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Can Cities Control Their Destiny?

The use of subsidies and preferential taxes to lure businesses creates a war among cities.



The U.S. economic expansion in the 1990s has been remarkable, not only in length but also in the broad-based participation across U.S. metropolitan areas and regions. Many cities fought hard to attract jobs during the rolling recessions of the 1980s, but by the end of the 1990s they were focusing on the headaches accompanying those jobs—growing traffic congestion and increased air pollution. How cities try to attract new jobs and how they deal with the social costs of rapid growth can significantly influence the quality of life in urban areas.

This article summarizes research on these topics presented at the August 1999 conference “Can Cities Control Their Destiny?” hosted by the San Antonio Branch of the Federal Reserve Bank of Dallas. (*For background information on the speakers and some of their research, see the boxes.*)

Strategies to Encourage Growth

The competition for industries can lead cities to offer big companies lucrative deals. For example, Dell Computer Corp., headquartered near Austin, announced in the summer of 1999 that it would build a second facility in Nashville, Tenn. The city of Nashville reportedly offered Dell a package in excess of \$100 million, including free land and site preparation, infrastructure and transportation

improvements, and recruitment and training assistance. Such large tax incentives up the ante for cities vying for new growth and raise the question of how much is too much.

Melvin L. Burstein, an attorney, contends that tax incentives are not the most efficient way to promote growth. He says the use of subsidies and preferential taxes to lure businesses creates a war among cities—both interstate and intrastate. According to Burstein, subsidies act as a negative tariff; hence they are illegal under the U.S. Constitution, which prohibits restrictions on trade among states. Traditionally, subsidies have not been held accountable to the commerce clause of the Constitution. If subsidies are not ruled illegal, Burstein suggests ending the war among cities through federal legislation that taxes subsidies. In other words, the federal government should penalize businesses that receive selective tax and public-service abatements.

Tax subsidies can result in heavier taxes on small businesses to offset lost revenue from the tax breaks to large businesses. William Testa, a Federal Reserve economist, says the competition for jobs can also cause a reduction in basic public goods—such as education—crucial to productivity, welfare and growth. Testa supports the “benefit principle,” which

Strategies other than tax incentives offer a broader approach to attracting economic growth to cities.

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Conference Speakers

Angelos G. Angelou, Principal, Angelou Economic Advisors Inc., Austin
Melvin L. Burstein, Attorney, Burstein, Hertogs & McFarland, Minneapolis
Paul Coomes, Professor of Economics and National City Bank Research Fellow, University of Louisville

Robert C. Lanier, Former Mayor of Houston and President and CEO, Landar Corp., Houston

Susan McLain, Deputy Presiding Officer, Metro Council, Portland, Oregon

Jeff Moseley, Executive Director, Texas Department of Economic Development, Austin

Randal O'Toole, Senior Economist, Thoreau Institute and Visiting Scholar, University of California at Berkeley

Samuel R. Staley, Director, Urban Futures Program, Reason Public Policy Institute, Los Angeles

William Testa, Vice President and Senior Economist, Federal Reserve Bank of Chicago

Brett Van Akkeren, Deputy Director for Research and Policy, Environmental Protection Agency, Washington, D.C.

seeks to equate the taxes charged to a business with the costs of government services received. "Through this approach, business taxes become locationally neutral with respect to where businesses are most productive, rather than having location decisions whipsawed by capricious tax incentives."

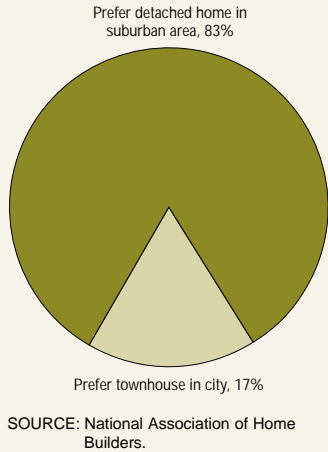
The Internet's proliferation means companies are no longer geographically defined or restricted by infrastructure or local markets. Jeff Moseley of the Texas Department of Economic Development asserts that this increased competition among cities and states forces the practice of subsidizing. While he favors prohibiting incentives, he recognizes that fierce competition may have positive attributes if it forces regional governments to create a climate conducive to free enterprise business.

Strategies other than tax incentives offer a broader approach to attracting economic growth to cities. The idea that "you can't manage what you can't measure" challenged economics professor Paul Coomes to perform a study

focusing on measurable variables a city can use to define its strengths and weaknesses. Using such a strategy, a city can identify specific goals and objectives to improve the quality of life and define specific criteria to see if it is succeeding. In developing such a plan for Louisville, Ky., Coomes looked at a wide range of data—including the cost of business and living, human and physical capital, and the quality of life—for Louisville and for competing cities. More specifically, Coomes included measures such as high school completion rates, property taxes, education performance measures, number of museums, and hospital beds per capita. Louisville then implemented plans to improve many of the human capital measures, such as the quality of education, in an effort to raise incomes. The city will monitor the human capital measures about every five years to see if it is reaching its goals. Coomes' findings offered a strategy to improve economic development, which is the foundation for growth.

Likewise, innovative market-

Chart 1
Suburbs Preferred to City Living



ing tactics succeed in attracting businesses. While working for the Austin Chamber of Commerce, Angelos Angelou developed creative strategies to encourage growth in Austin on a conservative annual budget of \$350,000. With an innovative media plan, Angelou was able to market Austin and receive free publicity around the world. Businesses throughout the city helped with recruitment, and volunteers encouraged development within the community. For successful growth, Angelou says, economic development officials should know their communities inside and out. Once they understand their community's needs, officials can develop an appealing marketing campaign. A community marketing strategy requires business, education and government entities to work together to create economic development. Angelou emphasizes that "successful economic development is a marathon, not a sprint."

Urban Sprawl

While most cities strive to attract industry, the other side of the coin is managing rapid growth that can strain the city's infrastructure. Nearly 20 states

have established growth management laws to protect farmland and open space. Dozens of cities have embraced urban growth boundaries to contain development in existing areas. A clear understanding of urban sprawl would help determine what issues to address in land-use policies; however, academics and urban planners struggle for a generally accepted definition. Most commonly, urban sprawl encompasses the following: low-density development consisting of single-family homes on large lots, strip commercial and leapfrog development, development that invades lands important to environmental and natural resource protection, and automobile dependency, which leads to more traffic and air pollution.

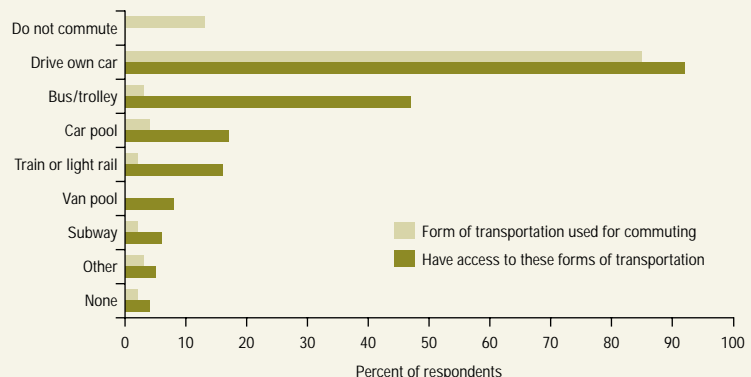
Clearly, the housing and commercial development markets are reflecting the changes in household preferences and lifestyles over time: first, the desire to move from the farms to the cities during the early 20th century, then the shift from the cities to the suburbs in the mid-1930s to mid-1960s. As shown in Chart 1, the 1999 Consumer Survey on Growth Issues by the National Association of Home Builders reports that Americans prefer a

single-family home on an individual lot in an outlying suburban market rather than a smaller townhouse near the urban core. The survey also reports that people prefer to drive their own vehicles rather than use public transportation when it is available (Chart 2). Given these preferences, it may be difficult for public policy to combat urban sprawl.

Brett Van Akkeren of the Environmental Protection Agency refers to urban sprawl as conventional suburban development. He expresses concern about land-use expansion, such as wasted resources, consumed green space and a lack of interconnectivity between the city and the suburbs. The concept of "smart growth" has developed out of these concerns. Smart growth involves long-term planning to sustain the demand for housing while protecting the environment and preserving open space. Van Akkeren suggests that smart growth is about a balance between growth at the edge and growth at the center.

Samuel Staley, an urban policy analyst, proposes that the real estate markets can better manage land development than can comprehensive land-use plan-

Chart 2
Private Vehicles Preferred Over Public Transportation



SOURCE: National Association of Home Builders.

Can Cities Control Their Destiny?

Papers and Readings

Burstein, Melvin L., and Arthur J. Rolnick, "Congress Should End the Economic War Among the States," *The Region*, 1994 Annual Report Essay, Federal Reserve Bank of Minneapolis, March 1995, woodrow.mpls.frb.fed.us/pubs/ar/ar1994.html.

Coomes, Paul, and Barry Kornstein, "Macro Performance Indicators for the Louisville, KY-IN Metropolitan Statistical Area," March 1996. For a copy of this publication, contact Paul A. Coomes, Ph.D., at pacoom01@ulkyvm.louisville.edu.

Oakland, William H., and William A. Testa, "The Benefit Principle as a Preferred Approach to Taxing Business in the Midwest," *Economic Development Quarterly*, vol. 14, no. 2, May 2000, pp. 154–64.

O'Toole, Randal, "Dense Thinkers," *The Reason Magazine*, January 1999, www.reason.com/9901/fe.ro.densethinkers.html.

Portland, Oregon, Metro web site: www.metro.dst.or.us.

The Smart Growth Network web site: www.smartgrowth.org.

Staley, Samuel R., "The Sprawling of America: In Defense of the Dynamic City," Reason Public Policy Institute, Policy Study no. 251, www.rppi.org/ps251.html.

"1999 Smart Growth Report," National Association of Home Builders, www.nahb.com/main_features/smartpdf.htm.

While city expansion appears to waste resources and consume green space, the land involved is a tiny fraction of all undeveloped land.

ning. His alternative, market-oriented approach maintains that the land-development market is not random or irregular but compelled by consumer behavior and production costs. Staley says the market is demanding low-density, single-family housing, leading to recent development trends that "require accommodating, rather than restricting growth and regulating it through market-oriented institutions."

While acknowledging the demand for suburban development, Staley also points out that cities often subsidize the development of public services to the suburbs, such as roads and water service, and he thinks this type of government subsidy should be eliminated. He emphasizes that current development patterns pose little threat to the environment and open space. While city expansion appears to waste resources and consume green space, the land involved is

a tiny fraction of all undeveloped land. Staley's research shows that less than 5 percent of the nation's land is developed, and acreage in protected wildlife areas and rural parks exceeds urbanized areas by 50 percent.

Staley also notes that declining inner cities suffer from "push factors," including low-quality public education, high crime, high tax rates and fewer housing opportunities. These negative factors threaten a city's ability to compete for middle-income families and households. The revitalization of inner cities will come from identifying and correcting these push factors.

Former Houston Mayor Robert C. Lanier also recognizes that problems like high crime contribute to the trend of people moving away from the city. Lanier's first priority as mayor was to "cancel the billion-dollar monorail system, which peaked at boondoggle, and take a por-

tion of that money and spend it rebuilding the city's police force, which had been depleted, and rebuilding the city's infrastructure and thus trying to reverse the outflow of people." He says that making central Houston a better place to live is the key to reversing the trend of people moving to the suburbs.

Portland, Oregon

As cities extend into outlying counties, governing jurisdictions become a more difficult issue. The Portland metropolitan area in northwestern Oregon developed the Metro Council as an elected, interregional government to serve more than 1.3 million residents of the urban portions of three counties, including 24 cities. Metro's primary responsibilities are regional land-use and transportation planning, the solid waste industry and regional facilities such as the Oregon Zoo and the Oregon Convention Center.

The Portland metropolitan region has received national attention for its unique approach to long-range growth planning. The region's growth plans have created land-use tools to achieve targeted goals: allowing more efficient development of land, reducing parking in future developments, protecting stream corridors, managing future retail store locations, keeping roads accessible and creating affordable housing. Susan McClain, deputy presiding officer of the Metro Council, says Portland is writing a success story on long-range growth planning. She asserts the importance of integrating land-use and transportation planning. "You cannot manage growth if you do those two functions in a void," she says. "Transportation and land use have to be done together. They have to be integrated in a way that's real."

In response to a growing population and in an effort to

maintain the region's current urban growth boundary, Metro encourages more compact urban development, such as accessory apartments above existing garages and single-family, detached houses on smaller lots. New commercial and retail developments are being built around light rail and bus corridors. A recent community-building project has developed apartments so that some residents can step out their front doors and catch the Interstate MAX light-rail line. Members of the Metro Council acknowledge the critical role transportation plays in the continued economic health and livability of their region. They advocate development offering a pedestrian-oriented environment, easy access to transit and a mix of residential, civic and commercial uses.

Randal O'Toole, an economist who lives in Portland, disputes smart growth programs' promises of less congestion, less air pollution, lower infrastructure costs, affordable housing, more open space and a sense of community. O'Toole argues that Metro's plan to restrict development outside of the urban growth boundary and to double the population density of its region will lead to more pollution and congestion. In fact, he finds that these goals will create a city much like Los Angeles, which has one of the highest population densities in the United States. He predicts that the promise to reduce congestion and air pollution will be abandoned in 50 years when the

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To purchase an audiotape of the conference "Can Cities Control Their Destiny?" call Rachel Peña at (210) 978-1663 or e-mail rachel.pena@dal.frb.org.

population increases by 75 percent, which means there will be five cars for every three cars driving around today. He also argues that light rail takes away funds from buses, which are more flexible and better able to serve the community's needs.

Summary

Cities today face difficult questions about how to attract and manage growth. Planners and city officials want to enact policies to control their destiny—to create a higher standard of living for their citizens. At the “Can Cities Control Their Destiny?” conference, experts from various fields presented arguments that highlight the impact policies have on growth and living standards. It is clear, however, that there are always two sides to an

argument. While tax incentives may force cities to offer a more competitive business tax, they may also subsidize large businesses at the expense of small ones and lead to less spending on infrastructure necessary for long-term growth. In addition, while urban sprawl policies seek to reduce traffic and air pollution and improve the quality of life, some studies suggest that the policies will have the opposite effects. City officials and citizens must decide what is best for their communities. This article briefly touches on some of the speakers' analyses; the publications in the reading list give much more depth to these important issues.

—Adrienne R. Peña
Keith Phillips

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