

## Book Proposal

### *Imperfect Union: Representation & Taxation in Multi-level Governments*

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## 1. Introduction

Between 1952 and 2002, a new government was created somewhere in the United States roughly every 18 hours. From cities and counties to school districts and transit authorities, there are now nearly 90,000 governments in the US with the power to tax. The proliferation of local governments has resulted largely from the layering of jurisdictions on top of one another. Territorially overlapping, single-function jurisdictions, including 35,000 special districts and 13,500 school districts, today constitute the majority of local governments.<sup>1</sup> In some areas, citizens fall under the jurisdiction of a dozen or more overlapping layers of local government. Collectively, these single-function jurisdictions have more civilian employees than the federal government and spend more than all city governments combined. Yet, scholars have written almost nothing about politics and policymaking in special purpose governments. My book aims to fill this gap.

The vertical layering of governments with independent tax authority raises fundamental issues of representation and taxation, which form the two major themes of *Imperfect Union*. Representation in local single-function governments operates through elected governing boards, which together employ a total of 173,000 elected officials. This figure dwarfs the number of federal (542) and state (19,000) officials, who have received the lion's share of scholarly attention until now. Because these jurisdictions overlap, individual citizens today are represented by dozens—in some cases even hundreds—of local elected officials. The demands placed on citizens of participating in so many elections are extraordinary. A citizen of Cook County, Illinois, for instance, would have to go to the polls on six separate dates over the course of four years in order to vote for each of the 70 different local officials that represent her. It is little surprise, then, that voter turnout in local single-function elections is usually in the range of 2 to 10 percent. In this low-participation environment, single-function jurisdictions are vulnerable to “capture” by interest groups. That is, as the burdens of participation rise and average citizens abstain, those with the most to gain from the election—the special interests—compose an ever larger share of those who turnout. For instance, Terry Moe (2006) has shown that teachers union members are up to seven times more likely to vote in school board elections than are other registered voters. Perversely, therefore, the proliferation of governments and elected officials may actually undermine democratic participation and accountability.

The narrow scope of participation in single-function elections has important implications for taxation and other policies enacted by special district governments. Each overlapping jurisdiction shares the same tax base but serves a different special interest constituency. Parents care more about school spending than other residents do, for instance, and bookworms care more about libraries, and nature lovers care more about parks, and so on. Because the benefits of a single-function jurisdiction's spending accrue disproportionately to a particular group but the costs of taxation are spread over all groups, a problem arises that is analytically similar to the “overfishing” problem seen in environmental economics (Benhabib and Radner 1992). That is, just as each individual fishermen has an incentive to overexploit the shared resources of the sea because he receives all the benefits of his increased catch but suffers only a small fraction of the adverse consequences, so too each government has an incentive to overexploit the shared tax base to provide benefits to its special interest constituency. This problem—overtaxation of the shared local tax base—is

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<sup>1</sup> As of the 2002 *Census of Governments*, the most recent available, there were 35,052 special districts, 13,506 school districts, 19,429 municipalities, 16,504 townships, and 3,034 counties in the US.

the major issue analyzed in my book. I estimate that the “overlap effect” accounts for a 10 to 15 percent increase in local government taxation, equivalent to about \$66 billion annually. In the process, I provide the first general theory of special district politics, conduct a rigorous empirical test of its predictions, analyze institutional remedies to the overtaxation problem, and develop an innovative set of concrete policy recommendations.

## 2. Background and Related Literature

Single-function jurisdictions are the subject of intense policy debate between competing schools of thought on local government organization. The municipal reform tradition (e.g., Bollens 1957, Downs 1994, Rusk 1993) contends that special districts are a source of wasteful duplication in the administration of public services, that special districts are too small to operate efficiently, and that their low visibility makes these jurisdictions politically unaccountable. Proponents of this view argue for metropolitan-wide government and promote consolidation of existing jurisdictions. On the other hand, scholars of the public choice school (e.g., Schneider 1989) and proponents of “polycentricity” (Ostrom, Bish, and Ostrom 1988, McGinnis 1999) argue that special district governments enhance desirable interjurisdictional competition, increase the number of public service bundles available for local citizens to choose from, and allow jurisdictional boundaries to be tailored to the geographic scope of specific public problems. They propose increasing the number of functionally specialized overlapping governments to spur competition in the local public sector. Recently, a similar debate has erupted in the cross-national literature on government organization, under the rubric of *multi-level governance* (Hooghe and Marks 2003).

A startling gap in the existing literature is that no one has yet offered an explicit theory of the *politics* of special district governance, much less an empirical test of such a theory. The municipal reform literature tends to approach the problem from the vantage point of corporate governance, and the resulting proposals unsurprisingly resemble calls for integration of the firm. The public choice literature has approached the problem of special districts as an extension of Tiebout’s (1956) influential model of interjurisdictional competition. However, neither literature captures the two defining attributes of single-function governments in the US. First, the electoral environment is one of low participation and special interest dominance. Second, the local tax base is a common-pool resource shared by multiple overlapping jurisdictions. An important contribution of *Imperfect Union* is to develop an explicit political theory of special district governance and to provide rigorous empirical evidence supporting it.

In developing a political theory of overlapping single-function governance, the most relevant literature comes from the areas of distributive politics and comparative fiscal institutions. An early discussion of the tax base as a *common-property resource* (CPR) is found in the distributive politics literature associated with Weingast, Shepsle, and Johnsen (1981). They analyze a geographically districted legislature in which individual representatives fully value the benefits of projects for their district but internalize only a fraction of the costs, which are financed from a common pool of national tax revenue. Because individual legislators do not internalize the full social costs of spending for projects in their district, there is excessive demand for public goods with geographically concentrated benefits

financed by nationwide taxes. Combined with a legislative norm of “universalism,” such fiscal externalities lead to overspending in the aggregate budget.<sup>2</sup>

Recently, a comparative political economy literature has relied on fiscal common-property models to explain persistent deficits in many countries (e.g., Alesina and Perotti 1999, Rodden 2005). In their summary of this literature, Poterba and von Hagen explain that “Deficits arise because the government’s general tax fund is a ‘common property resource’ from which projects of public policy are being financed.... This induces a ‘common-pool problem’ in which competing political groups vie for government expenditures that are financed using broad-based tax instruments” (1999, 3). A common theme in this literature is that more “fragmented” budgetary institutions generate a bias toward higher spending and deficits. In different contexts, fragmentation has been measured in terms of the number of representatives, the number of legislative committees, the number of spending ministers, and the number of lower tier governments. The basic CPR framework has been applied in a variety of institutional settings ranging from American states to OECD countries and Argentine provinces.<sup>3</sup>

A handful of recent empirical studies has examined the fiscal common-pool problems associated with concurrent taxation by national and state governments in a federation. With only two levels of government under consideration, the focus of these studies is on the response of one level of government to changes in the tax rate of the other. The first study to address the issue was Besley and Rosen (1998). Looking at gasoline and cigarette taxes in the U.S., they found that when the federal government increases taxes, there is a significant positive response in state taxes. Esteller-More and Sole-Olle found a similar positive reaction of state tax rates to changes in the federal tax rate for personal income taxes in the U.S. (2001) and Canada (2002).

I bring theories of common-property taxation to the study of the local public sector. In so doing, I hope to enrich the scholarly community’s understanding of both specialized local government and concurrent taxation generally. To date, Burns (1994) has provided a very fine study of the creation of special districts, and Foster (1997) has supplied a comprehensive picture of the functions and operations of these governments. Yet no one has analyzed the fundamental political and fiscal problems of concurrent taxation in this context. I will offer the first explicit theory and empirical analysis of the political and fiscal implications of jurisdictional overlap, which is the defining feature of contemporary local government in the United States. At the same time, my work should advance knowledge common-pool tax problems writ large.

### **3. Chapter Outline**

#### ***Chapter 1: Introduction***

This chapter introduces special district governments and traces their evolution from colonial times to the present day. Special emphasis is given to the proliferation of special districts since World War II. Next, I introduce the debate between the municipal reform school and the public choice school. I argue that neither school has produced a well-

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<sup>2</sup> For a review of the literature on overtaxation problems in legislatures, see Knight (2006).

<sup>3</sup> The contributions to Poterba and von Hagen (1999) provide a good representation of research in this area. In the same volume, Alesina and Perotti (1999) provide a useful literature review.

specified theory of the politics of specialized government, much less an empirical test of such a theory. I then suggest that the foundation of a theory of specialized local government should be built from a recognition of its similarities with other forms of specialized government. In particular, I argue that specialized local governments resemble Congressional committees in the US and spending ministries in parliamentary systems, in that each represents an effort to subdivide a multidimensional policy space into a series of single-dimensional policy authorities. I review the extensive literatures on these topics from American and comparative politics scholars and explain the parallels, and differences, with respect to local government. I conclude the chapter by arguing broadly that local politics is not *sui generis*, although it has been treated as such by too many for too long, and that great progress can be attained through strengthening its connections with the mainstream of the discipline.

### ***Chapter 2: A Political Theory of Specialized Government***

In this chapter, I offer the first formal theory of special district politics. My theory is built from microfoundations of utility maximization by voters and politicians. I begin with a basic theory of interest groups, link this to common-pool problems in distributive politics, and incorporate probabilistic voting and electoral competition. I model the decision by a reelection-minded politician of how much to spend on each of a set of multiple public goods. I contrast policymaking by one general-purpose government relative to a set of single-purpose jurisdictions. All spending is financed from a uniform tax on property in the jurisdiction. There is a special interest group that disproportionately benefits from each public good and whose members vote according to the tax-spending platforms offered by competing candidates. First I show that electoral competition can mitigate the common-pool tax problem when there is a single government. This is a noteworthy result in its own right. More important, I show that, due to the political transaction costs of participating in multiple elections, when there are several jurisdictions each interest group focuses its attention on the policymaker who controls its own preferred good. Because each group fully values the public service that benefits its members but only internalizes its own fraction of the tax price, the result is “overfishing” from the shared tax base. The important comparative static is that the aggregate size of the public sector increases as the number of overlapping specialized governments increases. Thus, I provide a theory of special district politics that yields clear empirically testable predictions. While the theoretical model is embedded in the institutional context of special districts, it applies broadly to specialized governments, such as congressional committees or spending ministries.

### ***Chapter 3: The Life and Death of Specialized Governments***

In this chapter I investigate the variation in the use of special districts over time and across space. The existing literature offers several competing explanations for the creation of special districts. The most prominent among them include economies of scale, a desire for racial exclusion, the need for debt financing by real estate developers, attempts to circumvent tax and expenditure limits on general purpose governments, timing of population settlement, and geography. I test these hypotheses using a panel of counties from 1957 to 2002, and a panel of states from 1942 to 2002. I assemble variables associated with each competing explanation and test whether they predict special district formation. I find that each theory explains some aspects of district formation, but by far the most important is historical timing of settlement. In particular, areas settled before roughly 1900 were very unlikely to ever develop special district governments, while areas developed after WWII were

highly likely to use special districts for at least some public services. I link this finding to theories of institutional innovation, punctuated equilibrium, and path dependence (Pierson 2000). In addition to providing new insights about district creation, this analysis uncovers plausibly exogenous sources of variation in the use of districts that aids in identifying causal effects of jurisdictional overlap in chapter 4. Finally, I explore the death of special districts. This final piece of the analysis is still in progress.

#### ***Chapter 4: Piling On: The Problem of Concurrent Taxation***

The central prediction from chapter 2 is that aggregate taxes and spending rise as specialized jurisdictions with independent tax authority pile on top of one another. In this chapter, I test that hypothesis using a panel data set of counties from 1957 to 2002. I compute the number of overlapping taxing jurisdictions in each county and relate this measure to aggregate taxes and spending. I use fixed effects panel models, in addition to instrumental variables and propensity score matching techniques. In all cases, I find strong support for the common-pool model. I estimate that the “overlap effect” is on the order of 5 to 25 percent of the total budget. I show that the results are *not* due to changes in the bundle of public services provided. The results are robust to controlling for infrastructure investment, tax and expenditure limitations, and economies of scale. Finally, I present a test to uniquely distinguish the common-pool model of specialized government: namely, general purpose governments should *increase* their own spending as the number of specialized jurisdictions overlapping their territory increases. Indeed, I find just this result using a panel of city governments from 1972 to 2002. I argue that only the common-pool model can explain this finding.

#### ***Chapter 5: Specialization and Quality***

The main argument of the book thus far is that interest groups dominate special district governments, leading to overexploitation of the common-pool tax base. An important related question is whether the increased spending produces higher quality public goods. In other words, interest groups concerned with a particular policy may effectively force other citizens to pay for higher quality services than they would otherwise like. On the other hand, if the relevant interest groups prefer wasteful or particularistic spending, then larger budgets may not translate into higher quality services. I explore such ideas in this chapter. While measuring the quality of public services can be a formidable challenge, I focus on a domain where the task is relatively straightforward: libraries. Using an panel data set of 8,100 library systems observed annually from 1992 to 2004, I find that special district libraries have larger budgets and more employees than municipally run libraries, but provide fewer books and fewer branches. I also review the secondary literature on government organization and service quality, with special attention to mayoral takeovers of public schools. Overall, I find little support for the proposition that special district governments provide higher quality services. Rather, the evidence suggests that interest groups use special districts to obtain particularistic benefits and wasteful spending.

#### ***Chapter 6: Governing the Fiscal Commons***

The preceding chapters have amassed evidence of a clear “tragedy of the commons” resulting from concurrent taxation of a shared tax base by multiple overlapping jurisdictions. The literature on common-pool resources is, however, replete with examples of institutions that have been developed to *govern the commons*; that is, to internalize externalities associated with shared ownership of a resource (Ostrom 1990). In this chapter, I analyze how political

parties can serve this function in the local public sector. I argue that, if a strong party controls multiple governments, it can serve to informally coordinate their policies. My argument builds on the work of Riker (1964), who contends that parties are the key determinant of the level decentralization in a federal system, and of Filippov, Ordeshook, Shvetsova (2004), who expand Riker's argument and apply it to contemporary comparative federalism. Consistent with these theories, I find that areas with strong political parties, using Mayhew's (1986) party organization typology, do not suffer from common-pool overexploitation due to concurrent taxation. Specifically, I estimate an interaction between party strength and jurisdictional overlap in the models introduced in chapter 4. I find that party strength offsets jurisdictional overlap, so that the common-pool effect exists specifically in weak party areas. In addition, I estimate the differential effects of elected and appointed overlapping jurisdictions, and investigate whether public service quality varies with party organization. These latter parts of the analysis is still in progress. While political parties are the exclusive focus of the empirical analysis, I conclude the chapter by discussing other institutions that might fulfill a comparable role in governing the local fiscal commons.

### ***Chapter 7: Conclusion***

I conclude by arguing that the Tiebout (1956) model, which has dominated studies of the local public sector for decades, must be brought up to date. Local government today is dominated by territorially overlapping, concurrently taxing, single-function jurisdictions, not the general-purpose territorial monopolies of yesteryear. The old Tiebout-inspired logic that more governments lead to more competition, which leads to more efficiency, does not comport with contemporary political institutions. I argue that the theoretical framework and empirical results of *Imperfect Union* provide the beginnings of a modern alternative view of local government. I emphasize that the two views are not necessarily in conflict. Where real government institutions approximate the general-purpose territorial monopolies of Tiebout's world, the competitive model applies. But in the more common cases where local institutions are specialized, overlapping, and concurrently taxing, the common-pool framework presented in this book provides a new lens for viewing local political economy. I also examine the policy implications that arise from my model of local government. Finally, I discuss how the ideas raised in this book apply broadly in different institutional contexts, including the US Congress, the European Union, and other governments with multiple layers or functionally specialized jurisdictions.

### ***4. Analytical Approach and Methods***

In addition to its novel theory of special purpose government, much of the strength of this book derives from its use of a comprehensive new data base and rigorous econometric methods. Specifically, I have constructed a data base of government finances and institutional features for all of the nearly 90,000 local governments in the US over a period of at least 30 years. I have compiled the data at several levels of aggregation. Detailed finance data for all individual governments are compiled at five-year intervals from 1972 to 2002, for a total of nearly 600,000 observations. In addition, a common practice in empirical local finance is to work with county aggregate data, because responsibilities of different types of governments often vary across states and counties, whereas the county aggregate is a comparable unit from place to place. I have assembled a second data set of county aggregate fiscal data covering the years 1957 to 2002 at five-year intervals, resulting in a total of 32,000

observations. Each finance data set contains hundreds of fiscal variables from the Census of Governments (COG). In addition, I have added dozens of variables on government organizational form from the COG, with a focus on computing the number of overlapping layers of government in a county over time. Many of the latter variables were entered by hand from print editions of the COG for the early years (which are not publicly available in electronic form). Finally, I have incorporated demographic variables from the Census of Population and Housing, and political variables from a variety of ICPSR studies. In sum, I believe this is the most extensive panel data set on US local government organization and finance ever assembled.

Methodologically, I use panel data models that heretofore have not been widely employed in studies of local politics. An obvious concern with any study of the fiscal effects of political institutions is endogeneity; namely, the possibility of simultaneous causation between institutional form and fiscal policy (Persson and Tabellini 2003). The rich panel structure of the data allows me to employ sophisticated econometric techniques to identify the key relationships among the variables of interest. I employ three approaches to estimation. First, I estimate models with unit (and year) fixed effects, which control for time-invariant heterogeneity and relate changes in spending to changes in jurisdictional overlap. Second, I use instrumental variables in two-stage least squares models to base identification on plausibly exogenous variation in jurisdictional overlap. My instruments are based on longstanding provisions of state constitutions that determine the difficulty of creating overlapping jurisdictions, and on deeply lagged values of jurisdictional overlap. Third, I use propensity score matching to base identification on comparisons of counties with similar predicted values of jurisdictional overlap but different actual values. Because jurisdictional overlap is a continuous variable and traditional matching methods are designed for binary treatments, I rely on the generalized propensity score methods of Imai and van Dyk (2004). In all cases, I use clustered standard errors to account for correlation of residuals within units over time.

In order to make the discussion as accessible as possible, I present results graphically wherever possible. I relegate the most complicated analyses to a methodological appendix and explain the findings intuitively in the main text. Each empirical chapter, therefore, uses two to three figures and three to four tables to convey the major results, supplemented by additional tables in the appendix.

## 5. Major Contributions

Special district governments are the subject of ongoing debate in the policy community. *Imperfect Union* will make several important contributions. First, problems of concurrent taxation in local government have been essentially unrecognized before now. My results demonstrate that concurrent taxation is an issue of first-order importance, which should be front-and-center in any discussion of local government organization. Second, I provide the first systematic theory of politics and policymaking in special district governments. My common-pool, common agency model of special interest politics provides a new lens for viewing a wide range of policy problems in local government. For instance, while I focus on taxation, the same basic model applies to other situations where vertical interjurisdictional externalities affect policymaking, such as environmental regulation, transportation, crime, collective bargaining, and the municipal bond market, to name only a

few. Third, I demonstrate a novel role for local political parties. Following Peterson (1981), the scholarly community has tended to view local parties as hollow shells of their national counterparts because local politics is thought to be non-partisan and to a large extent even non-ideological. I show that parties serve a crucial function in coordinating policymaking in a fragmented jurisdictional landscape. Thus, parties serve a different, but perhaps no less important, function in local politics. Finally, the project yields a variety of direct, practical policy implications. Fundamental institutional design recommendations are to limit the concurrent taxation of the same tax base by multiple governments and to encourage broad-based voter participation in special purpose governments. Even seemingly mundane changes, such as holding special district elections on the same day as municipal elections, may have significant fiscal effects by weakening special interest influence in district policymaking.

## 6. Related Books

The proliferation of special function governments has not, as yet, led to a proliferation of scholarly works on the subject. The two most closely related books are Burns (1994) and Foster (1997). Burns (1994) deals specifically with the *formation* of local governments, focusing on special districts, but does not investigate the politics and performance of districts after creation. Foster (1997) details the functions performed by special districts and develops a theory to explain why citizens and politicians choose special districts versus other government institutions to provide various local services. Both books make important contributions, but neither tackles the main issues of my book; namely, the *politics* of specialized government. Compared to the other two books, mine offers the first explicit political theory of representation and taxation in special purpose governments, has a unique focus on common-pool problems associated with jurisdictional overlap, and utilizes the most comprehensive data set and rigorous panel methods in the analysis.

## 7. Potential Readership

*Imperfect Union* covers topics at the intersection of political science, economics, and urban studies. As such, it may be assigned in courses in multiple disciplines. It is suitable for graduate or advanced undergraduate survey courses in American politics for a section on local politics. It could also be assigned in an urban or state and local politics course for a section on special districts. With its emphasis on relationships between overlapping layers of government, the book is a natural fit for courses on federalism. Given the focus on taxing and spending, the book would also be appropriate for courses in state and local public finance taught in economics departments, business schools, or public policy schools. Finally, because special districts are increasingly financing and performing functions historically controlled by municipal governments, the book would be suitable for a variety of advanced undergraduate and masters level courses in schools of urban and regional planning.

## 8. Author Bio

I am an assistant professor at the Harris School of Public Policy. I hold a PhD in political science from The University of Chicago and completed two-years of post-doctoral training in Harvard University's Program on Education Policy and Governance (PEPG). I

have written widely on the political economy of American local government. *Imperfect Union* is an extension of my dissertation, which won the American Political Science Association's 2004 William Anderson Award in recognition of the best doctoral dissertation in the general field of federalism or intergovernmental relations, state and local politics. My curricula vitae is attached as an appendix.

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