakeholders in the Central Business District and suburban office parks realize the region's competitiveness depends on a well-functioning and accessible transportation system. Suburb B supports the proposed measures as well, as it stands to benefit from expected airport-adjacent development. However, Suburbs C, D, E, and F opt out of the negotiations, as they correctly predict that the Urban Core will fund the new airport construction along with Suburbs A and B regardless of whether they choose to participate in a regional tax.

The potential outcome of this hypothetical arbitration is that Suburbs C, D, E, and F will free-ride on regional infrastructure. Even worse, perhaps, if the region is too fragmented, not enough jurisdictions and their associated tax bases will opt in for the airport to be built at all, harming the entire region's competitiveness. These governance structure issues can also exacerbate equity concerns, as oftentimes in the U.S. metropolitan context such small suburban jurisdictions are disproportionately wealthy compared to the metropolitan region as a whole. Thus, jurisdictions with lower per capita incomes may end up footing the entire bill for infrastructure assets that benefit the most economically prosperous portion of the population.

Race to the bottom behavior is another common problem within metropolitan areas (and even between higher levels of government), as local jurisdictions offer competing tax breaks or policies to poach firms from one another. This can lead to the creation of the metropolitan equivalents of parasitic "tax havens" or simply the defunding of public services that promote upward social mobility and economic growth for the metropolitan region. As mentioned at the beginning of the piece, some competition can be healthy; the threat of exit by people or firms constrains the taxation ability of local governments. However, such competition can also lead to lower overall societal welfare when the effects of tax revenue loss on public services are taken into account.

To illustrate, imagine a relatively consolidated metropolitan area with four local governments. The metropolitan area consists of an urban core jurisdiction, Suburb A, Suburb B, and a very small Suburb C:



Imagine Suburb C consists mainly of land zoned and used by commercial and industrial activities, with a relatively limited residential population. Race to the bottom behavior could occur if Suburb C were to adopt business tax rates that are significantly lower than the rest of the region. Suburb C may start to become home to numerous firms or corporate headquarters that relocate from the central business

district or suburban office parks in Suburbs A or B. Given Suburb C's relatively small residential population, the jurisdiction has the ability to maintain extremely low business taxes since it does not have much of a population to use city services (almost all the workers at the relocated firms in Suburb C drive in from the other jurisdictions when they come to work). The firms in the region benefit greatly from the metropolitan area's investments in public educations, infrastructure, and other public goods, adding to their bottom lines and competitiveness. However, these firms no longer pay their fair share of the costs to provide those public services, as they have relocated out of the jurisdictions where most of their workers live. This represents a classic case of "*privatizing the benefits and socializing the costs*." The public investments by other jurisdictions help the firms maintain their high levels of productivity and profit, but they no longer share in those benefits.

While this arrangement is no doubt positive (even if unfair) for the firms that experience the greatly reduced taxes in Suburb C, these relocations can deplete the tax revenues in the other jurisdictions, which could lead them to cut public funding of local education or regional infrastructure. These cuts could ultimately harm the region's long-term economic growth as well of the economic growth of the state and national government. Whether this long-term loss exceeds the increased economic growth due to lower taxes remains a fair question, but the secondary and long-term negative consequences of this arrangement should not be ignored.

In highly fragmented metropolitan areas, this behavior can be compounded by an even easier ability of firms to relocate among many different jurisdictions, especially in cases with very small local governments. This can lead to overall spending on public goods to fall below the optimal amount across the entire region, as individual municipalities engage in a "race to the bottom" on taxes and spending to poach one another's firms. Some of this can be alleviated by state-level taxation and distribution of state funding, but attempting to solve such issues can be politically difficult for state governments, as redistribution between local jurisdictions tends to creates winners and losers (Kaldor-Hicks improvements are almost always controversial for the jurisdiction that loses).

The last common category, **opportunity hoarding behavior**, stems largely from the fact that in the U.S. a vast array of public goods and social services are provisioned by either local governments or local districts. This situation leads to a very common condition among local governments where the local jurisdictions that are home to those with high incomes end up having the best public services while those jurisdictions with the poorest residents will often have struggling public services. Thus, the jurisdictions with the populations most in need of public assistance, or upward social mobility-producing public goods like schools have the fewest resources (per person) to provide such services. Nowhere is this truer than with local school districts, which are often funded by local property taxes.

Under the idea of a "free market of local jurisdictions," where local governments compete to offer the best public services at the best price point (lowest taxes), there at first glance appears to be some merit to local control, funding, and decision-making over the provisioning of public goods and social services. Different local governments can compete on taxes and public services, and individuals can "vote with their feet" to move to those jurisdictions that do the best job. But here-in lies the practical flaw of this idea in the American context: local governments can use their control over land use regulations to act as exclusionary policies (such as single-family zoning, minimum lot sizes, and bans on apartment buildings), effectively banning lower-income residents from moving to the jurisdiction.

While local governments cannot legally prevent residents from lower economic classes from entering a jurisdiction, many local governments in the US, particularly smaller and wealthier suburbs and exurbs, have land use policies and restrictions on housing supply that create a de facto "entry fee" to living in certain communities, a fee often in the hundreds of thousands of dollars. Even the few apartments that are permitted are often so rare that their rents will be out of reach of many lower income potential residents. Just as nefarious, the ability to bar lower income residents from entering a community also means less required spending on social services for that particular jurisdictions, ultimately meaning that such areas can have lower effective tax rates since their populations require fewer public services per person. The exclusionary behavior of such local jurisdictions can also drive up the value of individual homes, since local housing supply is constrained and local public services are excellent, such that only the wealthiest can live in such communities. This is what is meant by opportunity hoarding behavior, as local governments can behave analogous to an offshore tax haven, allowing the wealthy to skirt away from any investment in the broader upward-social mobility-producing public services and infrastructure, but not suffering the downside of regional degradation in public services since they can still fund good services locally. To the extent economic conditions correlate with racial groups, such a setup amounts to an effective continuation of residential segregation by class and race.

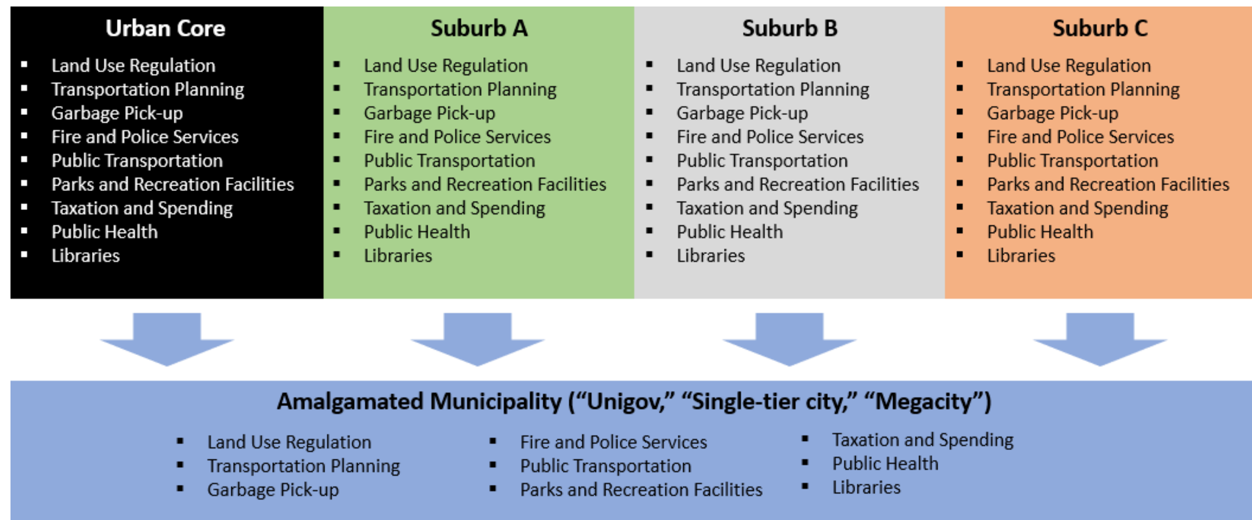
While there is much that can and should be done to revitalize and aid local governments with concentrated poverty, opportunity hoarding by nearby wealthy local governments in the same metropolitan area is an invisible yet pernicious reason that such concentrated poverty in certain jurisdictions continues to exist. Setting up conditions that allow lower-income individuals to escape concentrated poverty to other wealthier jurisdictions with better public services also helps the poorest jurisdictions get a handle on serving their neediest residents by reducing the scale of the challenge. Being born into a poor local jurisdiction with poor public services, combined with exclusionary behavior by nearby wealthier jurisdictions with good public services that prevent moving, contributes to continued intergeneration poverty and lowered upward social mobility in the United States. By the same token, it calcifies economic and racial inequality, and prevents citizens from achieving their potential, often regardless of their individual efforts to work hard and improve their lives. While society may cling to the feel-good stories of those who beat the odds, it at times forgets the vast majority for whom the deck is stacked against, forgetting those who never make it out, and not interrogating why the odds are so rare to be beaten in the first place.

Policy Options: Metropolitan governance policy generally seeks to alleviate some of the deleterious incentives local governments face due to intra-metropolitan competition and enhance coordination and efficiency in metropolitan investments and social policy. It also seeks to align local incentives to aid regional goals, and overcome issues with externalities that are spatial in nature. State governments are best-suited to addressing these types of issues, given their authorities over local jurisdictions, but certain policy approaches can allow for more local control than others. The Federal government can also play an indirect role, by creating incentives and attaching objective and measurable strings and criterion to federal funding, particularly with housing, transportation, and education funding.

Before we get into what actions higher levels of government can take, it's important to recommend what strategies they should avoid. Generally, higher levels of governments should **avoid any actions that do not change the fundamental underlying incentives for certain local government behaviors**. No amount of reporting requirements, or other planning processes that are qualitative in nature, will change underlying behaviors (i.e., shaming local governments is unlikely to be successful at exacting

behavioral changes). Local governments and their planning departments will always excel in the production of lengthy government reports and plans, and will always be able to write detailed prose about how and why their actions are acceptable. States should avoid adding to local government planning burdens with things that do not actually produce measurable results or where assessing results is ambiguous, such as adding non-binding planning requirements or setting qualitative metrics instead of quantitative metrics. Similarly, states should avoid setting performance targets with no costs if they go unmet, as such targets are unlikely to change behavior. Attempts to facilitate regional collaboration, while certainly not harmful, will generally not produce local behavior that differs from local incentives (for example, a local mayor or councilmember of a small exclusionary suburb may indeed believe the region would be better off if their community provided more housing, but politicians still need to be reelected within that jurisdiction and by that jurisdiction's constituents, and they ultimately answer to them *regardless* of regional needs).

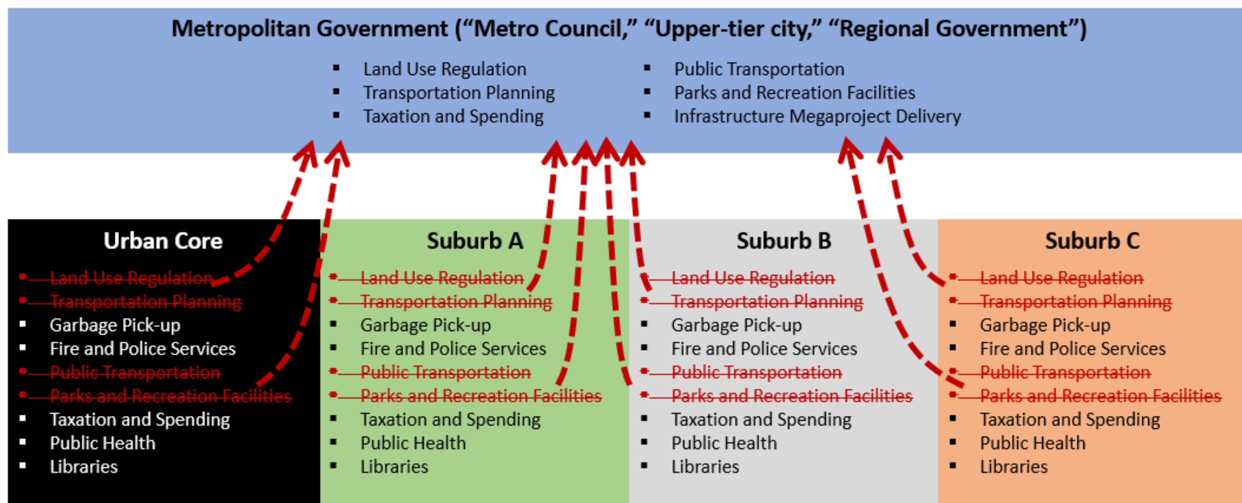
If a state desires to maintain some semblance of local control while still alleviating some of the governance challenges dealt with in this issue brief, there are actions that effectively "regionalize" decision-making authority while keeping the state government out of local and metropolitan affairs thereafter. One such policy, common in Canada, is known as **amalgamation**, or the consolidation and merger of units of local government, generally in an effort to rationalize decision-making authorities and public service provisioning. An example of an amalgamation is shown below, where all independent cities are effectively merged into one local jurisdiction which contains all the authorities and responsibilities previously held by the former jurisdictions:



Such types of amalgamations are common in Canada, notable examples being Toronto, Winnipeg, Ottawa, Quebec and many others. The number of municipalities in Canada's Ontario Province, for example, fell from 815 in 1996 to 447 in 2001. Though much rarer in the United States, some amalgamations, at a smaller scale, occur in the form of city-county mergers or consolidations (Jacksonville, Nashville, Indianapolis, Louisville, Philadelphia, etc.), or, rarer still, the consolidation of several counties into a new municipality (City of New York). However, unlike in Canada, U.S. mergers tend to create cities that ultimately have a much smaller proportion of the overall metropolitan population within their municipal limits, and have usually happened with an affirmative vote on a local referendum amongst affected entities.

The common U.S. approach of relying on city-county mergers via local referendums has two major disadvantages: (1) when economic inequality between two jurisdictions is high (i.e. the particular case where mergers or amalgamations could do the most good for the regional provisioning of public goods and alleviation of spatial inequality), wealthier jurisdictions are understandably likely to resist consolidation as they do not see it in their interest; and (2) U.S. city-county mergers generally don't end up creating a unified government with a significant proportion of the metropolitan area's population under one jurisdiction (for example, the merged city-county of Indianapolis had around 820,000 people in 2010, while the Indianapolis metropolitan region had around 2.1 million people at that time). Thus, the recent deference by states to local referendums in such cases means consolidations that could do the most potential good for regional equity will likely not end up occurring without state action, and the ones that do occur, while certainly helpful, are often still too small to alleviate many of the governance challenges dealt with in this issue brief given that most U.S. metropolitan areas are significantly larger than an individual county. In Canada, such mergers often happen at a larger or even metropolitan-wide scale, and often occur *without* the consent of those cities to be merged.

Another option for solving regional governance problems, if further localized control is desired, is the **establishment of "upper-tier" or metropolitan governments**. Under this governance reform, a state government establishes a regional or metropolitan government over a metropolitan area, and transfers *specific* authorities from lower level governing bodies to the new metropolitan government. An example of this governance reform is shown below, where individual local authorities are reorganized between the lower-tier cities and the new upper-tier city:



Under this governance reorganization, state governments can decide which authorities and responsibilities are best-handled at which level of government. In the above example, land use regulation, long range transportation planning, provisioning of public transportation, and regional parks and recreation are moved up to the new metropolitan government and out of the control of the lower level municipal governments. However, unlike in the amalgamation example, the lower levels of government remain, continuing to carry out some authorities and responsibilities. Additionally, spending and taxation authority are shared in this reorganization, and the upper-tier government is given new authority over infrastructure megaproject delivery, just as an illustrative example.

This governance reform is ideal if state governments want to maintain intra-metropolitan competition but also want to prevent types of competition that would harm the region, prevent exclusionary land use practices, and rationalize transportation and land use planning by delegating *both* authorities to the *same* entity. This method of metropolitan governance, again common in Canada (for example, in Vancouver), also has some analogous examples in the United States, such as the Met Council in Minnesota's Twin Cities and Metro in the Portland, OR metropolitan area. Metropolitan Planning Organizations, or MPOs, assuming they are consolidated and semi-coterminous with the metropolitan area, make ideal organizations to designate as upper-tier governments to re-delegate certain authorities to, particularly transportation planning, mass transit planning, and land use and zoning authority.

The advantage of this method is it allows for high flexibility. State governments could delegate long range transportation planning to an upper-tier government, or they could delegate that *as well as* ownership of transportation assets in the region, land use regulatory authority, public transportation operations and capital construction, or any other functions or authorities they deem efficient for the metropolitan government to have. It also allows lower-tier governments to maintain some level of control over authorities that may be more controversial to regionalize, whatever those may be. Additionally, rearrangement of local authorities could take place over time, as the metropolitan government proves its worth and competence, rather than having citizens gamble on having all authorities go to a brand-new entity. Such an entity can also be set up internally in ways that improve transportation planning efficiency by having at-large representatives (for example, proportional representation-based elections, or ranked-choice voting for multi-member at-large seats), ensuring regional transportation investments and land use decisions are efficient and representative for the region overall, while counteracting some of the challenges of fragmented and district-based representation. Such governance structures can also be a stepping stone to eventual full regional amalgamation, as was the case in the Toronto region.

The added benefit of both amalgamation or establishment of tiered government is that it allows state governments to remain less involved in local affairs. While initially heavy-handed, the goal of both approaches is to designate a new local government or reorganize local government so that such entities can provide for local needs and solve local problems *without* the state government having to get further or permanently involved. In essence, both of these approaches are an attempt to "help local government help itself." Additional details on these reforms can be found in Ray Tomalty and Alan Mallach's America's Urban Future: Lessons from North of the Border, delving into many of the advantages (and some shortcomings) of metropolitan governance reforms, an area of innovation where Canada is a world leader. Such reforms could of course be implemented from the bottom up, but in both Canada and the U.S. such instances are almost unheard of; no local government, mayor, or councilmember generally has interest in giving up their authorities, regardless of the merit of such an action. Thus, we believe state governments are the appropriate entity with the correct incentives and authorities to make such governance reforms.

Some U.S. states, such as Illinois, have been considering such proposals, usually from the standpoint of reducing expenditures (having high numbers of local governments creates a lot of duplicated administrative spending), rather than gains in coordination, equity, or rationalizing of regional planning. Evidence of the effect of government reorganizations on overall government expenditures is, however, mixed. While consolidation can improve the efficiency of how tax dollars are used, consolidated regional

governments may be more likely to enact a higher level of regional public services, offsetting some or all of the cost-savings (though, presumably gaining some benefit of better or increased public goods).

One-off or occasional reorganizing of local government authorities or municipal boundaries themselves aren't the only ways to achieve the efficiency, equity, on coordinated planning that higher levels of governments may be interested in. State governments have other tools at their disposal. One such tool is **revenue sharing mechanisms** that seek to foster greater collaboration between local governments in a metropolitan region.

In an effort to fight against race to the bottom behavior and opportunity hoarding behaviors, the Minnesota Legislature instituted a program of commercial-industrial tax-base sharing program within the Twin Cities metropolitan area in 1971, colloquially known as the Fiscal Disparities Program. Originally enacted in response to local governments offering competing tax breaks to poach one-another's local businesses, supporters of the program claim it has increased equity in the region and fostered more cooperation on regional needs. The program, combined with related historical efforts to locate affordable housing around the entire metropolitan area, has often been cited as a contributor to reduced income inequality and a reduction in concentrated poverty, removing some of the burden on individual cities in the region. Even if one locality ends up being home to a disproportionate amount of the region's low-income residents, it doesn't automatically mean public services in that jurisdiction will be significantly worse. None of these efforts of programs would have been possible without state actions.

State governments can **indirectly incentivize certain behaviors by attaching strings to state funding**. Some bills, such as SB 34 in Utah, mandate that local governments choose from a menu of state-approved steps aimed at encouraging additional housing. The bill requires cities to adopt at least three of those strategies as part of their state-mandated land-use and transportation plans to become eligible for cash from the Utah Department of Transportation to invest in transportation corridors in their communities, known as TIFF money.

Even more direct and ongoing interventions by states, such as states **increasing their oversight of local land use planning**, can achieve more efficient local government behavior. This approach is also common in Canada, and occurs to a looser extent in Oregon and Washington State. While land use controls in Canada still are implemented by local or regional governments, local land use plans often must follow input and be approved by the provincial level governments (and the key here is that provinces can and do overrule local governments, this is not a "rubber-stamp" exercise). A more recent U.S. reform along these lines includes the strengthening of California's Housing Element Law, which until recently was a relatively toothless ceremonial planning activity that did not hold local governments accountable for failing to meet affordable housing needs (though challenges and inadequacies in the process remain). Such oversight in assigning objective housing targets to local governments, with consequences for not zoning for enough housing, can force local jurisdictions to allow enough housing while leaving them some discretion in how to provide it (but, of course, not so much discretion that local governments can find loopholes to implicitly bar the housing from being built).

Perhaps the most unambiguous reform available to state governments, and potentially the most controversial, is the authority of states to **directly implement land use decisions themselves or preempt certain exclusionary activities**. While preemption of local governments by states is not new, preemption

of local land use authority is relatively recent in the United States, but had increased in popularity given increasing housing affordability issues. A timely summary from the Boston College Law Review found:

- *"Commentators have long decried the pernicious effects that overly restrictive land use regulations, which stifle new development, have on housing supply and affordability, regional and national economic growth, social mobility, and racial integration. The fragmented nature of zoning rules in the United States, which are set primarily at the local level, renders it seemingly impossible to address these concerns systematically. Although there have been some efforts to address local exclusionary tendencies and their suboptimal effects by means of greater state control, these efforts, which remain contentious, have been limited to just a few states. In the past few years, a new wave of state interventions in local zoning has appeared. These interventions are motivated in part by the harsh reality of housing shortages and skyrocketing costs in significant parts of the country, which have made housing affordability a salient issue for a broader segment of the population. At the same time, states have grown increasingly willing to preempt local governments across a range of policy realms. This Article contends that the confluence of these and other factors suggests the potential for a recalibration of the balance of power between state and local governments in the realms of housing and land use regulation. State governments are increasingly displacing local restrictions on new development, mandating that municipalities permit certain forms of housing, and providing incentives for local governments to adopt certain forms of housing. I argue that the current housing crisis justifies bold new forms of state intervention. Such interventions should expressly preempt certain narrow elements of local law, rather than, as an earlier generation of interventions did, add additional planning requirements, procedural steps, or potential appeals. At the same time, these interventions can, and should, provide clear mechanisms for addressing significant countervailing local interests."*

This type of preemption is becoming more common, with a flurry of bills being seen in many states. The recently passed bill in Oregon as well as proposed but failed bills in Virginia, Nebraska, Washington State and Maryland, preempt local governments from pursuing exclusionary land use practices such as mandating only single family homes. They leave significant discretion to local governments, but implement more direct involvement in local zoning by explicitly prohibiting certain regulations. Perhaps the most direct proposal, and, arguably, by far the most controversial, has been SB-50 in California. The bill, first submitted as SB-827, opened the door to similar preemption bills across the United States, and proposed to directly rezone areas near mass transportation lines statewide while implementing other deregulations. A similar, but less direct form of California's bill was proposed in Washington State to apply an automatic increase in zoned capacity in areas near transit only if more than 20% of households in a municipality are rent burdened, allowing local governments to have a first crack at alleviating housing affordability issues before direct intervention.

Finally, though the Federal Government of the U.S. plays an indirect role in land use and metropolitan governance, it retains the **ability to attach requirements and incentives to federal funding**. Similar to state governments, the federal government can incentivize certain lower level government behaviors through strings attached to federal funding. While most federal transportation funding goes to states via formula, Congress could tie certain requirements to the receipt of those funds, or attach strings to discretionary grant programs. The Capital Investment Grant Program at the United States Department of Transportation currently encourages, but does not require, transit-compatible land use policies near

proposed mass transportation facilities. This program could be altered to either mandate a certain amount of deregulatory action surrounding proposed transit facilities, or to encourage it through policy guidance and scoring criteria. Recently, the proposed bipartisan Build More Housing Near Transit Act received 19 co-sponsors, indicating further congressional interest in this issue. If recent state level activity is any indication, such proposals are likely to continue to be put forward. The United States Department of Housing and Urban Development, responding to an executive order, had been exploring what requirements could be attached to their Community Development Block Grants for similar purposes of addressing deficiencies in local government behavior. Additionally, federal programs and funding could be used to encourage more state-level involvement on these issues.

Every level of government has a critical role to play in carrying out essential activities for our population, and every level of government, working together, can bring-better functioning metropolitan areas to the United States. Additionally, putting local and regional governments on an achievable path to work through their own problems can free up capacities for higher levels of government to take on other problems. A key point to remember is that, if metropolitan governance issues are not addressed, higher levels of government will ultimately pay the price for shortcomings and inefficiencies, and the American people will pay the price of opportunity costs.

We hope this issue brief has illuminated a wonky and previously hidden world of metropolitan governance policy, the challenges of getting efficient and equitable behavior from local governments, and the potential policy options higher levels of governments can take to tackle some of these daunting structural challenges. We believe that local government, the government closest to the people, serves the people best, but we also believe in setting up an overall framework where local governments can succeed; drawing on more of the strengths of local governance, and fewer of its weaknesses. This requires us to get the delegation of authorities, local governance structures, and incentives right, so that each level of government can do what it is best-suited for, and so that regional and national interests are protected as well. We hope this issue brief will lead to metropolitan areas that are more fiscally and resource-efficient, more sustainable, more equitable, cleaner, happier, healthier, better-planned, and perhaps, even more beautiful. Thank you for your time, we hope you found this interesting and that you'll share this, or the ideas contained within it, with anyone that you think may find it a worthwhile read. Remember, each and every one of us, even doing something small, can make a big difference. As we stated in the beginning, we hope this can be the start of a healthy and robust debate that brings about positive change for the American people. That change, of course, begins with you.