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Cities and Governments

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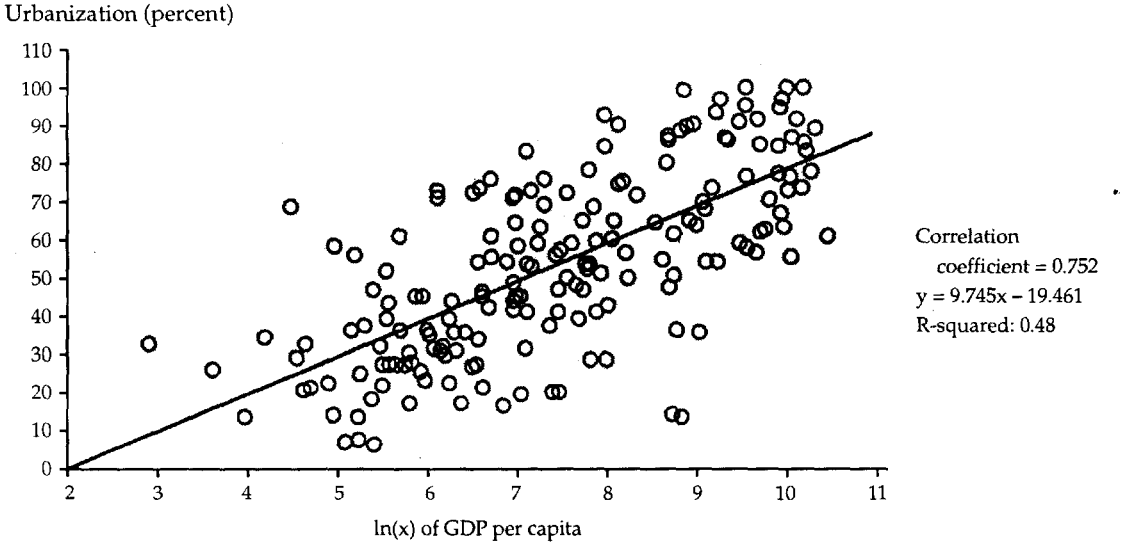
It is natural for economists to focus in part on urbanization, because urbanization is one of the most ubiquitous, and therefore important, features of development. Figure 8.1 shows the dramatic correlation between per capita gross domestic product (GDP) and urbanization. Indeed, given the tendency to mismeasure income, urbanization may be a better measure of economic development than income. We do not fully understand why increasing income and increasing concentrations of people in urban areas go hand in hand so often. Theoretically, one could imagine increasing wealth to be accompanied by a demand for more land and decentralization of population, which has proven to be the case in some industrial countries. However, the connection between wealth and urbanization remains pervasive.

Figure 8.1. *Urbanization and Income, All Countries*



Source: Authors.

In previous work, we have tried to explain the role that cities play in the economy. In particular, we have emphasized the intellectual exchanges that cities facilitate, because the generation and recombination of ideas in cities may be the wellspring of technological progress. Glaeser and others (1992) provide evidence that suggests that this progress is strongest in diverse cities. Dense urban areas also facilitate workers learning from one another. As Marshall (1890) wrote, in cities skilled workers learn from one another and "the mysteries of the trade become no mystery but are, as it were, in the air." Economists have increasingly come to the realization that ideas and human capital play an important role

in generating growth. Because cities appear to increase the flow of ideas and to help in the formation of human capital, they may indeed be extremely important to economic growth.

Cities' importance for economic growth indicates that understanding the positive and negative effects of governments on cities is particularly important because government policy affects cities in many ways. Consequently, if healthy cities are important for development, then getting urban policy right is critical.

However, arguing that cities play a crucial role in development does not mean that all development will take place in cities. One of the most striking changes taking place in urban areas over the past 50 years is the exodus of manufacturing from many cities. In 1950, seven out of eight of the United States' largest cities were over-represented in manufacturing. By 1990, six out of eight of the largest American cities were under-represented in manufacturing. Similarly, industry has begun to move outside developing economies such as Jakarta. The exact moment when industry began to flee from cities is hard to pinpoint. By the 1920s, the decline of manufacturing cities had already begun in many places in the United States. Even developing nations may already begin to see manufacturing move away from urban areas.

This exodus should not be interpreted as a general decline of cities. These shifts, when they are not the result of explicit government intervention through industrial parks, are often the result of high land prices in cities, which just means that other economic actors desire urban land more than manufacturing does. In the United States, information-intensive industries and services are replacing manufacturing in cities, and we should expect to see similar patterns of growth in developing countries.

While the movement of industry away from cities may create significant social disturbances in the short term, in general, spatially oriented government policies can, and perhaps should, do little to correct these trends. In general, U.S. policies oriented toward stemming the decline of industrial cities have had limited success. The trend is too big for governments to fight, and the efficiency gains from proper spatial allocation of industry are too great to ignore.

Furthermore, policies focused on spatial allocation will often exacerbate social problems. For example, when spatial policies keep former industrial workers in cities, they cause the development of a permanent underclass whose economic existence becomes dependent on government jobs. Stripping away the subsidies that distort locational incentives and trusting that labor will follow the changing spatial patterns of employment is a healthier option. However, we do not mean to suggest that temporary support for those who have been hurt in business cycle downturns is not warranted. We are simply suggesting that such support should not be tied to location and should not create spatial distortions.

What Does Sound Urban Policy Entail?

Urban policy includes both national and local policies. National policies include explicit urban policies, for example, national urban planning, urban housing programs, and so forth. However, most national policies that influence cities are perceived as being nonurban in character. For example, transport policies can have a large influence on the demand for cities. Similarly, trade policies–which are usually designed without any explicit spatial goals—can also end up having large spatial effects. Some spatial effects of these policies are inadvertent, but we believe that many policies are designed to favor particularly powerful spatial areas. For instance, policies that direct rents to particular areas will cause population to flow to the favored areas for as long as population flows are allowed.

These policies can be either procity or anticity depending on how the political system has been designed. In some industrial countries, the political system has given too much political representation to empty rural areas. As a result, these areas are able to attract national government rents, such as U.S. agricultural subsidies, which in turn attract people. In most countries, especially those without well-functioning stable democracies, large cities, particularly capital cities, are able to exert a large influence over the government. Spatial proximity leads to influence, thereby causing rents flow to the capital city, which leads to massive population flows of people following the rents.

Ideally, national policy will correctly evaluate all the externalities associated with different urban forms and act to correct these externalities. However, even in the absence of political economy concerns, this is difficult because of the absence of sound methods of measuring these externalities. Moreover, in practice governments are more likely to use spatial subsidies to favor politically powerful regions than to subsidize regions into which population flows would generate positive externalities.

In the absence of compelling congestion or pollution externalities, the best long-term governmental goal is probably spatial neutrality—the absence of transfers across spatial areas—as a benchmark rule of good governance. Spatial neutrality can be enforced through a variety of legal and constitutional means, which would guarantee that government would find it difficult to violate spatial neutrality.

One method of enforcing spatial neutrality is the decentralization of authority. When local areas such as cities and regions have autonomous control over their own policies, massive redistribution between areas becomes more difficult. Ideally, independent regions will have enough authority both to protect themselves from distortionary federal government actions and to spur healthy competition among localities for residents. Political economic theory argues that greater emphasis on local authority has many advantages: individuals have more political choice, local governments are forced to compete for citizens, and the possibility of local innovation increases. Decentralization appears to be the best way of achieving good urban government.

However, one warning is associated with the general case for local government authority. Local governments do not work well when they are allowed to redistribute wealth among their citizens. As Stigler (Leube and Moore 1986) argued more than 40 years ago, redistribution is clearly a national function. The problem is illustrated by cities in the United States where coalitions of poor and possibly nonpoor altruistic citizens occasionally capture local governments by voting for high levels of redistribution, which in turn causes a massive exodus of the wealthy. The net result is that the city becomes a pocket of poverty with little possibility of redistribution.

The problem with local redistribution is that the voters who receive the benefits are not paying the costs. Thus, the conditions needed for decentralized democracy to function well are not met and situations like the one concerning local government capture described before occur, leading to massive spatial distortions. Local governments work best when they are restricted to activities where those voters who receive the benefits also pay for the costs. Indeed, eliminating leadership whose appeal is based on redistribution and replacing it with leadership whose appeal is based on sound provision of basic urban services has been a prominent trend in urban governance since the 1970s. Where national rules that eliminate the tendency to elect redistribution-oriented local leaders can be implemented, cities will be in better shape.

Nine Empirical Issues

The following is a discussion of nine empirical issues from the urban literature, which will be followed by a lengthier discussion of the various policy issues involved in both national and local urban policy. The facts for the first three issues come from international cross-country evidence. Our fourth and fifth topics contain evidence both from cross-country evidence and from cross-city evidence in the United States. The final four empirical areas cite evidence from the United States only. This focus on the United States stems mainly from a desire to focus exclusively on local government policies. Because the United States has a great deal of variation in local government actions and looking within the United States by itself holds other factors constant, we believe that many of these findings will also hold up for other countries.

How to Think about Cities

Before going into these nine topics, let us first attempt to provide some definitions and an initial intellectual framework. Cities are defined by the absence of space between economic actors. As such, natural economic areas can rarely be called metropolitan areas. Individuals simply have interactions with

other individuals, both near and far. In some sense, political units, or cities, do mean something, because they at least represent a political jurisdiction. In the same sense, countries reflect a political reality; however, the term *region* really has no clear economic meaning.

Despite these highly idiosyncratic statements, much can still be said for metropolitan-area or regional analysis. Distinctions between metropolitan areas and regional areas can make sense for population density reasons. When a large cluster of people in a particular space can be clearly separated from other clusters because low-density areas surround them, then it may make sense to refer to this cluster as a metropolitan area. Other attributes that may be useful for defining a cluster of people as a metropolitan area include shared behavior, such as commuting to a single downtown area or a common set of trading relationships. Similarly, regions are defined either by being high-density areas surrounded by low-density areas—the Pacific coast area in Canada could be defined in this way—or by the existence of common characteristics among their residents, for instance, Catalonia is defined by a shared language and distinct history. Often these regional areas make sense, but they can be just as artificial in practice as states and nations.

If we define cities by the absence of physical space, then we can think about urban functions as resulting from the benefit of lowering transport costs. In other words, cities and dense regions exist to lower transport costs for goods, people, and ideas. This view of the purpose of cities has been most strongly popularized by Krugman (1991a,b) in whose models the costs of urbanization, incurred by the distance from agricultural output, are balanced against the benefits of urbanization, which result from manufacturers' ability to trade freely with one another. As discussed earlier, manufacturing has fled large cities for nonurban areas in many countries; a trend that could be interpreted as the result of the declining importance of eliminating transport costs for goods. Dumais, Ellison, and Glaeser (forthcoming) suggest that saving transport costs for inputs and outputs is only marginally important for industrial location in late 20th century America.

Alternatively, cities may exist to eliminate the costs of moving people. Marshall (1890) argues that a primary advantage of cities lies in the ability of urban workers who are laid off by one firm to work elsewhere. Dumais, Ellison, and Glaeser (forthcoming) provide evidence suggesting that the most important factor for explaining why industries generally locate with one another is the use of the same occupational mix of workers. The advantages of eliminating space between people also appear to matter in non-work-related activities; social existence tends to become easier when there are more people in the area to mix with. The importance of this factor does not appear to be diminishing.

Finally, another possible reason for cities' existence is the rapid movement of ideas over short spaces. As a consequence of this rapid movement, cities themselves become repositories of localized knowledge, which can take the form of trade secrets or basic production skills. A growing body of knowledge supports this important, but less well documented, function of cities.

Development, Urbanization, and Growth

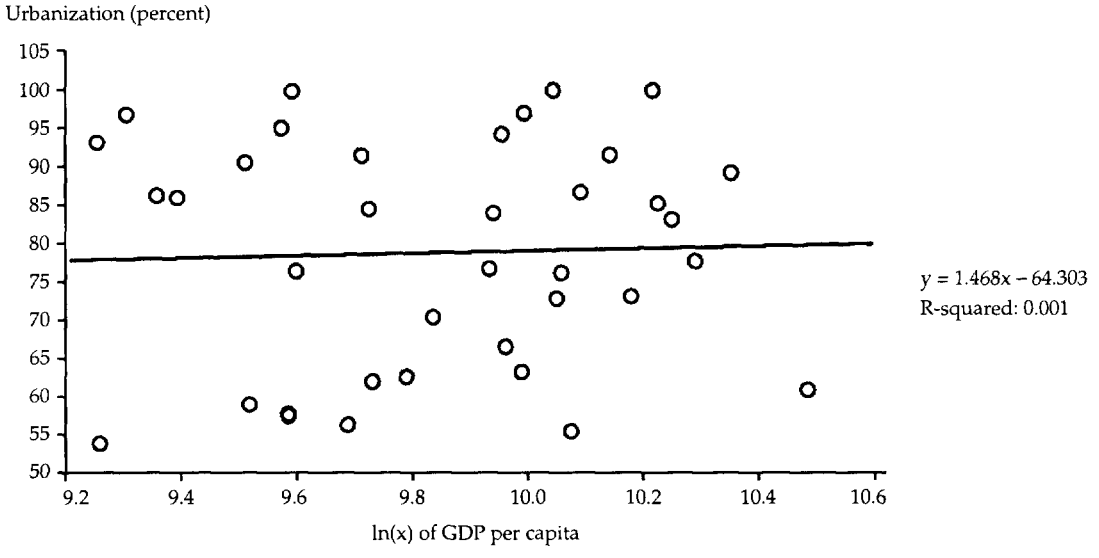
As discussed previously, a clear connection exists between urbanization and the level of development. Countries with a high GDP per capita are more urbanized than countries with a low GDP per capita. This connection is apparent in figure 8.1. This relationship also tends to hold true in the time series of individual countries. As countries industrialize, they urbanize. However, once their wealth reaches a certain peak, urbanization stops. Figure 8.2 illustrates that for countries with GDP per capita over US$10,000, the connection between industrialization and urbanization fails to hold.

The best basis for explaining the relationship between industrialization and urbanization is that development generally means a move away from agriculture into industry. Agriculture requires much more land than industry, and as a result, agriculture does not permit settlements as dense as industry permits. Because the common path of development involves replacing more land-intensive activity with less land-intensive activity, it is not surprising that masses of individuals tend to become denser as countries develop.

This relationship immediately suggests that different development policies will have different effects on urban form. Except for the unusual case where the income effects of agricultural policies are

outweighed by the price effects of these policies, policies that emphasize agriculture will generally lead to less rural-urban migration. Lower levels of rural-urban migration may result in fewer of the problems and benefits of cities. Policies that emphasize the raw materials of the country, which usually involve land-intensive industries, will also generally lead to less urbanization. However, economies that rely heavily on raw materials may become focused on rent seeking, which could distort the urbanization process and lead to the formation of megacities.

Figure 8.2. Urbanization and Income, Wealthy Countries Only



Source: Authors.

The net effect of policies that encourage urbanization depends on whether we see urbanization as a blessing or a curse. Figure 8.3 illustrates that the level of urbanization in 1960 is positively correlated with the growth in GDP per capita between 1960 and 1985. Although this relationship is not conclusive because it accounts for a large set of other country controls, such as schooling, it does suggest that higher levels of urbanization could have benefits (for example, production of ideas or more efficient division of labor) that are returned with higher growth rates.

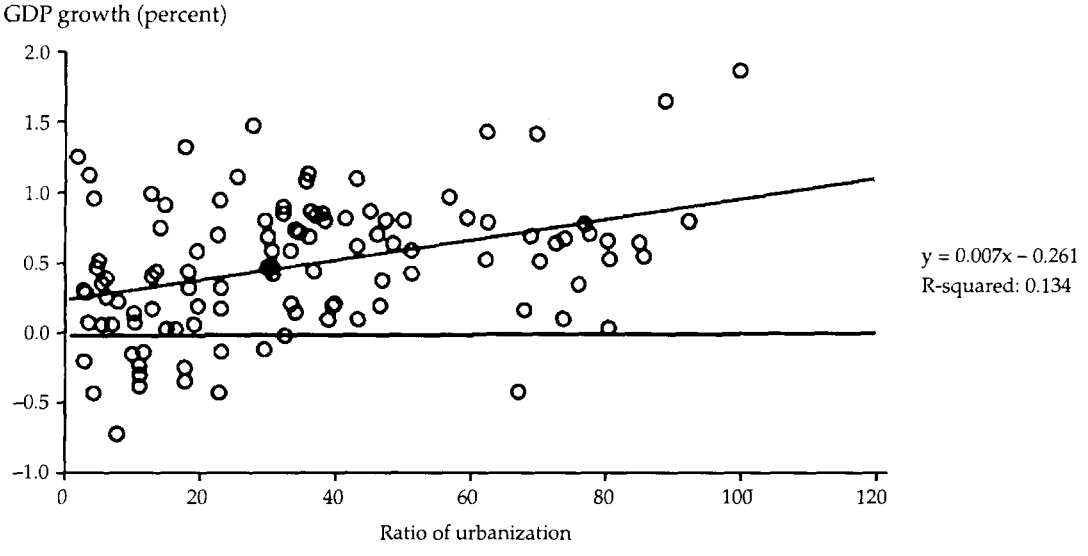
Primacy and Politics

A second significant relationship occurs between primacy—the dominance of a single city over rural areas—and political factors. Hoselitz (Nash 1977) was an early pioneer of the concept of the parasitic city, by which he meant a city that existed because of rent seeking from the hinterland instead of existing for more socially productive reasons. For example, the leaders of cities that are political or ecclesiastical capitals have often transferred wealth to the capital. This transfer may occur because the leadership wishes to enrich itself off the wealth of the hinterland and spend that wealth where it lives. Examples of this phenomenon range from the pharaohs of ancient Egypt to Papa and Baby Doc Duvalier in modern-day Haiti.

Another reason for the transfer of wealth is political pressure created by residents of the capital city. This political pressure can take the form of protests or riots by the disadvantaged. Political pressure appears to grow weaker with distance. Riots in the distant hinterland do not threaten the government;

riots in the square outside the government seat do. Political pressure may also take the form of lobbying by wealthy industrialists seeking protection for their markets. Political leaders respond to both forms of political pressure by transferring wealth to the capital. This transfer may take the form of public education and housing, or it may take the form of trade barriers.

Figure 8.3. Growth in Per Capita GDP 1960–85 and Initial Urbanization



Source: Authors.

As the government transfers wealth to the capital city, or other seats of power, population follows this transfer. Some regimes are strong enough to simply bar the movement of population (for example, the former Soviet Union and modern China). However, weaker regimes cannot regulate the flow of population, and people move where the government is disbursing funds or where the government is artificially increasing the marginal product of labor in protected industries.

We can see the phenomenon of government transfers of wealth in the connection between political instability and primacy and in the connection between dictatorship and primacy. Instability leads to primacy because unstable regimes have a stronger incentive to try to bribe residents of the central city into supporting them. Dictatorship leads to primacy because dictators allocate wealth to themselves and much of that wealth gets spent in capital cities. As figure 8.4 illustrates, stable democracies are much less likely to have their population concentrated in their largest cities because their political regimes protect the residents of their hinterlands from appropriation.

The evidence suggests that the primary causal order is that political factors cause primacy and not the reverse. Ades and Glaeser (1995) illustrate that these connections are not the result of reverse causality where large central cities lead to instability or dictatorship. Henderson (1986) shows the role of federalism, which leads to political protection of the hinterland, in limiting primacy.

Cities and Trade

Krugman and Livas-Elizando (1996) argue that high levels of protection lead to primacy. One explanation of this connection is political. Protection is a means by which governments transfer wealth to politically powerful firms in the hinterland. The Krugman and Livas-Elizando model suggests that in open

economies the gains from agglomeration are reduced. Following Krugman (1991a), they argue that megacities occur in part to reduce transportation costs. However, when goods are supplied from abroad, little is gained from locating activities in a single city because foreign suppliers can ship just as easily to several dispersed locations.

Figure 8.4. *Dictatorship, Stability, and Primacy*

Stable Democracies	*Stable Dictatorships*
Share of urbanized population in largest city=0.23 Number of observations=24	Share of urbanized population in largest city=0.30 Number of observations=16
Unstable Democracies	*Unstable Dictatorships*
Share of urbanized population in largest city=0.35 Number of observations=6	Share of urbanized population in largest city=0.37 Number of observations=39

Source: Ades and Glaeser (1995).

Alternatively, when an economy is closed, the role of foreign suppliers is reduced. The benefits of agglomeration get stronger as more domestic producers move together to save on shipping costs. Krugman and Livas-Elizando argue that Mexico City's size dates from the period when Mexico was a closed economy (Krugman and Livas-Elizando 1996). Hanson (1995) illustrated that the opening of the Mexican economy coincided with a decrease in the capital's share of Mexico's industry. Ades and Glaeser (1995) showed that a general global pattern of closed economies with larger central cities exists.

Trade also plays a role in creating large cities and agglomeration economies. As Rappaport and Sachs (1998) showed, many U.S. cities owe their location to natural ports, and, in many cases, trade is associated with increasing size of particular port cities.

Cities and Human Capital

Modern growth theory (Lucas 1988, Romer 1986) emphasizes the critical role of intellectual spillovers in fomenting economic development. This theory argues that the aggregate level of knowledge in the economy is the critical ingredient underlying growth, and that a high knowledge level increases the productivity of everyone in the economy. Naturally, this view has led to a revised assessment of the role of cities. Lucas (1988) in particular suggests that it is in cities where knowledge spillovers operate most strongly. He supports Jacobs' (1969) view that the primary economic role of cities is the generation of new ideas and that these new ideas are the linchpin of economic growth.

This new growth theory, and the idea that cities were centers of intellectual spillovers, has incited a wide variety of urban research beginning with Jaffe, Trajtenberg, and Henderson (1993); Glaeser and others (1992); and Henderson, Kuncuro, and Turner (1995). Jaffe, Trajtenberg, and Henderson (1993) present the best evidence that ideas flow more slowly over greater distances. They based their findings on examinations of patent citations, which show the path of ideas. Patent citations are spatially concentrated. This is shown by the fact that patents are more likely to cite older patents that were awarded in geographical proximity. As patents age, they are more likely to be cited in more distant places, which suggests that ideas move slowly over distance. Because the whole idea of the intellectual city rests on the

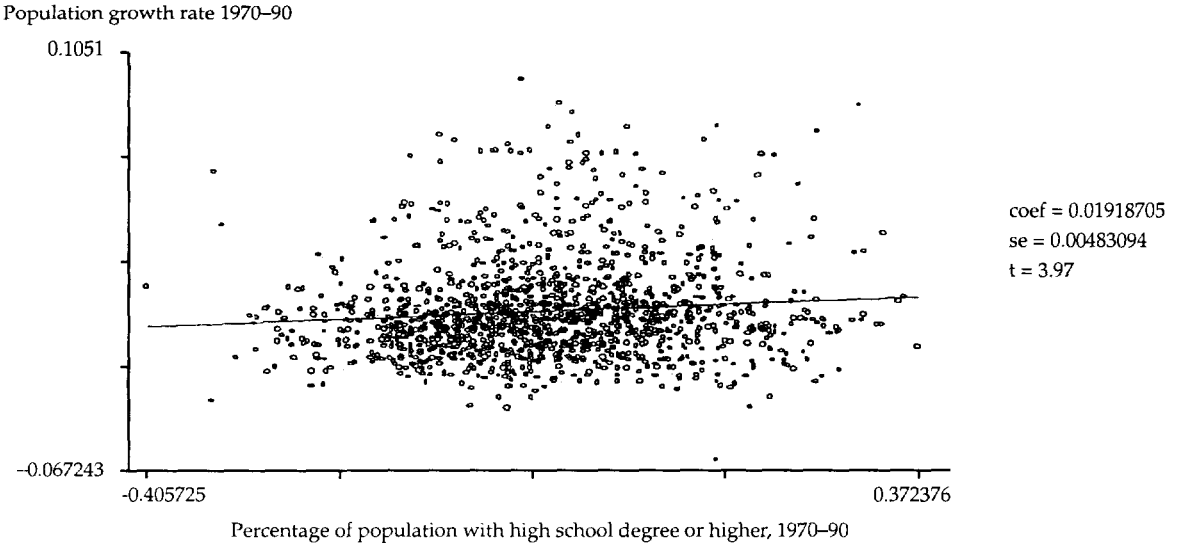
idea that there are geographic limits to the flow of ideas, this evidence is a vital underpinning for all research in this area.

Glaeser and others (1992) present evidence from cities in the United States showing that intellectual spillovers appear to be strongest when cities are centers of diverse industries. Henderson, Kuncuro, and Turner (1995) argue that some degree of concentration is important for industries that are just starting out in particular areas. Both papers share a common focus on industrial growth in cities as the result of intellectual spillovers in those urban areas.

In the growth literature, papers such as Romer's (1986) that emphasizes the stock of disembodied ideas and Lucas' (1988) that emphasizes the stock of human capital in the economy appear to be in disagreement. Papers such as Henderson, Kuncuro, and Turner's (1995) or Glaeser and others' (1992) tend to focus on the role of disembodied ideas. Glaeser, Scheinkman, and Shleifer (1995) looked directly at the stock of human capital in cities and found a strong connection between the level of human capital in the city and the city's later growth.

Figure 8.5 shows this connection for U.S. cities between 1970 and 1990. A strong connection exists between the percentage of adults older than 25 in the city's population and the growth of that city over the next 20-year period. Glaeser, Scheinkman, and Shleifer (1995) showed that this connection has become stronger with time, that is, it existed, but was less powerful in the period between 1950 and 1970. Simon and Nardinelli (1996) show that knowing the average level of human capital in a city is useful for explaining the growth of cities between 1880 and 1990. One interpretation of this connection is that higher levels of human capital in a city lead to faster technological growth. An alternative interpretation is that the average level of human capital is an urban productive amenity that has become more important over time as the returns to skill have increased.

Figure 8.5. *Population Growth versus Education, 1970–90*

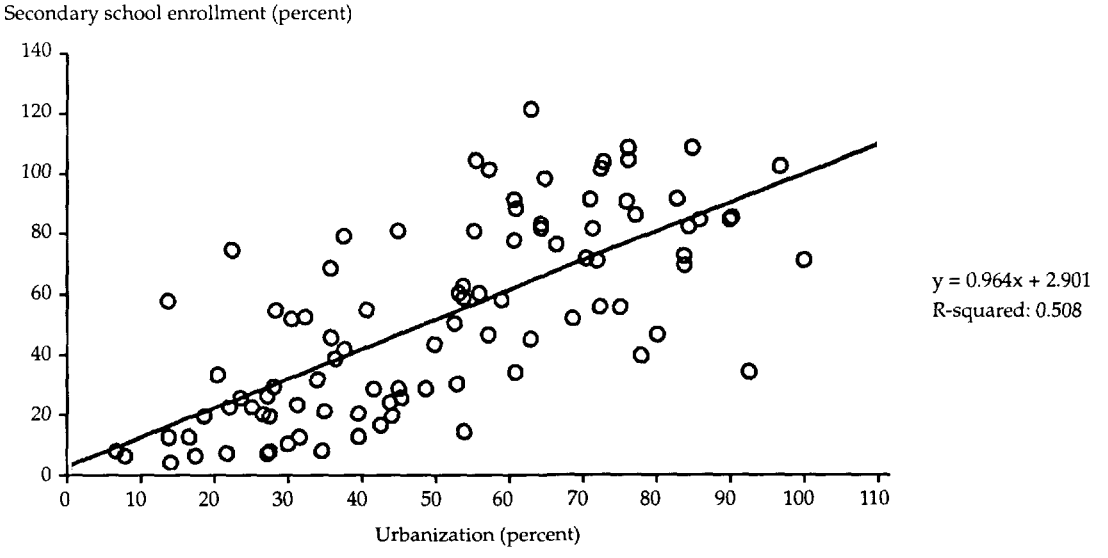


Note: This figure has a universe of 1970 metropolitan areas with a population greater than 10,000.
Source: Authors.

A second important fact concerning human capital and cities is that wages are higher in cities where the average level of human capital is higher. Figure 8.6 shows that throughout the world, higher levels of urbanization are associated with more schooling. This is true even when controlling for GDP per capita.

Rauch (1993) documented that higher levels of urban human capital are associated with higher levels of urban wages (holding individuals' own levels of human capital constant). He also showed that these higher levels of human capital are associated with higher housing costs. Rauch (1993) interpreted these results as evidence of the role of human capital spillovers in cities.

Figure 8.6. Urbanization and Secondary School Enrollment



Note: This figure has a universe of 1970 metropolitan areas with a population greater than 10,000.
Source: Authors.

Glaeser and Mare (1994) examined the significant wage premium that workers in cities receive relative to workers outside of cities. They found that individuals newly migrated into cities do not immediately experience wage increases. They experience new wage gains slowly over time. In addition, migrants from cities do not experience wage reductions. One interpretation of these facts is that a primary benefit of cities is that workers learn from one another and thus accumulate human capital faster. This accumulation of human capital then stays with workers when they leave. Glaeser (1998) models this phenomenon and suggests that it can also help explain why younger people with more formal education choose to live in cities.

The Curse of Concentrated Poverty

The previous section discussed the bright side of human capital spillovers; workers in high human capital cities learn from their neighbors and become more skilled. However, the same argument that suggests that cities can be centers of human capital also suggests that low human capital areas can create negative spillovers for their inhabitants. Indeed, the neighborhood effects literature has focused primarily on the possible harm done to youths growing up in disadvantaged neighborhoods.

Case and Katz (1991) examined a survey of youths in the Boston area and documented local spillovers in a wide variety of behavior. Other research also suggests that neighbors can influence each other in negative ways. Glaeser, Sacerdote, and Scheinkman (1996) use an alternative methodology to similarly capture the extent to which social interactions are important in determining criminal behavior. Cutler and Glaeser (1997) showed that ghettos appear to have highly detrimental effects on African-

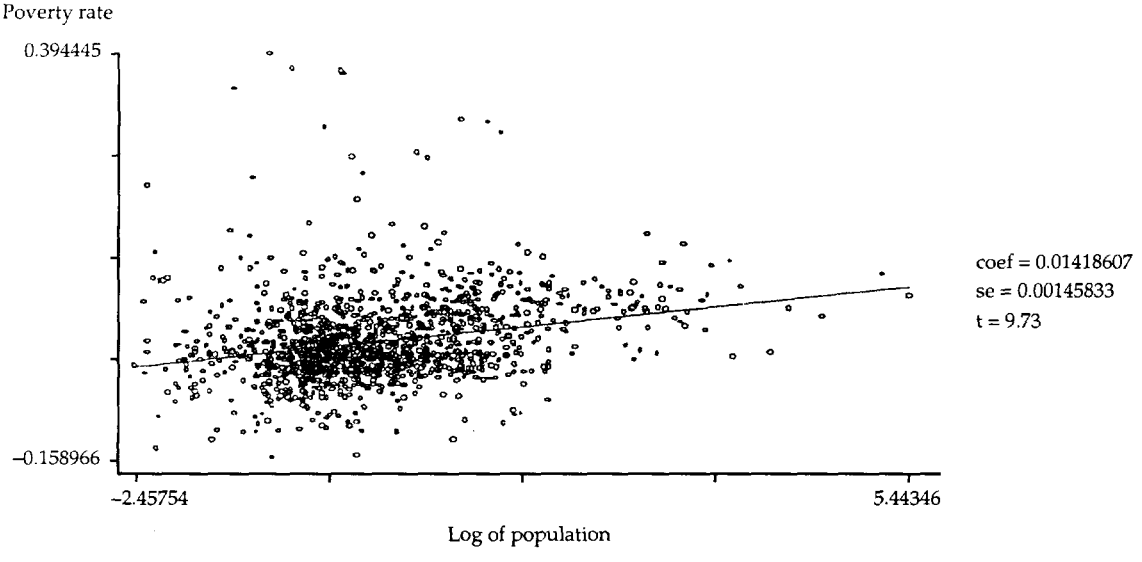
American youths. In total, a great deal of evidence suggests that concentrations of poverty lead to negative schooling and labor outcomes, high crime rates, and high rates of female-headed households.

This type of evidence is important because it suggests that government policies that lead to high concentrations of poverty can produce particularly adverse effects on the children who grow up in such concentrated poverty. If there were no spillovers, government housing policies that concentrate the poor in spatially concentrated high-rise buildings might not matter. However, because such spillovers exist and are important, the government's role in concentrating poverty may be particularly salient and deleterious.

Cities, Poverty, and Redistribution

A final important fact about cities concerns the concentration of poverty, particularly in U.S. cities. Poverty is less concentrated outside of the United States (see Brueckner, Thisse, and Zenou 1999). However, as figure 8.7 shows, a striking correlation exists between city size and the portion of inhabitants who live in poverty in U.S. cities. In the United States, this relationship appears to have grown stronger over time.

Figure 8.7. *Poverty Rate versus Population, 1970*



Source: Authors.

This relationship is primarily seen in comparisons between big cities and smaller towns in the United States. Nonurban areas still have substantial pockets of poverty. This is especially true in the developing world, where rural poverty is often severe. The Harris-Todaro model argued that unemployment rates are higher in urban areas, but they are offset by higher wages in urban areas. However, it appears that these differences in unemployment rates are not a general feature of urban areas and that the actual relevance of the Harris-Todaro model is quite suspect in many ways. This model has always lacked explanations for why unemployment exists to begin with and why unemployment would be higher in cities.

Rural and urban poverty differ in two primary ways. First, the roots of urban poverty often lie in inappropriate government redistribution policies that provide benefits to the poor in urban areas. Later, we will argue that one possible explanation for higher unemployment rates in cities is the greater

incidence of government policies that reward unemployment. Second, rural and urban poverty differ in that urban poverty is often associated with social breakdowns and a proximity between rich and poor that is not present in rural areas. Social breakdowns occur in cities for many reasons (Glaeser 1998). The main reasons for the increased social breakdowns in cities are the increased anonymity of individuals and the ease with which individuals who violate social norms can escape the community. In addition, the proximity between rich and poor increase the returns to crime and other rent-seeking activities (Glaeser and Sacerdote 1999).

The poor are likely to experience poverty in cities and rural areas as equivalently bad. However, urban poverty may create externalities and be associated with social pathologies such as crime and single parent families that are not present in more stable and less anonymous rural areas.

The traditional explanation for concentrations of the poor in urban areas was that rich people who have a greater demand for land choose to live where land is cheap. However, Wheaton (1977) and Glaeser, Kahn, and Rappaport (forthcoming) both document that this effect is not sufficient to explain the concentration of the rich in smaller towns and the observed concentration of the poor in cities. Alternative explanations stress the role of public transportation in cities, which means that the poor do not need to buy cars. However, these two explanations do little to explain why more of a connection exists between poverty and city size in the United States than elsewhere.

One possible explanation for the concentration of poverty in U.S. cities is the greater availability of redistribution there. Figure 8.8 shows the connection between per capita welfare spending by cities and the overall size of the city, which is not just the result of the higher concentration of poverty in cities. Figure 8.9 shows that the same relationship continues to hold even after controlling for the share of the city's population that is poor. This connection between redistribution and city size is another fact about large cities that helps us to understand why the poor live in cities.

Figure 8.8. Welfare Spending versus Population

Source: Authors.

Note that the largest fraction of redistribution comes from nonlocal sources, which leads us to ask why state and federal governments allocate more resources to the poor in large cities. Note also that the choices local governments make about the focus of local public services, such as police and education, may be more

significant than actual welfare spending. For example, to the extent that urban policing emphasizes civil rights over property rights, it may serve to attract the poor and repel the rich (as the rich with more property presumably care more about property rights relative to civil rights). Thus, we believe that actual welfare spending is a small portion of the full connection between city size and the level of redistribution.

Figure 8.9. Welfare Spending versus Population, Controlling for Poverty Rate

Source: Authors.

This role of redistribution provides us with a second difference between urban and rural poverty. Rural poverty stems ultimately from the low returns to traditional agriculture. Urban poverty comes from government policies that make cities relatively more attractive to the poor. Government policy may be more effective in fighting urban poverty because to a large extent government policy is the source of urban poverty.

Local Redistribution and Growth

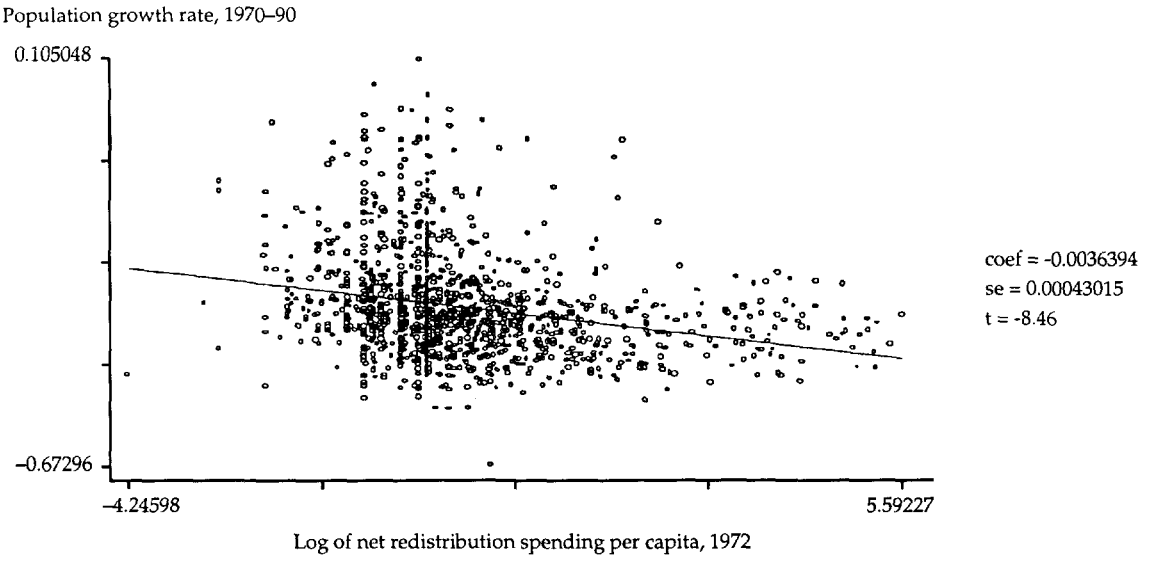
Evidence suggests that local governments that focus on redistribution rather than basic services create unpopular cities. Figure 8.10 shows the connection between the share of city spending on redistribution in 1970 and growth in population between 1970 and 1990. Figure 8.11 shows the same connection when we have controlled for a variety of other urban attributes that may predict growth. These results are given in table 8.1, which also shows the negative relationship between redistribution and local growth.

Figure 8.12 shows that in cities with more redistribution property values are lower. Property values are a primary means of assessing the quality of local government (Gyourko and Tracy 1991). When individuals appreciate the quality of local government, they are willing to pay more to live in those areas. When individuals are unhappy with government, they leave. This urban flight can be seen in outflows of population and declining property values.

A variety of case studies also suggest that local governments that engage in redistribution suffer major outflows. The exodus of wealthy individuals from Coleman Young's Detroit and Marion Barry's Washington, D.C., supports the idea that redistributional city governments can have major effects on their cities. Mayors such as Ed Rendell of Philadelphia, Richard M. Daley of Chicago, or Rudy Giuliani of New

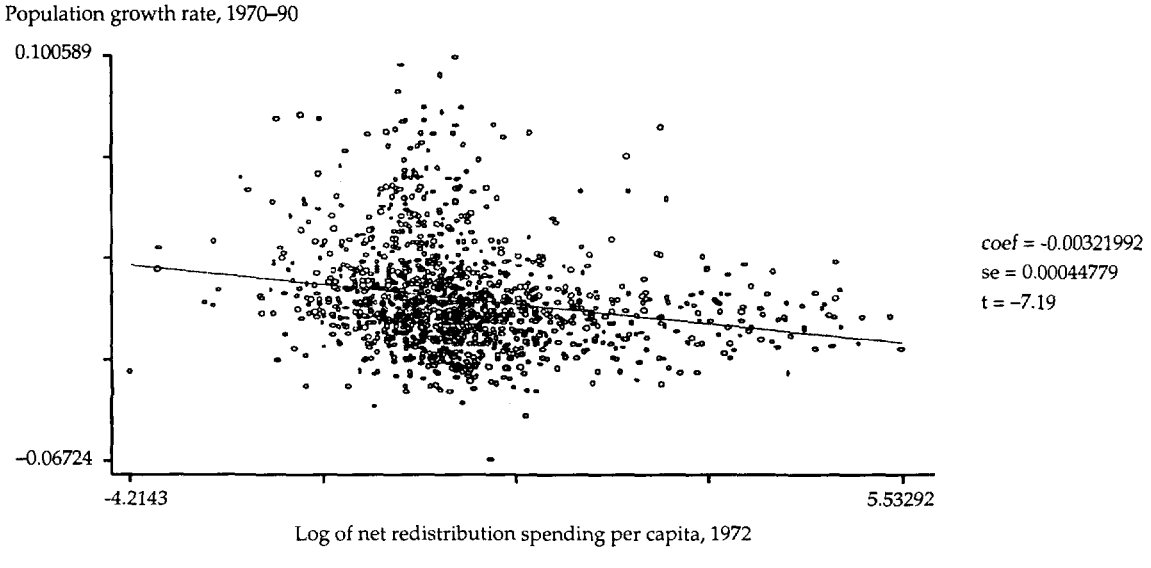
York have emphasized redistribution less and focused instead on the quality of these cities' services. As a result, they have received plaudits and appear in some cases to have stemmed the flight from their cities.

Figure 8.10. Population Growth versus Redistribution Spending



Source: Authors.

Figure 8.11. Population Growth versus Redistribution Spending, Controlling for Education and Poverty



Source: Authors.

A simple view of the world is that in the absence of redistribution, the rich and the poor would live together. The poor would receive no direct redistribution, but would instead receive positive spillovers from

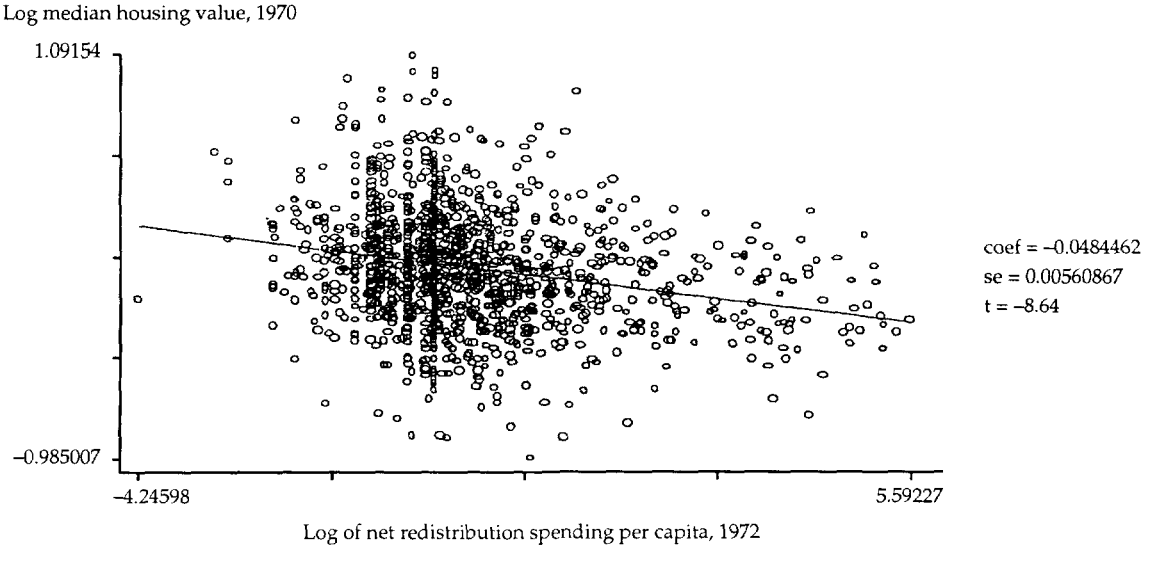
living in a mixed environment. If governments were to attempt redistribution, the rich would flee. Eventually, enough of the rich would leave to significantly reduce the level of redistribution that actually reaches the poor, and the poor would also be deprived of the positive spillovers from the rich. Thus, local redistribution may actually hurt the poor because it exacerbates segregation, and it clearly hurts the rich and the cities.

Table 8.1. City Growth and Government Redistribution Policy
(All regressions include state fixed effects)

Right-hand side variables	*Population growth (annual rate, 1970–90)*	*Income growth (annual rate 1970–90)*	*Median housing price growth 1970–90)*
Percentage of persons graduated from high school (1970)	0.0723	0.0301	–0.0112
	(0.0113)	(0.0040)	(0.0052)
Percentage of persons with a bachelor's degree or higher (1970)	–0.0950	–0.0010	0.0402
	(0.0137)	(0.0048)	(0.0063)
Percentage of persons below the poverty level (1970)	0.0282	0.0064	–0.0071
	(0.0146)	(0.0051)	(0.0067)
Log of net redistribution spending (per capita, 1972)	–0.0032	–0.0007	–0.0012
	(0.0004)	(0.0002)	(0.0002)
N	1,346	1,346	1,346
R^2	0.3312	0.2819	0.7545
Adjusted R^2	0.3054	0.2542	0.7450
Sum of squared residuals	0.6114	0.0754	0.1285
Number of independent variables	50	50	50

Source: Authors.

Figure 8.12. *Property Values versus Redistribution Spending*

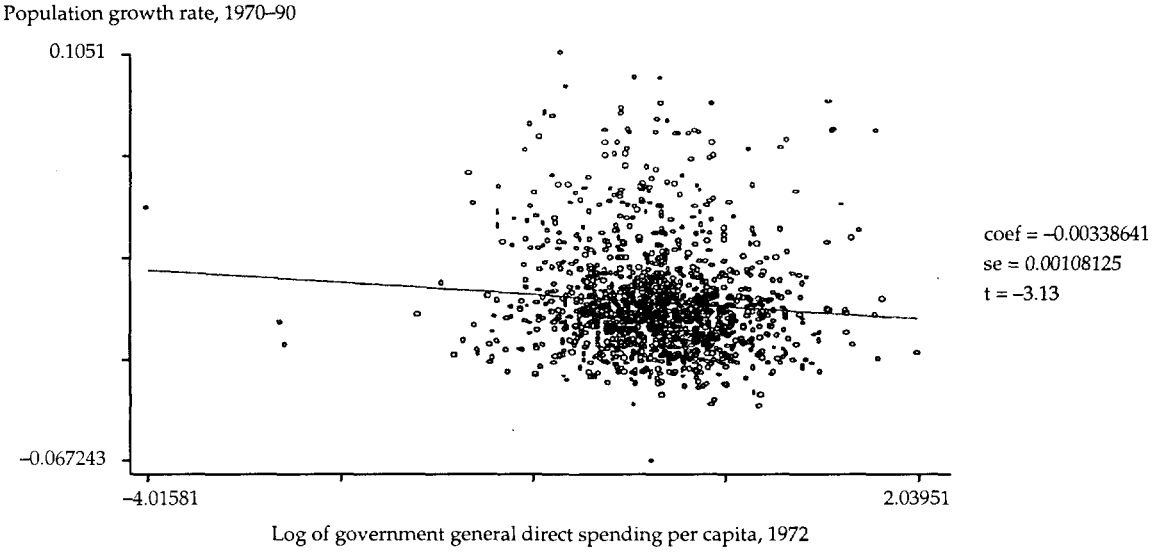


Source: Authors.

Overall Government Size and Growth

The effects of overall government size are less clear. However, it appears that since the 1970s larger local governments have tended to hurt both property values and local growth. Figure 8.13 shows the connection between population growth and overall local government size. Figure 8.14 shows that a drop in property values coincides with the increase in the overall size of government. Glaeser, Scheinkman, and Shleifer (1995) showed that this connection did not occur before the late 1960s, perhaps because local governments were less redistributional in nature prior to the late 1960s.

Figure 8.13. *Population Growth versus Overall Government Size*



Source: Authors.

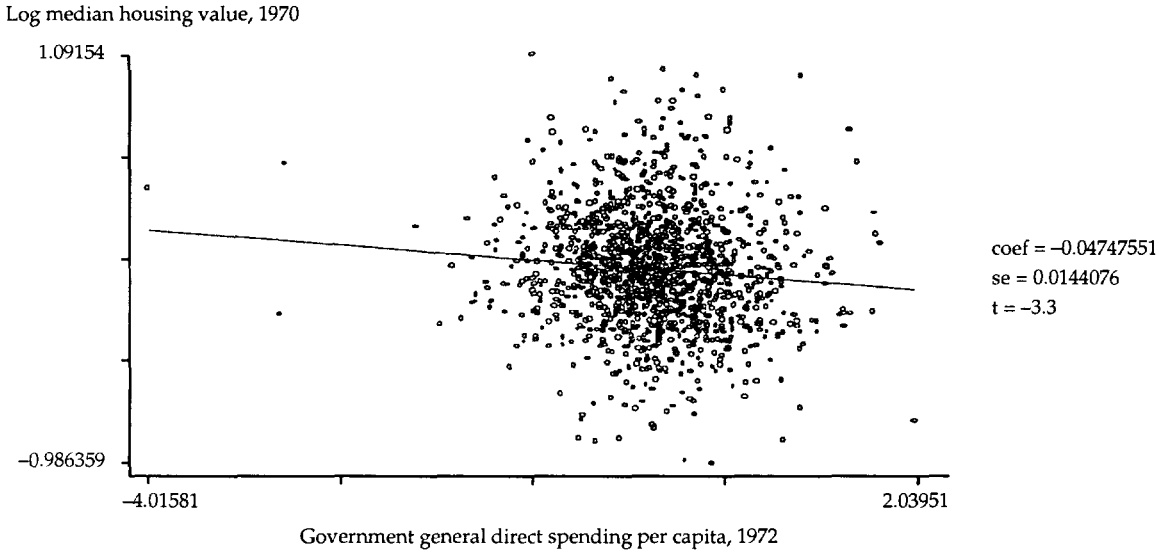
Vigdor (1998) showed the results of tax reform propositions in California and Massachusetts, which is better evidence for the connection between overall government size and property values and local growth. These tax reforms placed limits on the ability of localities to raise income through property taxes, and in many cases led to a somewhat exogenous decline in the size of local government. Those areas where local government declined the most in size had the greatest increases in property value and employment.

One explanation for these phenomena is that local government leaders tend to prefer to run bigger government organizations, and they do so against the interests of their voters. When these governments reduce their size, their localities become more attractive. Thus, one lesson from the U.S. data is that smaller local governments tend to make stronger cities.

Schools and Growth

The ninth and final fact about local government is the connection between schools and population growth. In the United States, school districts rather than cities do a significant amount of spending on schools. Thus, empirical studies show that spending on education makes more sense at the county level than at the city level. To examine the connection between schools and population growth, we have aggregated all spending up to the county level, and this spending includes spending by cities and spending by all school districts.

Figure 8.14. Property Values versus Overall Government Size



Source: Authors.

The basic facts are straightforward. Higher levels of school spending have been strongly associated with growth in county population and income over the past 20 years. In addition, higher levels of spending on education also appear to be linked to higher property values. Successful areas spend more on schooling.

The likely reason for this link is that schools produce human capital, and human capital appears to be the primary ingredient for urban success. Good schools obviously produce well-educated adults, but they also attract adults who care about better schooling for their children. Because the correlation between spending on schooling and adult education is high, we must surmise that well-educated adults generally want to spend more on their children's education. Thus, schooling has two effects: attraction of educated adults and development of educated children. Through the connection between human capital and urban growth, spending on education increases the popularity of urban areas.

Lessons for Central Government

Sound urban policy depends on the actions of both central and local governments. We begin this section with an overview of the appropriate actions that central governments should take. The bulk of these points come from economic theory rather than controlled policy experiments. However, a wide variety of historical examples generally exist to support these ideas.

Governments Should Minimize Spatial Distortions

Modern urban economic theory allows the possibility of a large number of externalities and market failures. Agglomeration economies certainly exist in this world, and in principle they justify government intervention. In many compelling articles, Henderson has argued that interventionist local developers are needed to internalize the various externalities at the local level (see, for example, Henderson 1997; Flatters, Henderson, and Mieszkowski 1974). However, most of these externalities are far too subtle and unpredictable for a central bureaucracy to control. In most cases, national governments should really not be in the business of urban planning.

However, this does not mean that policymakers can simply go home. As discussed previously, governments often distort the location decisions of firms and individuals. They may make it difficult or impossible for firms to do business unless those firms locate in the capital city, where they have access to central government. In addition, governments may redistribute wealth to the poor in central cities only. The net result is that governments create spatial distortions that may skew the entire urban system.

Let us define spatial neutrality: spatially neutral policies require that (a) the government correct for any pre-existing, location-related externalities; (b) the government not explicitly or implicitly redistribute across regions; and (c) the government not favor particular regions with either prices or quantities of government services. This means that governmental correction of congestion- or pollution-related externalities has a role in large or dense cities. In principle, if gains to agglomeration exist, then the government may also engage in positive subsidization of a particular region. It is safest to focus on real, measurable externalities and directly tax the externality-causing actions, rather than tax the region itself.

A second part of spatial neutrality argues against subsidizing particular regions. Basically, no region should receive government resources beyond those it pays for. A useful benchmark is comparing the levels of inflows and outflows of government resources, which should be roughly equal. However, if a region has a particular abundance of the poor these levels may not be equal. In that case, the government may allocate more money to citizens of that region, but spatial neutrality demands that the allocation be tied to the person not to the area. In other words, if transfers are tied to people, then there is no spatial distortion because the people will get the same transfer no matter where they go. If transfers are tied to places, then a substantial distortion will occur and keep the poor in high poverty areas. This point provides a strong argument against the creation of a special urban safety net. Nothing is wrong with national safety nets, but they should not encourage the poor to live in particular areas.

Finally, the government should not make services available in only one area, and it should not subsidize areas with special pricing. This does not mean that outcomes of government services need to be equal. In fact, if location-specific attributes make it difficult to provide government services in a particular region, then these difficulties should be allowed to dissuade migrants from coming to that area. This is true both for exogenous area-specific characteristics and for characteristics related to the competence of government. If a local government is incompetent, it is better that the population leave than the government try to bribe the population to stay.

Although spatial neutrality dictates spreading equally valuable public bundles throughout space, these bundles do not need to be identical. Ideally, locales will respond to different local conditions by providing different types of services. For example, even though redistribution is a national responsibility and the overall level of redistribution should be set at the national level, localities can still play a role in determining the redistribution's exact form.

The first goal of government should be to eliminate spatial distortions. The full implications of this are worked out in Glaeser and Meyer (forthcoming), but the basic ideas can be put forward here. If governments spend on redistribution, then spending per individual should be roughly equal everywhere to ensure spatial neutrality. If this means that the government can buy more in low-cost areas, then this is an advantage of low-cost areas that potential migrants should incorporate into their spatial decisions.

More generally, spatial neutrality means that central government taxes should be tied to people, not places, and central government services should also be relatively equally available. Of course, privatization eliminates the need to worry about most of these things. However, if the government continues to provide basic services, then these services should not be subsidized in some regions and not in others. More importantly, political decisions should not determine whether those services should be available only in some places. If costs preclude availability of services, and no one is willing to pay these costs, then of course a lack of these services is the correct, spatially neutral policy.

Sometimes governments may wish to violate spatial neutrality. In particular, governments often want to populate lightly populated areas that border other countries to shore up governmental positions in border disputes. It is not the place of an economist to argue with such policies (as their purpose is only

political, not economic), but if these policies exist they should at least be clearly acknowledged, and the costs should be evaluated.

Spatial Neutrality Requires Good Institutions

Spatial neutrality does not occur naturally. Certain areas and certain cities will be intrinsically endowed with more political clout than others. This political clout comes from proximity to the capital, or historical factors, or the stronger political organizations of large cities. Government wealth is naturally targeted toward politically powerful areas, and this flow of wealth will end up attracting more people and creating spatial distortions. Good political institutions are the only means of preventing the occurrence of spatial distortions.

Privatization and decentralization are two actions governments can take to stop spatial distortions. True privatization will remove government subsidies from all areas, thus blocking distortions. Decentralization, where each area is forced to live within its own budget, will also diminish the possibility for these distortions. However, there are cases, such as national defense and redistribution policy, where privatization and decentralization make little sense.

In principle, pre-existing distortions or a lack of free market traditions may mean that decentralized, minimalist government will not be efficient. Indeed, most of the evidence we have given refers to U.S. experience, and discussions of developing countries have been more cursory. However, the experience in many countries other than the United States suggests an even greater need for government restraint. While it is usually true that both developing countries and the industrial world have substantial distortions that in principle make government-led corrective mechanisms reasonable, in practice, urban and central governments generally seem to cause more problems than they solve. Calls for massive government intervention almost always tend to underestimate the possibilities for government corruption and incompetence.

For these reasons, national political systems should be set up in such a way that distortions are prevented. For example, the U.S. system of government specifically awards political power to low-density areas. Although this method creates strange distortions where too much central government wealth favors agricultural producers in these areas, it also stems the natural tendency of large cities to garner a disproportionate share of national handouts. More generally, policies that encourage political power in areas that are distant from the capital and that are hard to organize politically will generally result in fewer spatial distortions.

The Advantages and Disadvantages of Decentralization

Decentralization of political authority is one of the great debates of our age, and it matters in this context because of its clear importance for urban policy. The advantages of decentralization are straightforward. As a result of decentralization, individuals can choose their preferred level of public service out of a greater variety of public service levels. Decentralization leads to competition among districts, which drives government to be more disciplined. Decentralization can lead to better connection between voters and leaders, because decentralizing authorities leads to more experimental policy initiatives, which provide information for everyone to follow. Decentralization mitigates the possibility for cross-jurisdictional subsidies that lead to spatial distortions.

Decentralization also has costs. In some government activities, such as defense, decentralization does not make sense. For some activities, government expertise is developed by doing, and in this case, decentralization leads to a lack of knowledge. Although this force is real, we think it is usually overemphasized. When local governments are given authority, they can usually hire experts who can provide sufficiently good advice. Another possible cost of decentralization can occur when jurisdictions take actions that spill over into other jurisdictions, and these spillovers are not incorporated into the

decisionmaking of a localized area. For example, a particular area may cut its welfare levels down to zero, hoping to drive the poor to another area, thus creating a negative externality. This is one example of the reasons why localities should not be given responsibility for redistribution.

In general, decentralization should proceed in most areas where there are not clear returns to scale (the only example that is not debatable is defense) and in areas of redistribution. Redistribution is an exception because certainly externalities exist across districts, including the idea that altruism does not end in your district and the fact that policies that induce the poor to move will have spillovers elsewhere. Furthermore, in redistribution activities, voters who receive the services do not actually pay for them. As a result, the poor have an incentive to move to more generous areas, which is a pure distortion. However, the incentive of general voters to move to areas with better police protection will be tempered by the fact that their taxes are needed to pay for that protection.

The question arises, what is the optimal level of decentralization? No one argues that block-level administration is correct in many cases. However, local provision is more appropriate for many services. In addition, nothing (other than saving on transaction costs) stops many services from being provided at a local level and some services at a nationwide level.

As this discussion should make clear, federalism is not a panacea, but some degree of decentralization is generally beneficial. Ideally, healthy competition will take place between different jurisdictions in a federal system, but the national government will still play a role. The national government may need to monitor some cross-jurisdictional externalities, and it may also need to focus on some countrywide public goods.

Trade and Globalization Affect Cities

As we discussed earlier, a strong interplay exists between trade policies and cities. In general, globalization should increase the importance of cities that are centers of trade and human capital. However, globalization may reduce the importance of megacities, because trade with the outside world may limit the agglomeration economies that lead to megacities, as Krugman and Livas-Elizando (1996) suggest. Alternatively, trade with the outside world may support the growth of cities that specialize in global contact.

International evidence (Ades and Glaeser 1995) supports the idea that open economies tend to have more small cities rather than one megacity. However, this effect will be limited if trade is highly politicized and international firms need to deal with the political powers in megacities to operate. In the absence of these distortions, trade is not likely to support the megacity, and indeed trade can be expected to expand the smaller, more diverse cities that are rich in human capital.

No specific policy approach exists to bring about the integration that is needed to create better urban outcomes. However, micromanagement of capital flows is surely a mistake. The most important policy step a government can take is to ensure that international trade does not need to surmount a large amount of regulation and corruption. Simple, transparent rules that are easily obeyed anywhere in the country are the best method of ensuring a healthy interaction between trade and urban systems.

Spillovers across Cities

While it is generally true that governments should allow cities to progress on their own, in many cases some central government intervention is needed. Transportation networks often need central guidance to ensure compatibility. Indeed, domestic transportation is also a major factor in reducing the amount of agglomeration in megacities. Although much domestic transportation can be privatized, if it is not, it does not make sense for 10,000 separate municipalities to build a national highway system.

A second area where spillovers across districts may occur is in crime prevention. Certainly, a common rule of law is immensely helpful for controlling crime. It would be a nightmare for each city to

have separate laws, as they are very much a public good that provides better returns at the country level. Local policing often involves spillovers, because crime prevention in one area may induce criminals to act elsewhere. The U.S. evidence suggests only low levels of migration among criminals, but this is not supported internationally. For example, in Brazil criminals appear to be much more mobile than they are in the United States.

The presence of spillovers across areas supports a role for government intervention, while spillovers within areas can be handled locally. Thus, pollution-related spillovers that are the result of negative externalities associated with city growth do not need the intervention of the federal government and can be handled by local government.

Lessons for Local Government Behavior from Economic Theory

While the previous advice was aimed at central governments, the next set of lessons is aimed at local officials. In an ideal world, entrepreneurial localities would compete for residents by offering attractive sets of local policies and taxes. The competition among U.S. localities serves as a reasonable approximation of such a world. However, local policies that have proven attractive in the United States may not be appropriate for developing countries. Nonetheless, certain lessons have proven universal.

Local Redistribution Is Disastrous

Rarely should localities be held responsible for alleviating local poverty. In the United States, almost every case of postwar, large-scale urban disaster reveals the presence of a local government that focused more on redistribution to the poor than on providing basic services. New York's fiscal crisis was set off by the redistribution efforts led by John Lindsay. Detroit has suffered from the attempts of Coleman Young to take care of his poor residents. Washington, D.C. has been a center of decent treatment of its poorer residents for more than a century. Many of its troubles are the harvest of that decency. Most striking is East St. Louis, which neighbors larger St. Louis but has more generous welfare payments because it is in Illinois (rather than Missouri).

In cities that have attempted to turn around, basic services have replaced redistribution. Ed Koch and Rudy Giuliani in New York shifted the city's functions away from redistribution toward basic services. Richard M. Daley in Chicago and Ed Rendell in Philadelphia also reduced these cities' redistributive functions. Note that we are not advocating any particular stance on the level of redistribution in the country as a whole. We are simply claiming that local redistribution will have disastrous consequences. While the U.S. examples focus on redistribution from rich to poor, in principle, any sort of redistribution at the city level creates distortions and social losses, because redistribution repels the rich and creates concentrations of poverty. Cross-jurisdictional externalities are associated with the migration of rich and poor, and intrajurisdictional externalities are associated with the poor clumping together in a particular place. The basic rules for efficiency of localities are violated because the people who vote or migrate do not actually pay for what they receive.

The best way to end this type of situation is for the national government to make policies that limit the ability of local governments to redistribute to particular subgroups. Thus, subgroups could sue their localities if those localities spend less on them than they pay in taxes. If localities are allowed to redistribute, then migration will eventually punish those cities that do redistribute, but this will occur at a grave social cost. These cities' infrastructure will be wasted, and the poor that remain will be isolated and neglected.

So far, because of centralization, few countries outside the United States have directly observed the costs of local redistribution. In some cases, effective barriers against mobility protect strong mayors, such as Yuri Luzhkov in Moscow. In other cases, such as in Brazil, where local redistribution has occurred at the state rather than the city level, the costs are much less extreme than those observed in U.S. examples. However, well-meaning cities that attempt to solve local poverty may end up attracting the poor and

exacerbating the rings of shantytowns, such as those surrounding Rio. The intentions of leaders in these cities are laudable. However, we suggest that local redistribution will not actually make anyone better off in the long term.

Indeed, developing policies with respect to shantytowns is enormously difficult. Shantytowns exist in part because of the greater productivity of industrial or urban labor relative to agricultural labor. They also exist because of the failure to protect property rights in urban areas and often because of a greater availability of government-provided services in those areas. Inappropriate government responses include not attempting to eliminate the shantytowns and not attempting to eliminate poverty in the shantytowns beyond national antipoverty policies. Eliminating the major distortions involved in shantytowns, such as more government services in cities, free land, and distortions stemming from added congestion in urban areas, is the appropriate government response. If these distortions are eliminated, then there is no reason not to applaud the continuing urbanization of the rural poor as they seek out a better life near the cities. The focus should be on eliminating distortions associated with the shantytowns and pricing any externalities the shantytowns create. If it is established, for example, that each new resident in a shantytown imposes a negative externality on the city as a whole, then some active policy is appropriate. Either new shantytown residents should be taxed, perhaps by reducing the amount of government services available there, or residents of the rural area should be subsidized, perhaps by increasing the availability of government services.

Human Capital Is One Key to Local Growth

Mayors who want to strengthen their cities will profit from encouraging and creating human capital. We now understand that cities are informational entities and the spillovers of knowledge across people are the forces that make cities healthy. Accordingly, cities will do best to court high human capital individuals and allow them to flourish. In the long term, this sort of policy is more effective than bribing specific firms to keep them in localities.

Attracting human capital can take several forms. First, cities can create strong school systems. Schools both attract and produce skilled individuals. Theoretically, a privatized voucher system seems to be among the most effective means of encouraging good schools. However, we do not preclude the possibility of local government providing high-quality urban schools.

Second, human capital is attracted by legal conditions that allow it to flourish. This means developing a local legal environment that allows entrepreneurship and growth. Limiting local regulations and providing solid protection of property rights are good ideas. A local government that is open to new businesses will also attract human capital, and will thus be able to develop a healthy city.

Third and finally, cities are centers of consumption and production. Many people, particularly those with high human capital, are attracted to cities that are centers of services and consumption. Again, creating a legal environment that is conducive to high-quality living environments is important. Furthermore, public amenities such as parks and clear air determine the quality of life in a city (Kahn 1999). City governments should focus on providing such amenities to keep levels of human capital high.

Combining these points helps to illustrate why cities such as Delhi, which had a considerable advantage in the level of its local human capital, have failed to live up to the promise implied by their skill bases. Even the best human capital in the world will not lead to urban growth unless the city has a political and legal infrastructure that will support such growth. Schooling is not enough. The opportunity for the schooled to take advantage of their skills is also necessary.

A second key problem involving skill compositions facing many cities in developing countries is that the supply of less skilled workers is just too vast to offset with any changes in local policy toward the more skilled. Thus, when a vast agricultural hinterland where labor is less productive than in the urban sector is associated with a city, then that city often becomes crowded with less skilled workers. This is not

necessarily bad from a social perspective. Presumably, migration makes many agricultural workers better off. However, the cities will themselves have major problems, at least temporarily.

One method of offsetting this problem is to allow for the ready formation of new cities. In one model of urbanization, farmers only move into existing metropolises. This is particularly true when those metropolises are receiving handouts from the central government. In an alternative, better model, new cities form to take in some of the growing urban population. When countries allow for the ready formation of new cities, then the problems of overcrowding in existing cities will certainly decline.

Protection of Property Rights Is a Second Key to Local Growth

Berry and Levitt (1996) confirm that people leave cities where crime levels are high. A host of anecdotal evidence also supports the importance of the protection of property rights as a major source of urban (and national) growth. Certainly, property rights are a good way to appeal to high human capital individuals. Berry and Levitt (1996) confirm this by showing that it is the rich, in particular, who leave high crime cities.

While national legal systems make more sense than local systems, the results of decentralized police networks have varied. Brazil employs a mixed system of military patrol police and state-level investigatory police. That country has extremely high crime rates, and most evidence suggests that police corruption and lack of focus on eliminating crime have played major roles in creating this problem. However, Japan also has a national system, but it has been quite effective, in part because of a sensible system of rotating police. This limits the ability of any police officers to form the networks needed for corruption. All in all, we believe that little theoretical justification exists for national police in most areas of law enforcement and that local policing tends to make more sense. The cost, however, of local policing is that it tends to create a greater potential for corruption.

In general, the evidence on law enforcement suggests some linkage between economic inequality and crime and a stronger linkage between deterrence and crime. Social problems, such as single parent families, are also closely linked to crime. Incarceration tends to reduce crime because of both incapacitation and deterrence. One explanation for the extraordinarily high crime rates in Brazil is the low level of incarceration in that country; however, no silver bullet for proper design of police systems exists. Using the latest information technology is clearly optimal, but this also increases fears of a police state.

U.S. attempts at community policing, which means developing closer connections between the police and the areas that they patrol, has had mixed results. It leads to less antagonism between the poor and the police, which is clearly a benefit. However, tight connection between the police and the community can also lead to more corruption. In the absence of any clear best practice, it is probably best to simply give localities control and let them compete for residents, knowing that a primary function of localities is to provide strong protection of property rights.

Note that the privatization of police is often quite difficult. The problem is that enforcing contracts is hard when one groups has guns and the other group does not. However, as long as a basic core of public police exists to enforce contracts, having private policing that supports the public police is quite feasible.

Provision of Basic Local Services

Local governments also do well to provide basic public services efficiently. An old statement of urban economics that is still true today is that the first responsibility of local government is to provide clean water. Clean water, clean air, and good sewage systems are areas that local governments must focus on.

In many cases, basic public services can easily be privatized. For example, the general track record of private provision of trash collection has been quite positive. However, when private providers have a strong incentive to reduce quality to increase profits, then the state must continue to provide these

services itself (Hart, Shleifer, and Vishny 1997). For example, in the case of clean water, we may worry that a private provider will cut corners to shave costs, thereby endangering the entire city.

Overall, whether through private or public providers, good local governments focus on providing high-quality local services. The central government can provide help in this area by making good information about the quality of local services easily available. This information helps people and firms to make informed locational decisions and helps to keep incentives for local governments strong.

Zoning, Urban Planning, and Land Use Restrictions

Certain types of urban planning play a role in strengthening cities. For example, efficient transportation networks require large-scale planning to ensure that traffic is able to move swiftly. However, the basic uses of urban planning have often been vastly expanded in a harmful manner.

Land use restrictions are a classic example of this type of urban planning. These restrictions have a real function in internalizing certain types of externalities. For example, building an industrial plant next to a residential district may cause large-scale externalities that would affect those residents. In most cases, however, quantity restrictions, such as land use restrictions, are less efficient than taxes aimed at getting the firms to internalize behavior. In the case of an industrial plant, taxes could create a situation where the plant is able to reduce its pollution in such a way that it creates few spillovers. In that case, the plant could still locate near the residential district that provides its workers. If zoning alone were used, the plant would not consider changing its technology to eliminate the externality.

In addition, city governments often use zoning regulations to limit migration. Limits for this reason can be efficient if the negative externalities created by marginal migration are sufficiently high. However, this type of limit is more often the result of a political equilibrium where the desires of some residents, such as the landowners who would benefit from selling the land, are sacrificed to the desires of other residents. As such, land use restrictions can often be thought of as a type of undesirable redistribution.

The Role of Local Political Institutions

Which political institutions tend to yield the best outcomes? Many institutions appear to be fairly irrelevant. For example, Glaeser, Scheinkman, and Shleifer (1995) show that the difference between cities that have classic political systems and cities that are run by city managers appears to be small. Rauch (1995) shows that civil service reform has had little effect on urban growth.

However, in general it is worth stressing that good urban government tends to maximize the value of the city's property. The reason for this is that property values reflect how much people desire the community, which in turn is a function of the quality of local government. This is an old point in urban economics (Brueckner 1977) that has only recently been used as a practical guide for urban governance. Glaeser (1996) argues that property taxes tend to give local governments a real stake in keeping property values high because they will have more money to control. As such, using property taxes may be an efficient means to generate good local policies. Alternatively, the pay of local officials could be based on the value of local property.

Certainly Henderson's work on developers is an extreme example of the case of good government maximizing the value of a city's property. The Henderson view, that developers internalize the externalities of cities, holds true because developers own all of the property. Taken to an extreme, this view may be seen as support for private cities run by corporations that own all of the land. This may be an exciting possible path for urban government to take. However, many difficulties are involved in having public services such as safety and health provided solely by private means.

Conclusion

The world's population increasingly lives in cities, and the quality of life for many of the world's people depends on how those cities are run. Good city governments that focus on human capital, public safety, and basic services will lead to better lives. However, when city governments become overly involved in redistribution activities, cities can become centers of poverty and crime. Reforms should focus on ensuring high levels of competition among cities in the areas of public safety, human capital, and basic services and should eliminate the ability of cities to compete using levels of redistribution.

National governments also play an important role in urban development. They must abstain from creating spatial distortions and ensure that the benefits of international trade extend beyond the capital city. To ensure this, they must allow low levels of regulation that make it possible to operate in any city in the country. Finally, they must permit decentralization to encourage healthy competition among cities.

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