

## URBAN FISCAL POLICY

FINANCE 730, BPUB 773, REAL ESTATE 730

Fall, 2011

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Office Hours: Monday: 11:00-12:00; Wednesday: 3:30-5:00; or by appointment.

### Course Outline and Reading List

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

This course will examine the problems of, and prospects for, financing the provision of public services through state and local governments. The course assumes a solid understanding of micro-economics and an ability to apply that understanding to solve *numerically* problems in property valuation, public budgeting, and fiscal design.

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

The primary economic purpose of city-corporations is to protect and enhance a region's competitive advantage -- a.k.a. "agglomeration" economies -- through the provision of important services for residents and businesses: for example, infrastructures such as roads, ports, and communication systems and services with significant consumer interdependencies such as safety, environment and (depending on what you consider to be an "appropriate education") school services as well.

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

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

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

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

**Assignments and Grading:** *There will be two, two hour examinations: One will be scheduled for the end of October in the evening (most likely, October 31) and the second exam will be given on the regularly scheduled date for the class final examination. **You should plan to attend the final examination date. NO EXCEPTIONS. The scheduled date for our final examination is December 15 from 9-11 am.***

In addition, there will be two graded homework assignments which ***you will be expected to complete on your own or with one other classmate.*** Your course grade will be based on the sum of your two examination scores and your scores on the two graded assignments. Assignments will be available on a Wednesday and due no later than 5 PM on the following Wednesday. **Late assignments will not be accepted.**

## CHEATING POLICY

It goes without saying – but let's say it: All students are expected to comply with the University of Pennsylvania's Code of Academic Integrity. It is the policy of the Department, and this course, to immediately fail any student for the course who is in violation of the University's Code of Academic Integrity. ***Cheating in any manner, on a graded assignment or exam, will result in a failing grade for this course. Additional sanctions may be imposed of the Office of Student Conduct.*** The Code of Academic Integrity can be reviewed at:

<http://www.upenn.edu/provost/PennBook/academic> integrity code of

**How to Use the Assigned Readings:** Obviously I want you to read everything. You will, however, find overlap between the articles and class lectures, so to that degree they are substitutes – but not perfect substitutes. Perhaps the best way to use the readings is as a supplement to the lectures, and then when a topic strikes your fancy, read the articles more carefully. *You will be responsible for readings not covered in class.*

There is a text for the class: *Making Cities Work: Prospects and Policies for Urban America*, Robert P. Inman (ed.), 2009 available at the Penn Bookstore. The book is the result of a Wharton Impact Conference held in May, 2007. Each chapter is written by one of the (if not the) world's top scholar on each topic and provides perhaps the best summary of what we now know about each subject. The chapters will provide you with the background knowledge you will need to think carefully about the problems we will address in class.

**Class Lectures:** *Class Lectures* are available for each class and you should bring those lecture notes to class. *I will not have extra copies in class.*

#### GUEST SPEAKERS

We will have two guest speakers this term. This is a chance for us to talk with folks who are doing UFP in the trenches. They will join us for class.

OCTOBER 24: Ms. Gail Sussman, Managing Director, Public Finance, Moody's Investor Services.

DECEMBER 5: Mayor Michael Nutter, Philadelphia. Our last class will focus on the necessity of strong leadership for successful cities. No one better to share his insights with us than Mayor Michael Nutter, Wharton, '80.

#### CLASS READINGS

O. **Overview:** (September 7)

R.P. Inman, "Introduction: City Prospects and City Policies," in *Making Cities Work: Prospects and Policies*.

R.P. Inman, "Chapter 11: Financing City Services," in *Making Cities Work: Prospects and Policies*.

I. **Introduction: Why Cities?** (September 12, 14)

A. *The Cultural City*

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

B. *The Economic City*

E. Glaeser, "Chapter 2: The Death and Life of Cities," in Making Cities Work: Prospects and Policies.

G. Carlino, "The Economic Role of Cities in the 21<sup>st</sup> Century," Business Review, Federal Reserve Bank of Philadelphia, Fall, 2005.

**LECTURE NOTES 1**

II. **Does Public Finance Matter?** (September 19, 21, 26)

A. *Facts*

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

B. *Causes*

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

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

C. *Consequences*

R.P. Inman, "Chapter 11: Financing City Services," in Making Cities Work: Prospects and Policies, Table 11.1 and 11.2 and related discussion.

**LECTURE NOTES 2 & 3**

**REFRESHER: NOTES ON REGRESSION ANALYSIS** (Optional Extra Class) You should read these notes on your own and if they make sense, then you are fine. If not, I will hold 1 or 2 extra sessions – probably 4:30 to 6:00 – to go over the notes. Since we use the results of empirical studies throughout the course, you will be expected to be familiar with the basic approach to empirical analysis and statistical inference in social sciences.

III. **Urban Public Finance: The Ideal** (September 28, October 3, 5, 12, 17)

A. *The Technology of Local Government Services*

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

B. *The Efficient Provision of Local Public Goods Through Fiscal Competition*

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

C. *When Fiscal Competition Fails: Service Inequalities and Urban Sprawl*

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

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

**LECTURE NOTES 4, 5, & 6**

**MIDTERM EXAMINATION I:** Previous Midterm Examination with Answers.

(Tentative Date: OCTOBER 31: 6 PM to 8 PM)

IV. **The Reality of Urban Public Finance:** *Public Employee Unions* (October 19)

**LECTURE NOTES 7**

OCTOBER 24:

SPEAKER: Ms. Gail Sussman, Managing Director, Public Finance, Moody's

**V. The Reality of Urban Public Finance: *Urban Poverty*** (October 26, 31)

J. Currie, "Chapter 8: Poverty Among Inner-City Children," in Making Cities Work: Prospects and Policies.

J. Vigdor, Chapter 7: The Perplexing Persistence of Race," in Making Cities Work: Prospects and Policies.

"Why Poverty Persists," NBER Digest.

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

**LECTURE NOTES 8**

**VI. The Reality of Urban Public Finance: *Crime*** (November 2)

P. Cook, "Chapter 10: Crime in the City," in Making Cities Work: Prospects and Policies.

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

**LECTURE NOTES 9**

**VII. The Reality of Urban Public Finance: *Keeping the Middle Class*** (OPTIONAL CLASS)

**LECTURE NOTES 10**

**VIII. From Reality to the Ideal: Reforming Education** (November 7, 9)

*A. What Works for Better Services: Education*

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

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

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

"Acting White," NBER Digest, January, 2006.

B. *Managing What Works: Education*

R. Murnane, "Chapter 9: Educating Urban Children," in Making Cities Work: Prospects and Policies.

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

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

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

**LECTURE NOTES 11**

**IX. From Reality to the Ideal: Reforming Taxation** (November 14, 16)

R.P. Inman, "Chapter 11: Financing City Services," in Making Cities Work: Prospects and Policies.

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

**LECTURE NOTES 12**

**X. From Reality to the Ideal: Economic Development and City Poverty** (November 21)

R. Blank, "Welfare to Work," CESifo Dice Report, 2, 2005.

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

B. O'Flaherty, "Chapter 18: Urban Economic Development," City Economics.

W. Rybczynski, "Chapter 4: The Design of the Urban Environment," in Making Cities Work: Prospects and Policies.

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

**LECTURE NOTES 13**

**XI. Financing Cities in Developing Economies (November 28, 30)**

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

"Argentina's Provinces Struggle to Stay Afloat," NYTimes, November 17, 2001.

"Camden Recovery Bill Signed, But School Board Challenges It," NY Times, July 23, 2002.

**LECTURE NOTES 14**

**XII. So, You Want to be the CEO? The Mayor's Job**

DECEMBER 5:

SPEAKER: Mr. Michael Nutter, Mayor, City of Philadelphia

*"Old Style" Leadership:*

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

*"New Style" Leadership:*

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

DECEMBER 7: MAKE-UP & WRAP-UP

**SECOND MIDTERM EXAMINATION II: Previous Exams with Answers**

(Scheduled for December 15, 9-11 AM)