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2011

Online at <https://mpra.ub.uni-muenchen.de/33068/>  
MPRA Paper No. 33068, posted 30 Aug 2011 16:14 UTC

# Quasimarket Failure<sup>\*</sup>

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## Abstract

The efficiency of “quasimarkets”—decentralized public goods provision subjected to Tiebout competition—is a staple of public choice conventional wisdom. Yet in the 1990s a countermovement in political economy called “neoconsolidationism” began to challenge this wisdom. The neoconsolidationists use the logic of government failure central to public choice economics to argue that quasimarkets fail and that jurisdictional consolidation is a superior way to supply public goods and services in metropolitan areas. Public choice scholars have largely ignored the neoconsolidationists’ challenge. This paper brings that challenge to public choice scholars’ attention with the hope of encouraging responses. It also offers some preliminary thoughts about the directions such responses might take.

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\* This paper was prepared for a conference on State and Local Public Choice at the DeVoe L. Moore Center at Florida State University, February 17-19, 2011. We thank the participants of that conference, especially Randall Holcombe and Richard Wagner, for discussions about the early ideas that formed this paper.

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# 1 Introduction and Background

The metropolitan governance debate asks the following question: What level of government should provide the public goods and services metropolitan citizens demand? There are two sides to this debate. On one side are the consolidationists who maintain that a single, metropolitan-wide government is the appropriate level of metropolitan public good and service provision. On the other side of this debate are the polycentrists who maintain that a metropolitan governance system that permits multiple, competing, lower-level governmental jurisdictions is the most appropriate means for this purpose.<sup>1</sup> This paper reevaluates the metropolitan governance debate in light of its recent developments—developments that of late have been mostly one-sided, coming overwhelmingly from the consolidationists.

The early consolidationists were part of America's progressive movement (V. Ostrom 1973). As that movement's leader, Woodrow Wilson, (1885) argued in his book *Congressional Government*, America's Founding Fathers were wrong. The modern science of public administration showed that effective government was centralized, hierarchical, and controlled by professional administrators. Thus America's system of checks and balances was "mischievous" and the multiple governance bodies that system entailed was anathema to good governance.

The progressives considered the array of multiple, overlapping jurisdictions supplying public goods and services to various parts of metropolitan areas chaotic and wasteful. According to them, decentralized provision resulted in duplication, was unable to adequately cope with interjurisdictional externalities, and precluded the economies of scale that a centralized provision

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<sup>1</sup> "Superiority" has taken on different meanings in this debate, sometimes relating to efficiency—i.e., how satisfied citizens are with the tax-service bundles they consume—and other times relating to distributional/equity considerations. This paper ignores the latter considerations. It does so not because distributional/equity concerns are unimportant, but rather because we don't believe that economic analysis has much of interest to say about those considerations compared to efficiency ones. Or, at least, we don't have much of interest to say about distribution compared to efficiency. For further background on the metropolitan reform debate and how it shaped the subsequent research program of the Bloomington School of Institutional Analysis, see Aligica and Boettke (2009).

of public goods could enable. The progressive reformers had a straightforward stance: unconsolidated metropolitan areas suffered from “too many governments and not enough government.”

The early consolidationists were largely innocent of public choice considerations. This innocence is understandable. Before the mid-20<sup>th</sup> century many of the ideas that would eventually become central to public choice thinking were either just beginning to be developed or hadn’t yet been developed at all.

But in the 1950s and 60s things changed. A group of scholars who came to constitute the polycentrists pioneered concepts in the context of the metropolitan-governance question that eventually became staples of the public choice diet (see, for instance, Ostrom, Tiebout, and Warren 1961; Bish 1971; E. Ostrom 1972, 1983a; V. Ostrom 1999). The polycentrists’ contribution to the metropolitan governance debate had two major elements. The first element highlighted that what appeared to be a bewildering, chaotic array of multiple, overlapping jurisdictions within metropolitan areas in fact contained order and sense. Whereas the consolidationist perspective tended to treat metropolitan citizens as confronting a uniform, homogeneous problem situation amenable to a uniform, homogeneous government response, the polycentrists pointed out that metropolitan citizens confront multiple, heterogeneous problem situations, necessitating multiple, heterogeneous government responses to address them adequately. According to the polycentrists, the chaos and duplication of multiple, overlapping jurisdictions within metropolitan areas reflected such responses.

The second and complementary element of the polycentrist contribution to the metropolitan governance debate argued that multiple jurisdictions enable interjurisdictional competition. According to the polycentrists, such competition has two important and closely

related effects. First, it permits citizens to sort themselves into differing tax and public good/service packages that better suit their particularized needs. Second, interjurisdictional competition subjects local public authorities to competitive pressures. In doing so it incentivizes them to satisfy citizens' demands lest they lose those citizens—and the tax revenues they represent—to neighboring jurisdictions.

Shortly after Tiebout (1956) and Ostrom, Tiebout, and Warren (1961) made much of this argument informally, Oates (1972) demonstrated a similar result formally with his “decentralization theorem.” This theorem showed that efficient public goods provision occurs at the lowest level of government that internalizes relevant externalities. When strong economies of scale or spillovers are present, public good provision at a higher level of government is more sensible. When they’re not, provision at a lower level of government is more sensible. Thus, as Stigler (1962: 146) described it a decade earlier, “if we give each governmental activity to the smallest governmental unit which can efficiently perform it, there will be a vast resurgence and revitalization of local government in America.”

According to the polycentrists, within a system of federalism their system of multiple, competing jurisdictions permits public goods provision at the efficient level of government since jurisdictions can always “contract up”—remit public good and service provision to a higher level of government—when the characteristics of public goods and services render provision better tailored to this level of government. Indeed, lower-level governance bodies may not even need to do this. In some cases it may be possible for them to realize the benefits of scale economies or internalize externalities simply by contracting for coordinated public good provision with each other.

In contrast, a single, metropolitan-wide government—what the polycentrists dubbed “gargantua”—lacks this feature. Gargantua, the polycentrists pointed out, may be efficient for the provision of public goods and services whose features render them best supplied at higher-levels of government, per the decentralization theorem. But gargantua is inefficient for the many public goods and services that lack such features and thus are best left in lower-level governing bodies’ hands.

The polycentrists’ response to the consolidationists’ arguments presented a model of metropolitan governance akin to the market model. That model of “quasimarkets” contained properties and dynamics analogous to the properties and dynamics inherent in “real” markets, including the efficiencies of the latter.<sup>2</sup>

Polycentrists’ arguments for quasimarkets’ efficiency won the day. By the last decades of the 20<sup>th</sup> century those arguments not only achieved intellectual victory. They achieved policy victory too. Toward the end of the last century public goods and services in metropolitan areas were indeed decentralized, subjecting them to quasimarket competition. Quasimarket efficiency became a conventional wisdom in nearly all quarters of political economics, perhaps nowhere as strongly as in public choice.

In the wake of polycentrist victory, in the 1980s and 90s the consolidationist movement regrouped. These “neoconsolidationists,” or “neoprogressives” as one prominent member of this movement styled them, reoriented in an unexpected way (see, for instance, DeHoog et al. 1990; Lowery 1998, 1999, 2000, 2001).<sup>3</sup> They absorbed many of the major public choice critiques of

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<sup>2</sup> Though, according to Vincent Ostrom, this wasn’t necessarily intended. As he (1972 [1999]: 54) put it, the polycentrists “never intended to develop a strict market model for the supply of public goods and services to individual buyers. Nor did we intend to present an economic analogy based upon classical economic theory. On the other hand, we thought an indication that quasi-market mechanisms were operable in a public service economy would imply important new dimensions for a theory of public administration.”

<sup>3</sup> The neoconsolidationist “movement” appears to be small. To our knowledge it consists of those few authors cited in this paper. Foremost among them is David Lowery who we refer to here.

government. And rather than denying those critiques, they embraced them. Indeed, the neoconsolidationists embraced public choice's government failure arguments and then turned them against public choice arguments in favor of decentralization to suggest that public choice scholars' much-beloved quasimarkets suffered from a variety of quasimarket failures. As neoconsolidationist David Lowery (1999: 38-39) describes it, the neoconsolidationist movement uses "public choice theory itself to both critique quasimarkets and to defend traditional progressive institutions of urban service provision and production."

The neoconsolidationist critique is hard for public choice economists to swallow: it directly challenges the decentralization conventional wisdom. But it's equally hard for public choice scholars to reject. The quasimarket failures neoconsolidationism identifies are government failures—the same sorts of failures public choice economists are fond of leveling at persons who see state intervention as a panacea for so-called "market failures."<sup>4</sup>

Public choice economists' response to the neoconsolidationists' arguments has been virtually nonexistent. As one of the leaders of the neoconsolidationist movement rightly complains, "public choice scholars have hardly recognized the new arguments raised by neoprogressive research" (Lowery 2001: 134). And where they have, their responses have been glancing at best.<sup>5</sup>

Parks and Oakterson (2000) contend that the metropolitan governance debate overdraws the distinctions between consolidation and fragmentation. The evidence suggests that a mixing

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<sup>4</sup> The neoconsolidationist response to public choice addresses a range of quasimarkets including Tiebout competition, contracting, and vouchers (see, for instance, Lowery 1998). We limit our attention to Tiebout competition since we take that model to form the core of the public choice argument for decentralization.

<sup>5</sup> The neoconsolidationists have written predominantly in the public administration and political science literatures, as opposed to the economics one. This is likely a large part of the reason why public choice scholars have haven't responded to their critique. Public choice scholars haven't been aware of it. As we indicate below, in light of this fact, one of this paper's main goals is to bring the neoconsolidationists' arguments to the economics literature's attention and to public choice scholars' attention in particular.

between the two is optimal.<sup>6</sup> McGinnis (1999: 18) notes that Lyons and Lowery's (1989) findings supportive of neoconsolidationist arguments don't contradict polycentrists' earlier findings because the "latter focused specifically on public evaluation of police performance, whereas Lyons and Lowery paint on a broader canvas that encompasses a wide range of public services." The implication of these statements is that perhaps the consolidationist-polycentrist disagreement has just been a misunderstanding.

A few public choice scholars have conducted empirical studies that claim to find support for various polycentrist claims against neoconsolidationist ones. Schneider (1986, 1989) tests fragmentation's effects on municipal government budgets' and services' growth. He finds that fragmented regions experience slower increases in local government expenditures and services. Oliver (2001) finds that smaller government encourages higher civic participation levels. And Carr and Feiock (1999, 2003) find that consolidation doesn't enhance development. These studies address particular aspects of neoconsolidationist arguments, albeit often indirectly.<sup>7</sup> But none engage neoconsolidationism's core, overarching conceptual challenges to polycentrism or address the neoconsolidationist critique directly.

Given public choice scholars' near silence in the face of the neoconsolidationist critique, this paper has two goals. First, we aim to bring the quasimarket failure arguments of the neoconsolidationists to members of the public choice community who are unfamiliar with them. Our hope is that in doing so members of that community will be encouraged to think seriously

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<sup>6</sup> As Ostrom and Parks (1999: 292) conclude, "Neither a single layer of small production bureaus nor a single large bureau appears to have as high a performance potential as a complex mixed system with many smaller agencies producing some services and some intermediate and large agencies producing others."

<sup>7</sup> A related literature addresses centralization's effects on prosperity. See, for instance, in this issue, Holcombe and Williams (2011) and Buser (2011), and the papers referenced in the latter, especially Feld, Zimmerman, and Doering (2003), Feld and Dede (2004), and Feld, Baskaran, and Schnellenbach (2008). Our point here isn't that public choice scholars have ignored benefits of centralization vs. decentralization entirely. They have examined this issue on several dimensions. Rather, it's that they haven't addressed the neoconsolidationist arguments directly.

about the neoconsolidationists' challenges and offer some response to them. This paper's second goal is to sketch some preliminary thoughts about what kinds of potential responses to those challenges public choice scholars might consider.

## 2 The Neoconsolidationist Critique: Quasimarket Failure

The neoconsolidationists highlight three important sources of alleged quasimarket failure in the context of Tiebout competition: (1) government monopoly failure, (2) political information failure, and (3) unintended consequence failure.<sup>8</sup>

According to the first failure, barriers to jurisdictional entry and anticompetitive jurisdiction behavior under polycentric governance thwart the interjurisdictional competition central to quasimarket effectiveness. According to the second failure, polycentric governance produces politically uninformed citizens, precluding interjurisdictional competitive pressures key to quasimarket success. According to the third failure, interjurisdictional competition under polycentric governance fails to sort citizens according to their tax and service preferences and instead sorts them along unintended, undesirable lines, such as race. Each of these failures short circuits a primary mechanism that drives quasimarket efficiency in the polycentrist model. Further, in some cases at least, polycentric metropolitan governance allegedly exacerbates these failures compared to what consolidated metropolitan governance could achieve.

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<sup>8</sup> Our description of these failures in what follows is based on our rendering of the quasimarket failures in Lowery (1998, 1999). The reader should note two items with respect to our descriptions. First, the names of the failures we discuss are our own rather than the terms Lowery uses. Second, and closely related, our descriptions attempt to render the failures Lowery discusses from a "public choice perspective." That is, we attempt to describe the neoconsolidationists' quasimarket failure arguments in terms that would make them appear most sensible and, presumably favorable, from a public choice economist's perspective. In doing this we hope to (a) give the neoconsolidationists' arguments the "best-case" reading from a public choice economist's perspective and to (b) make those arguments as accessible to public choice economists as possible. If we've done violence to the neoconsolidationists' basic arguments in our rendering, we apologize to them and note that such violence has only been done accidentally and in an effort to be as charitable as possible to their arguments in presenting them to the public choice literature.

## 2.1 Government Monopoly Failure

In the traditional Tiebout model there are no barriers to jurisdictional emergence. If existing jurisdictions fail to supply the appropriate tax and public good package a subsection of citizens desire, a new jurisdiction that satisfies their desires emerges for this purpose. The local governance quasimarket is fully contestable. Thus the threat of entry by a competing jurisdiction looms ever present even where only a small number of jurisdictions might exist, pressuring existing jurisdictions to faithfully satisfy citizens.

The neoconsolidationist critique points out that these assumptions in the traditional Tiebout model are fiction. In real-world quasimarkets there are significant legal barriers to incorporating or otherwise establishing a new jurisdiction. And there are legal limits to the kind of local governance package that jurisdictions can offer.

Neighborhoods of citizens can't simply choose to secede from the greater jurisdictional areas they reside in and create their own jurisdictions. Similarly, federal law prohibits groups of citizens who, say, decide that they want to create a jurisdiction that permits crack-cocaine production and consumption to keep their police-services bill down from doing so. These legal barriers to entry in metropolitan quasimarkets dampen (though don't eliminate) the competitive forces that would enable sorting by tax/public good packages and discipline local governments.

Further, according to the neoconsolidationist critique, existing jurisdictions introduce policies that stifle quasimarket competition. One common way of doing so is for a jurisdiction to introduce strict land use regulations. Such regulations help insulate neighboring jurisdictions from competition from the regulation-introducing jurisdiction by making it prohibitively costly for low-income citizens in neighboring jurisdictions to exist their current communities and enter the regulated one (see, for instance, Hill 1974; Neiman 1976). Low-income citizens in

neighboring jurisdictions can't establish their own, new jurisdictions because they lack the minimum viable tax base to do so, existing jurisdictions having monopolized that base (Lowery 1998: 146).

Notably, such anti-competitive jurisdictional policies don't aim to capture a larger "market share" for the regulation-introducing jurisdiction. They don't aim to attract more citizens, preventing those citizens from moving to competitors. They aim to do the reverse: to prevent more citizens from moving to the jurisdiction that introduces anti-competitive policies.

Such behavior is puzzling from the perspective of the traditional Tiebout model in which, at least up to their congestion points, jurisdictions seek to attract citizens, not deflect them. Indeed, such anticompetitive behavior is precluded in that model, which assumes that local governments care only about tax revenues.

The neoconsolidationist argument suggests that this assumption bears little resemblance to reality. In reality, local governments care about things besides tax revenues, such as the racial or income heterogeneity of their communities. Thus they may engage in activities that serve these ends at the expense of expanding their number of citizens and thus their tax base, such as introducing land-use regulations that mute interjurisdictional competition.

## 2.2 Political Information Failure

In the traditional Tiebout model citizens have perfect information about the alternative tax and public good packages that competing jurisdictions offer. They also have perfect information about local government actors' behavior in those jurisdictions. Thus citizens are aware if better tax and public good packages exist elsewhere. Further, citizens know which local government

actors (or jurisdictional units) deserve credit or blame for outcomes that satisfy or dissatisfy them where multiple overlapping jurisdictions supply the public goods and services they consume.

The neoconsolidationist critique points out that in reality citizens' information in the political realm is highly imperfect. Few citizens are aware of the differences between the package their current jurisdiction provides them, let alone the packages that potentially competing jurisdictions offer. In fact, few citizens are even aware of how the tax price they pay for their current package differs from the tax prices that potentially competing jurisdictions offer. For example, in one study Teske et al. (1993) found that only 20 percent of Long Island citizens surveyed could identify whether their school district's expenditures were above average, about average, or below average compared to the seventy-one districts in their county. These citizens were ignorant of their jurisdiction's tax price despite the fact they had access to that information in annual budget referenda.<sup>9</sup> If citizens are ignorant of even the most basic elements of the tax and public good packages they confront in the quasi-marketplace, it's difficult to see how interjurisdictional competition in that marketplace could be effective.

According to the neoconsolidationists, polycentrism exacerbates this informational deficit by introducing ambiguity about which of the overlapping jurisdictions citizens reside in is providing the various public goods and services citizens consume. When the county provides some public services, the city and special districts others, and neighboring jurisdictions perhaps others still, citizens have difficulty identifying who's responsible for services they're pleased with and who's responsible for those they're not.

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<sup>9</sup> Although Lowery (1998: 148-149) points to this study as evidence of political information failure in quasimarkets, one should note that the study's authors are proponents of polycentric governance and interpret their findings as evidence of polycentric effectiveness instead of failure. Teske et al.'s (1993) point is that citizens' political information, though low, improves with the amount of time citizens spend in the community. This highlights a learning process under polycentrism.

This confusion is less severe under consolidation where a unitary public-good provider ensures that that provider's identity is clear. For example, in a study of Jefferson County, Kentucky, Lyons and Lowery (1989) found that citizens in Tiebout quasimarkets had difficulty identifying whether their city was the provider of eleven basic public services. "Contrary to expectations based on the public-choice [Tiebout] model, citizens of small, rather homogenous government jurisdictions operating in highly fragmented systems are not significantly better informed, more efficacious, more participatory, or more satisfied than their counterparts living in consolidated settings" (1989: 540).

According to the neoconsolidationists, polycentrism also exacerbates political information failure by providing self-interested, local government actors a means of manipulating citizens' information for private purposes (Lowery 1998: 152-3). When metropolitan governance is polycentric, incompetent or corrupt public-good providers can shift blame for their failures to other public-good providers servicing the same public. Similarly, they can steal credit for successes. The result is again that citizens lack the basic information they require to make jurisdictions compete. Because of information failure, citizens may wrongly punish one jurisdiction through migration or wrongly reward another through entry. This prevents citizens from sorting according to tax/public good packages effectively or holding local governments accountable along the lines quasimarkets' proponents envisage.

## 2.3 Unintended Consequence Failure

In the traditional Tiebout model, competing, local public-good providers offer alternative tax and public good packages to citizens, permitting citizens to sort themselves by their tax and public good demands efficiently. According to the neoconsolidationist critique, in reality citizens'

jurisdictional demands vary in ways other than their according to their preferences for taxes and public goods. This confounds policy objectives grounded in facilitating citizen sorting on the basis of tax and public good packages and produces undesirable, unintended consequences.

To the extent that quasimarket competition facilitates sorting, it produces sorting along those dimensions that citizens value most. In principle this is the very feature of quasimarkets that makes them desirable from an efficiency perspective. However, when the dimensions citizens value most clash with the ones that quasimarket creators—public policy creators—intend citizens to sort along, an important problem from a public policy perspective results.

According to the neoconsolidationists, quasimarkets permit citizens to substitute their own preferences for those of public policy creators. For example, public policy creators may decentralize education provision with the hope of sorting citizens on the basis of their education needs. However, since it's citizens who are the quasimarkets' consumers, and thus citizens who ultimately do the sorting, citizens may use decentralized education provision to satisfy their preferences for racial segregation instead of education needs. In this case school choice doesn't enhance education quality from policymakers' perspective. It undermines that quality.

Consolidation can prevent such “preference substitution” and the undesired, unintended consequences that result by making it harder for citizens to sort themselves along dimensions that public policy creators object to. For example, consolidated education would prevent parents from sorting based on preferences, such as for race, that contradict policymakers’ education policy goals.

### 3 Modes of Response

The discerning reader will note that the neoconsolidationists' quasimarket failures are traditional, public-choice proffered government failures. The applications are different. But the basic reasoning is the same.

For example, public choice scholars are well aware of the government failures that political monopoly generates. They make this argument themselves when they argue that political competition is limited in plurality elections, when they argue that the national government's monopoly requires constitutional constraints to prevent political predation, and when they argue for the abolition of state-created barriers to entry in industry.

Similarly, public choice scholars are well aware of the government failures that politically ignorant citizens generate. They make this argument themselves when they argue that rational ignorance prevents citizens from disciplining politicians, and when they argue from the logic of special interest groups.

Public choice scholars are also well aware of the government failures that politically created unintended consequences generate. They make this argument themselves when they argue that regulatory capture is likely to follow regulatory efforts, when they argue that minimum-wage laws facilitate racial discrimination, and when they argue that efforts to protect endangered species may lead to those species destruction instead of their preservation.

The logic of government failure in the neoconsolidationist line of argumentation is familiar. But the application and result of that logic is foreign: government failure plagues and may even be exacerbated by decentralization. What's going on here?

What's going on is that quasimarkets are *quasimarkets*—not markets. Although the neoconsolidationists don't characterize their arguments this way, a reasonable public choice

rendering of these arguments might characterize them as follows: governments fail *and that includes local governments*. The source of the quasimarkets' failure doesn't lie in their "marketness." It lies in their "quasiness." The quasi part of quasimarkets is the governmental part of them. And it's from this part of them that government failure flows.

Curiously, public choice scholars have tended to ignore the quasi part of quasimarkets, proceeding instead in discussions of quasimarkets as though quasimarkets were immune from such failure and that only centralized governments suffered from it. Thus in the traditional public choice perspective we find an important tension. Public choice scholars have a list of government failures describing in myriad ways why "political markets" are inefficient. But they also have a list of quasimarket virtues describing "political markets'" successful operation at more local levels in ways that seem to deny their list of government failures.<sup>10</sup> Donald Wittman (1989, 1995), who famously rejects traditional public choice government failure claims and instead argues that "political markets" are efficient, is perhaps the only scholar to note this peculiar and problematic inconsistency. "Tiebout (1956)," Wittman notes, "claimed that competition among localities creates efficient local governments but," oddly, he "did not believe that his model applied to national governments" (1989: 1395).

Perhaps ironically, the neoconsolidationists' arguments for quasimarket failure and desirability of centralizing metropolitan governance bring this tension in public choice thinking into focus. It's precisely by leveraging this tension that the neoconsolidationists' arguments find their force. That tension is what enables the neoconsolidationists to turn public choice scholars'

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<sup>10</sup> Though in their analysis of quasimarkets under socialism public choice economists avoided this tension by acknowledging quasimarket failure. As Buchanan (1969) and Nutter (1983) recognized, the problem with the quasimarket model of socialism that Lange and Lerner developed was precisely that the idea of "markets" without property was a grand illusion. It didn't matter whether the government setting of prices took place in a decentralized or centralized administration. In either case the prices didn't emerge from individuals valuations and their exchange relationships based on those on those valuations. As Buchanan and Nutter correctly noted, the problem with the quasimarket model of socialism lied precisely in the fact that the "market" it employed was a quasimarket rather than a real one. See also, Boettke (1993).

government failure logic against those scholars' argument for polycentric public good provision grounded in the supposed benefits of inter-governmental competition.

A successful response to the neoconsolidationist critique therefore requires a solution to this tension in traditional public choice thinking. Below we offer three potential approaches of public choice response to the neoconsolidationists along such lines.

### 3.1 “Consolidation Fails Worse”

The first potential mode of response to the neoconsolidationist quasimarket failure critique that avoids the public choice tension described above would acknowledge quasimarket failures but maintain polycentrism's *relative* superiority to centralization. Quasimarkets fail. But consolidated governance fails worse. This kind of response admits that perhaps public choice has been too hasty in lauding the benefits of quasimarkets. But it rejects the neoconsolidationist argument, or at least implication, that consolidation could do better.<sup>11</sup>

This kind of response is probably the most comfortable for public choice scholars. It requires no fundamental shift in their thinking: governments still fail; and polycentrism is still preferable to consolidation. Though it does require them to adopt a less sanguine attitude toward interjurisdictional competition.

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<sup>11</sup> For example, Schneider and Teske (1993) and Schneider, Teske, and Mintrom (1995) argue that polycentrism permits a level of experimentation that consolidation would preclude, permitting public entrepreneurs to learn under polycentrism but not under consolidation. Flexible systems, such as polycentrism, they argue, “allow innovations to develop and be tested, thereby increasing the likelihood of successful adaptation to changing circumstances. Less flexible systems, whether they are economic systems, individual business firms, or governments, may be rendered ineffective or even obsolete in a rapidly changing environment. The American system of multiple local governments is often criticized as fragmented. But this very system creates multiple opportunities for entrepreneurs who then help local governments develop flexible and innovative responses to the ever changing environment” (1995: 220-221). More generally the empirical literature in public choice referenced in note 7 has addressed the “consolidation fails worse” argument, albeit indirectly, in a variety of other ways. Our point here isn't that this empirical literature is irrelevant to making the consolidation fails worse argument, but rather that, for reasons we describe below, to be compelling, public choice also requires theoretically persuasive reasons for why consolidation might fail worse, which the existing literature has done comparatively little to provide.

To make this argument persuasively, public choice scholars would need to explain why, exactly, polycentrism fails less severely than consolidation. Merely pointing to the fact that more governance options, which even the admittedly imperfect competition of polycentrism provides, are better than fewer options won't do. The neoconsolidationists' arguments suggest reasons to think that polycentrism's larger number of options may produce weaker inter-governmental competition than consolidation's fewer options. More competition may be desirable. But more competition isn't the same thing as a greater number of governmental units. *Effective* competition—the kind that permits citizen sorting according to tax/public good preferences and political discipline—is a function of the number of competing units *and* the “quality” of that competition. The neoconsolidationist point is that these things may move in opposite directions.

For instance, according to the neoconsolidationist view, more jurisdictional options exacerbate the sources of political information failure under polycentrism compared to consolidation (Lowery 1998: 150-154). With less information, citizens under polycentrism are less able to hold local governments accountable and less able to make voting decisions with their feet that correspond to their tax/public good needs. In contrast, if governance were consolidated into a single, metropolitan-wide government, those information imperfections would be less severe. The absence of lower-level jurisdictions would prevent competition and thus sorting and political discipline at lower levels. But it might strengthen inter-governmental competition *overall* by subjecting consolidated, metropolitan governments to stronger competition between each other since under consolidation citizens would have a better idea about which political agents to reward or punish through the voting booth or migration and when to do so.<sup>12</sup>

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<sup>12</sup> Bish (1999) offers a different kind of informational failure argument—one that centralized governance suffers from but polycentrism doesn't. According to his argument, interjurisdictional competition produces knowledge through policy experimentation that could never be generated in a consolidated system, which would prevent such experimentation.

The neoconsolidationists may be wrong in making this assessment. But their argument is plausible and so deserves consideration. In terms of inter-governmental competition, more may not be preferred to less. As Richard Wagner (2007: 156) points out, if public choice scholars believe that, to quote Mark Twain, “no man is safe when the legislature is in session,” it’s reasonable to wonder why they would think that multiplying the number of legislatures would improve things. All this is simply to say that the “consolidation fails worse” argument requires elaboration theoretically and empirically to render it a convincing response to the neoconsolidationist quasimarket failure argument.

With respect to other quasimarket failures the neoconsolidationists identify, for example government monopoly failure, it’s less clear how polycentrism might fail worse than consolidation. Barriers to entry in creating local jurisdictions may be significant. But it’s hard to imagine how those barriers could be higher than they are under consolidation. In raising those barriers to their maximum by completely disallowing the emergence of new jurisdictions, consolidation raises them infinitely. This seems like a reasonable public choice response.

But neoconsolidationists may reply by connecting to one of their other quasimarket failures, for instance unintended consequence failure. It’s true, they might argue, that polycentrism suffers from less of a monopoly problem than consolidation. But since in practice citizens under polycentrism sort along dimensions that aren’t intended by polycentrism in the first place—namely race—the greater monopoly failure of consolidation, which alleviates such objectionable sorting, comes at little, and possibly even a negative, cost to consolidation. The neoconsolidationist position would argue that the limited interjurisdictional competition polycentrism permits is too limited to permit significant sorting along the desired dimensions—

tax and public good packages—but sufficient to permit significant sorting along undesired, objectionable dimensions, such as race.

Thus polycentrism gives us the worst of both worlds. Consolidation, on the other hand, gives us the worst of only one. Indeed, it might not even do that. To the extent that government monopoly failure only constitutes a failure because it weakens inter-governmental competition, a monopoly in metropolitan governance under consolidation may not constitute a failure at all—at least if one buys the neoconsolidationist argument about how consolidation may strengthen inter-governmental competition discussed above.

Whether such a neoconsolidationist defense would “go through” is unclear. Even if it would, there may very well be effective public choice responses to this line of argument. Our point isn’t that the neoconsolidationist position is correct. It’s merely that this position can’t be dismissed out of hand. Simply asserting that polycentrism, while subject to government failure, is less prone than consolidation because it permits a larger number of governance units isn’t enough. Public choice scholars need to do more than merely appeal to the fact that polycentric governance systems give citizens more options than consolidated ones.

### 3.2 “Going Wittman”

A second way of responding to the neoconsolidationist quasimarket failure arguments that avoids the public choice tension described above would be to deny that quasimarkets fail. It’s not hard to think of particular responses along these lines for several of the failures the neoconsolidationists point to. Donald Wittman (1989, 1995) has written extensively on the efficiency of “political markets.” His arguments, which he develops in the context of national “political markets,” could be deployed to defend “political market” efficiency in local

governments too. For example, political information failures may not be as severe as the neoconsolidationists suggest because citizens can rely on information-economizers, such as political-agent party identity, to help them make political decisions.

Other market-like responses in the local political realm may help to alleviate other quasimarket failures neoconsolidationists identify. For example, in response to government monopoly failure, public choice scholars might argue that low-income or minority citizens who desire to set up their own jurisdictions but lack the tax base to do so can attract the requisite tax base by offering businesses in neighboring districts superior tax/service deals. In this way they're able to circumvent the competition-muting regulations of existing jurisdictions.

A different tact would be required to address quasimarkets' alleged unintended consequence failure. Public choice scholars might argue that however citizens choose to sort themselves in quasimarkets, such sorting is welfare enhancing since citizens desire it. Stated differently, the preferences of policy creators—quasimarket designers—don't matter. What we want in a governance system is for localities to reflect citizens' desires, whatever those may be. It's lamentable if citizens desire racial segregation. But the purpose of polycentrism is to give citizens what they demand, not to sort them according along the dimensions policymakers see fit, however noble those dimensions may be.

These kinds of responses to the neoconsolidationists have several drawbacks. First, many, if not most, public choice scholars will be reluctant to "go Wittman" in reply to the neoconsolidationists' challenge. And with good reason. Going Wittman would require them to forsake the government failure arguments central to the way they view political economy. Presumably these public choice scholars haven't gone Wittman already because they object to his political efficiency arguments (see, for instance, Rowley 1997). Thus it's unclear how they

could embrace those arguments in the context of defending polycentrism in the metropolitan governance debate.

A second drawback of this line of response is that it, as suggested above, it may require public choice scholars to embrace a repugnant conclusion: racial segregation is a permissible quasimarket outcome; and a system that facilitates such repugnant sorting is fine as long as it comports with citizen demands. Some public choice scholars may feel comfortable taking this line. It's certainly consistent with economics' traditional notion of consumer sovereignty and value-free approach. However, there's at least some evidence to suggest that some public choice scholars in the metropolitan debate feel uncomfortable embracing the repugnant conclusion, rendering this mode of response problematic.

For example, in reply to consolidationist claims that quasimarkets facilitate racial segregation, Elinor Ostrom's (1983b: 95) response wasn't to argue that this outcome was fine because we don't care what dimension polycentric governance sorts citizens on as long as citizens choose that dimension. Instead her response invoked an application of the "consolidation fails worse" mode of reply discussed above. She argued that while racial segregation does plague decentralized metropolitan areas, it plagues centralized areas equally severely. Thus consolidationists can't use racial segregation to argue for centralization's superiority to polycentrism.

### 3.3 “Bite the Bullet”

A third kind of response to the neoconsolidationists' quasimarket failure arguments that avoids the public choice tension discussed above would be for public choice scholars to “bite the bullet”—accept quasimarket failure and at least the possibility that consolidation may be a

superior mode of metropolitan governance. This kind of response has the obvious benefit from public choice scholars' perspective of permitting them to remain true to their thinking about government failure in general. Indeed, it would render their thinking about such failure more consistent, permitting them to extend it to local governments as much as national ones.

If biting the bullet sounds too difficult, the prospect of doing so may made easier by recalling that even some of polycentrism's staunchest supporters recognize centralization's superiority in some cases.<sup>13</sup> For instance, per the decentralization theorem, polycentrists acknowledge that larger-scale provision might be necessary to internalize externalities or exploit scale economies (see, for instance, E. Ostrom 1983b; Parks and Oakterson 1989; Hill, Wolman, and Ford 1995). However, they typically view these as "special cases" that don't undermine polycentricism's superiority in the large majority of situations.

Admittedly, then, biting the bullet would require going much further than this. It would require removing polycentricism as public choice scholars' default metropolitan governance form and embracing the idea that decentralization's failures are, at least in principle, as severe as centralization's failures, and perhaps even more so. Biting the bullet therefore has the drawback of requiring public choice scholars to consider the possibility that they have to leave their traditional arguments in favor of polycentrism behind.

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<sup>13</sup> Thus the superiority of centralized vs. decentralized provision may depend on, for instance, the type of good in question and the type of government production involved. This suggests the importance of empirical work, such as that pointed to in notes 7 and 11, to establish in which particular cases one method of provision is superior to another. However, as indicated below, it also suggests the necessity of dropping the default position of decentralization's superiority and developing theoretically compelling reasons for decentralization's *or* centralization's empirically observed superiority in particular cases.

## 4 Another Way Out? Taking the Quasi out of Quasimarkets

We don't want to claim that three kinds of public choice responses to the neoconsolidationists' quasimarket failure arguments we describe above are necessarily the only ones that avoid the public choice tension. We highlight these modes of reply because they seem to us like the most straightforward ones that both address the neoconsolidationists' overarching conceptual claims explicitly and do so in a way that avoids the inconsistency of simultaneously holding strong views about government failure and strong views about quasimarket superiority rooted in logic that seems to require political efficiency.

Public choice scholars much cleverer than us may see glaring problems with various elements of the neoconsolidationists' quasimarket failure arguments that render them internally contradictory, show them to be based on faulty economic logic, or demonstrate that those arguments are obviously wrong from some other reason. It seems to us that this is rather unlikely unless public choice scholars are willing to say that some of their favorite government failure arguments suffer from the same flaws, in which case public choice scholars are back again in the position described above requiring them to abandon these government failure arguments. Indeed, it's precisely this fact that gives the neoconsolidationists' arguments against decentralization their strength. But we're very much open to the possibility that we're mistaken. And, as we pointed out in the introduction, one of this paper's main goals is to hopefully elicit responses from public choice scholars along precisely these lines.

Regardless of one's evaluation of the merits of specific neoconsolidationist arguments and the styles of potential response we sketch, we hope the reader will agree that, at a minimum, there's something to the tension in public choice we discussed above—governments failing and yet being efficient in models of local, inter-governmental competition—that the

neoconsolidationist argument brings to the surface. If the reader agrees with this, that means that thinking about the neoconsolidationist argument is a valuable exercise—one that would help sharpen for public choice scholars what, exactly, their arguments about government failure and quasimarkets are grounded in—and thus an exercise worth engaging in.

In concluding our discussion, we'd like to suggest one other potential "way out" of the neoconsolidationist line of argumentation—a way we favor because we think it may be the closest response to the "correct" one. That response goes something like this. Governments fail. As the neoconsolidationists correctly point out, that means local governments fail too. In acknowledging as much, this final kind of response bites the bullet. But it doesn't stop there.

The neoconsolidationist conclusion from quasimarket failure is to suggest that metropolitan governance be centralized. But an alternative conclusion would be to suggest that metropolitan governance be decentralized more radically—indeed, that it be decentralized altogether. We're not talking about "contracting out" local services, which is a traditional element of quasimarket thinking. We're talking about getting the government out of local governance completely.

As we discussed earlier, it's the political part of quasimarkets—the quasi part—that leads to quasimarkets' failures. Thus a different and perhaps more effective way of avoiding these failures than consolidation is to abandon the quasi part of quasi markets—to make them genuine markets by putting metropolitan governance services exclusively in the hands of private actors producing governance and competing for governance consumers in a genuine governance marketplace.

Both sides of the metropolitan debate have ignored this possibility. They've removed it from the menu of options at the outset by assuming that local public goods and services are in

fact *public* goods and services. Under this assumption we need local government to provide metropolitan goods and services because private markets would fail to do so. The consolidationists and polycentrists disagree about the appropriate level of government for providing such goods and services. But they agree that *government* at some level must do so.

The problem with this starting point is that most, if not all, “public” goods and services at the local level have significant privateness characteristics.<sup>14</sup> They correspond to what Buchanan (1965) called club goods rather than true public goods. Clubs goods are excludable but nonrival up to a point. Local “public” goods and services aren’t like national defense. They’re like the goods and services that homeowners’ associations and gated communities provide to their members routinely. These kinds of goods and services can be, and have been, provided privately without government.<sup>15</sup>

What the neoconsolidationist quasimarket failure argument may highlight is the failure of “middle-of-the-road” metropolitan governance solutions. Quasimarkets are precisely such a solution. But at least some of those failures don’t plague purely private metropolitan governance. For example, in a genuine governance marketplace, government monopoly failure evaporates because government evaporates. In such a system there are no legal restrictions on the number or

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<sup>14</sup> Admittedly, whether many, or perhaps all, such goods and services display sufficient “privateness” to render them amenable to successful market provision is debatable. Our point is simply that, on the surface at least, many, if not all, local, “public” goods and services do seem to display such privateness. At the very least this issue is one that should be subjected to genuine debate (empirical and theoretical) instead of simply assuming, as both the polycentrists and neoconsolidationists have to date, that successful market provision is impossible. As we indicate below, while some “public” goods and services provided at the national level, such as national defense, have significant publicness characteristics, this doesn’t seem to be the case for local “public” goods and services which aren’t nearly so “public.” If in fact genuine inquiry reveals that some local “public” goods and services currently provided by metropolitan governments are in fact public, our proposed “way out” of the neoconsolidationist critique won’t hold for these goods and services. However, to the extent that such discussion reveals that at least some such goods and services can be successfully provided by the market, for these goods and services, our “way out” holds and, in doing so, reduces the set of goods and services government must provide and thus the government failures associated with government provision under the polycentrist or neoconsolidationist mode of provision.

<sup>15</sup> For a discussion and some examples of at least limited private provision of local-level public goods and services, see for instance, Foldvary (1994), Beito, Gordon, and Tabarrok (2002), and Nelson (2005). For a theoretical discussion of how a private system of “clubs” fares compared to a public system of government, see Leeson (2011).

kind of self-governing communities that can emerge. Natural barriers to entry may remain in a genuine marketplace for governance where scale economies are significant. But since governance markets remain fully contestable in the absence of legal barriers to entry, competition remains maximal.

Similarly, in a genuine governance marketplace, political information failure evaporates because politics evaporates. In genuine marketplaces citizens have strong incentives to become informed about the goods and services they consume because they bear the full costs or benefits of being informed. This is as true for governance as it is for milk. Further, in a genuine governance marketplace, confusion about who is providing what service a citizen is consuming should be minimal. All a citizen needs to do to find out is look at his bill from his service provider.

Unintended consequence failure in a genuine market for metropolitan governance would also evaporate—though admittedly in an unsatisfactory way from neoconsolidationists' perspective. Unlike quasimarkets, genuine markets aren't designed. They have no policymaking creators who are attempting to mould how citizens sort themselves. That means that citizens' decisions within the market can't collide with policy goals. Where's there no policy, there can be no such goals. Of course, some citizens may object to the outcomes that genuine governance markets create. If some citizens form racially homogenous communities this may run counter to other citizens' preferences in the same way some persons' consumption of alcohol is objectionable to the preferences of teetotalers. Genuine governance markets can't eliminate such "externalities." But neither can consolidation completely, even if it can prevent citizens from making certain choices. The only way to purge "objectionable preferences" from being manifested in a governance system *en toto* is to suppress citizens' freedom of choice.

Presumably neoconsolidationists agree that this isn't a desirable thing to do even if, regrettably, free citizens sometimes exercise that choice in objectionable ways.

In offering the above “way out” of the neoconsolidationist critique we’re not suggesting that a genuine governance market would be free from potential “market failures.” We’re suggesting that, consistent with traditional public choice arguments, government failures tend to be worse than the “market failures” they’re designed to correct. This puts our argument squarely within traditional public choice territory—territory that, in embracing the basic government failure arguments of public choice, neoconsolidationists share.

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