Chapter 4: The Median Voter in Local Government Politics

The previous chapter described and defended the Tiebout-Hamilton model of local government. Yet this is almost an oxymoron. There is hardly any government in the model. Its engine is mobility of the population, not politics. In this chapter, I integrate my view of municipal corporations as deliberate, value-maximizing agents of homeowners into the Tiebout model.

Economists have for years shamelessly poached on the territory of political science in addressing the governance of business corporations. Their shyness about the governance of municipal corporations is the product of their unnecessary quest for a nonpolitical solution to the problem of public goods. This quest started with Charles Tiebout himself, as I will explain using the biographical information I obtained about him.

The rest of the chapter is dedicated to showing that a fairly straightforward political model, the median voter, is applicable to almost all local governments. The major exceptions are large cities, but even in these places homevoters are a force to be reckoned with. They are among the reasons that rent control is such an uncommon policy in the United States.

4-1 Podiatric Politics: Exit or Voice?

When I was at Princeton in the early 1970s, the graduate students used to put on skits at the annual economics department holiday party. Wally Oates, who had put Tiebout's model on the map with his evidence about capitalization (1969), was one of the more genial members of the Princeton faculty, and we were confident that he would take the following skit in good humor:

Narrator: “We're here on election day at the Borough of Princeton's polls. We've noticed an odd event. Professor Oates has gone into the voting booth, and he is taking off his shoes and socks. Professor Oates, what's going on?”

Student impersonating Oates: “Well, it's hard to pull the levers with my shoes and socks on.”

Narrator: “Why don't you use your hands?”

Oates impersonator: “Oh, I do use my hands for state and national issues, but for local issues, I have to vote with my feet.”

The metaphor of “voting with one's feet” is older than Tiebout's economic exposition of it. (Tiebout did not actually use the term.) It has an honorable history for most Americans, who are
not many generations removed from ancestors who voted with their feet against an oppressive
regime, or at least against a society that was unresponsive to their political, religious or economic
aspirations. But there's also a seemingly different American tradition, which is to stand your
ground and try to change the system from within. The tension between these traditions was nicely

It is worth emphasizing that when economists use the term “exit,” they do not confine its
meaning to the obvious case of removing one's person and assets from an unsatisfactory
jurisdiction. We also mean the unwillingness of outsiders to enter a jurisdiction because of the
unappealing conditions there. If the latter seems like a strange use of the term “exit,” the reader
should keep in mind that it comes from the tribe of social scientists who insist that a prospective
benefit forgone is a “cost.” Likewise, an exit is an entrance forgone.

Moreover, when we think about it, leaving a municipality is by itself harmless if the exiting
family or firm is replaced by another with the same essential characteristics. That's just
“turnover.” Thus when we say that “exit” is a way of penalizing a local decision to raise taxes
without simultaneously improving services, we must mean that there are fewer or less
satisfactory replacements for the taxpayers who have left. There has to be some net loss imposed
on municipal authorities for exit to be any sort of discipline.

There are cases in which exit is encouraged, as when Kansas prohibitionists said “good
riddance” to the beer-drinking German immigrants who veered off to the wetter climes of
Missouri and Nebraska in the 1800s (Robert Bader 1986, p. 111). But that only points to the
benefits of a having a variety of independent jurisdictions to accommodate differences in taste.
Exit has to hurt to be a meaningful discipline.

Although Hirschman's work is often cited by economists in support of the Tiebout model,
Hirschman himself was ambivalent about reliance on mobility. In a follow-up article (1978), he
opined that having too easy an exit would make it more difficult to accomplish desirable income
redistribution in some jurisdictions. His example of undesirable mobility was that of the modern,
multinational corporation, whose inclination to leave high-tax jurisdictions he thought
inequitable. Among political scientists and legal scholars, the Tiebout model is suspect for the
same reasons. Too much mobility is said to promote too little politics (Richard Briffault 1990b, p. 414; Gary Miller 1981, p. 3).

4-2 The Housing Portfolio Causes Exit to Amplify Voice

I think there is an error here on both sides, that of the Tiebout admiring economists and the Tiebout skeptics such as Hirschman, at least when considering local governments. “Exit” from a local government is regarded as being equivalent to selling stocks in a corporation, the usual way by which stockholders who are unhappy with management's decisions can exit the corporation (Vicki Been 1991). The latter discipline only works if the sale results in a lower price for the stock, which leaves inefficient managers with less-valuable stock options, makes them vulnerable to hostile takeovers, and reduces their ability to raise new capital. The exit discipline — selling the stock — hurts the seller as well as the wayward managers, insofar as the price is made lower upon leaving. But most stockholders have diversified portfolios, so the hurt is seldom acute, and the capital loss is likely to be offset by capital gains elsewhere. Examination of managerial ability by stock-pickers uncovers potential buy orders as well as sell orders.

The owner of a home, by contrast, has a large fraction of her wealth tied up in the property. To sell it at a loss has much greater consequences than selling the stock of an incompetently managed company. Owners of homes cannot diversify their portfolios by spreading out ownership of their asset among more risk-neutral investors.

As a result of this enormous concentration of wealth in one asset, people who buy houses are more careful about it than almost any other episodic transaction, save, perhaps, getting married. Such care is reflected in the evidence that public benefits and costs are capitalized in the value of owner-occupied housing. But this creates what may seem like a paradox: Evidence of Tiebout mobility from the capitalization studies is actually support for the idea that, once you buy the house, you are stuck with it, and you then have an incentive to exercise as much voice as you can to protect and enhance its value. “Exit” — unwillingness by prospective homebuyers to enter — promotes “voice” (political participation) by would-be homesellers.

It is rare for homeowners to move just because the public service mix is not to their liking. One reason for this is that the knowledge that taxes have become unexpectedly high or schools are worse than anticipated is probably not limited to the homeowner in question. Because the new knowledge is likely to be public, moving in response to bad news is more difficult because
the seller would get a lower price for her house than otherwise. This reduction in wealth — the bank doesn't reduce your mortgage obligation just because taxes go up — is apt to make it more difficult to move.

Reduced mobility as a result of capitalization has a distinct upside: It makes homeowners — the dominant municipal stockholders — eager to organize to prevent the unhappy events that reduce their home values. Once you're stuck having made the purchase, your only protection against community decline is watchfulness and activism. No one sells insurance against the risk of community decline.

The prospect of being stuck with a devalued asset makes those who are mobile into very careful shoppers, and this makes the housing market an unexpectedly accurate indicator of community qualities. This resolves the seeming paradox of voice being promoted by exit. They are not really contradictory disciplines. After the house has been purchased, the best hope of maintaining or improving one's investment is “voice,” involvement in the political process. The capital loss that the owner might suffer upon exit in fact is what encourages so much voice by homeowners in local government, and it is what makes prospective buyers of homes so eager to be informed about local conditions.

4-3 Charles Tiebout Challenged the Free-Rider Theory

I have written for years about the Tiebout model and occasionally wondered what the author of the idea was like and how he had come up with it. Tiebout had died in 1968. When I was in Seattle in 1998, Dick Morrill, a retired geography professor, mentioned that Tiebout had spent the last six of his fourteen-year academic career at the University of Washington. In the autumn of 1999, I contacted several of his friends and colleagues and talked with his son, Bruce Tiebout, to obtain some of the facts about his life.

Charles Mills Tiebout was born on October 12, 1924 and grew up in Greenwich, Connecticut, a suburb of New York City. He was the second of the three children of Harry Morgan and Ethel Mills Tiebout. Harry was a psychiatrist and was famous as the first of his profession to endorse the methods of Alcoholics Anonymous.

After service in the Navy during World War II and graduation from Wesleyan University, Charlie Tiebout began working on his PhD in economics at the University of Michigan in 1950. Richard Musgrave, the doyen of American public economics, was at Michigan at the time, and
Tiebout took his course. But Musgrave’s influence was indirect. Tiebout published his famous 1956 article after he had taken a job as an assistant professor of economics at Northwestern in 1954. The article was not based on Tiebout’s Michigan dissertation (1957), which had been directed by Daniel Suits and which analyzed Keynesian multiplier effects in local economies.

Musgrave, however, did inspire Tiebout’s article. While Tiebout was at Michigan, Musgrave was putting together his landmark work, *The Theory of Public Finance* (1959). He had years before written an influential article, “The Voluntary Exchange Theory of Public Economy” (1939). Musgrave showed that such a theory, advanced by some European economists of the late 1800s, was untenable because of human nature. People would not reveal their true valuation for public goods if the goods would be provided regardless of whether they paid. A market-based “voluntary exchange” mechanism would simply not work. Paul Samuelson embedded this pessimistic assumption in his seminal article, “The Pure Theory of Public Expenditures” (1954), in which he showed that an optimal level of public expenditures existed in principle, but it could not be attained by ordinary market processes.

The upshot of the Musgrave-Samuelson view of public goods was that economists conceded that politics, not the market system, necessarily determined the level and composition of collective goods. It was this deference to politics that Tiebout set out to challenge. The title of Tiebout's work, “A Pure Theory of Local Expenditures” (1956), obviously paralleled Samuelson’s title, but its inspiration was more likely the work of his Michigan professor, Musgrave. Tiebout’s avowed objective was to suggest a model by which public goods could be provided efficiently without politics.

**4-4 Tiebout Had to Be an Out-of-the-Box Thinker**

Although Tiebout did not write about his idea while at Michigan, it did occur to him while he was there. Richard Musgrave told me in 1994 that Tiebout had orally presented his hypothesis in his Michigan seminar (which I infer was around 1952). As Musgrave recalled for me in a conversation in 1994, however, Tiebout had presented his ideas in a lighthearted, joking manner. That Musgrave did not take it too seriously is suggested by the fact that there is only passing mention of it (p. 132) in his 1959 book. The “voting by feet” idea, attributed to Tiebout, is described briefly in Musgrave and Musgrave's text, *Public Finance in Theory and Practice* (1989, p. 453), but it is dismissed as “unrealistic” in most settings.
Tiebout's light-hearted presentation of his theory in Musgrave's class was initially puzzling to me. Why would someone come up with a good theory and not be serious about it? But as I interviewed more people who knew him, I found that humor was one of Tiebout’s most notable traits. Almost everyone remarked on this, and many of his contemporaries have stories about his capers. Even Tiebout's kids thought he was funny, an accomplishment any parent can envy. Bruce Tiebout told me that his father's Christmas cards were legendary. After moving from Evanston to Los Angeles in 1958 to take a job at UCLA, he sent as his card a photograph of his family on the beach. The three young children are smilingly reading economics texts, while Charlie and his wife Betty are poring over comic books with looks of great concentration.

My point in this digression is to suggest that Tiebout's insight into the problem of public goods was a product of his out-of-the-box way of looking at things. Such a viewpoint may have been essential. Government centralization was the watchword of the world of the 1950s, whose adults remembered all too clearly two world wars and the Great Depression they bracketed. The focus on national governments, the only institutions believed capable of responding to such cataclysms, was everywhere. In his wide-ranging survey of fiscal federalism, Wallace Oates (1999, p. 1142) pointed out that centralization of governments reached its worldwide high point in the 1950s. For those intellectuals who thought about it at all during that era, America’s fragmented system of local government was regarded as an embarrassment (Jon Teaford 1997, p. 85).

One might suspect that the town-meeting tradition of Tiebout's New England hometown (Greenwich, Connecticut) led him to think more seriously about local government, but his best friend from his youth, Philip Worn (who married Tiebout's sister), recalled no such interest. I like to suppose instead that Tiebout's anarchical sense of humor, his ability to look at the world with the off-center detachment that humor both requires and engenders, had something to do with formulating his revolutionary hypothesis.

4-5 Tiebout’s Work Remained Unfinished

Tiebout's model did not have a political sector because his primary objective was to show that it was possible to obtain a market-like determination of the ideal level of public goods. He did insert “municipal managers” in his model, but they were assumed to be entirely nonpolitical. They simply offered a set of services, and people then selected a community. To avoid the need
to inquire about how the managers got direction, Tiebout (1956, pp. 417, 420) alluded to the Darwinian possibility suggested by Armen Alchian (1950). Deliberate profit maximization by such managers was not necessary for them to achieve the effect of profit maximization and, hence, the least-cost level of public services. A competitive process analogous to biological natural selection would ensure that the surviving firms' objectives would appear to be profit maximizing. This would occur even when managers were radically uncertain about future market conditions.

But, as many scholars have concluded, Tiebout's model still seems to require politics to ensure that its municipal managers will not behave inefficiently, at least when landowners cannot secede from jurisdictions and municipalities are not infinitely divisible (Epple and Zelenitz 1981; Vernon Henderson 1985). I concur. The evolutionary process of winnowing out unprofitable firms that Alchian suggested as a substitute for profit maximization seems less applicable to municipalities. They seldom go out of business, secession from existing municipalities is rare, and new towns and cities are created only episodically (sections 2-3 and 3-14 above). Moreover, the uncertainties of the market, which led Alchian to propose his evolutionary theory, seem less important for local public services. It takes less entrepreneurial guesswork to know the demands of community residents for municipal services. Unlike corporate shareholders, resident “owners” of municipal corporations are the consumers of the product. If the public works director fails to maintain local roads, municipal shareholders feel it in their shock absorbers.

Tiebout did not publish or even suggest an empirical test of his 1956 hypothesis. Perhaps for this reason, it did not get much attention until Oates published his 1969 study showing that local government taxes and spending were reflected in house prices. It is probably more accurate to call it the Tiebout-Oates hypothesis. Tiebout did not even mention property taxation in his model, though, to be fair, he was responding to Musgrave's and Samuelson's theories of expenditure determination, not taxation. It was not until Bruce Hamilton (1975) introduced zoning into Tiebout's model that one could answer the criticism of Buchanan and Goetz (1972), among others, that the poor would endlessly chase the rich around the metropolitan area in a Tiebout model.

Tiebout wrote only a few other papers about local government, and only one of those, co-authored with Vincent Ostrom and Charles Warren (1961), has had much influence. The larger part of his research focused on regional economic development, and he achieved considerable
success in this area as a scholar and as a high-level consultant. He devoted most of his professional time at the University of Washington, to which he had moved in 1962, to its distinguished geography department. The department maintains a Tiebout website listing his publications, and the Western Regional Science Association has a dissertation prize in his memory. His writing in regional science, however, had almost no connection with his now-famous 1956 paper.

The fame of the “Tiebout hypothesis” is primarily among social scientists with an interest in local government and fiscal federalism. His name appears in a whopping 1500 articles in the Social Science Citation Index between 1975 and 1999. Of the most recent 100 citations (as of 1999, covering less than a year), all are to his 1956 article. He died in Seattle from a sudden heart attack on January 16, 1968, at age 43. His wife, Betty, survived him by 31 years, and his three children, Charles, Jr., Bruce, and Carol, still live in the Seattle area.

4-6 Homeowners Rule (and Renters Do Not)

I have proposed to remedy Tiebout's omission of a political sector by inserting homeowners as the prime movers of the model, and this section defends my focus and its neglect of renters. The largest and most active group of voters in all but a few cities consists of homeowners. (I am counting, as the U.S. Census does, owner-occupants of condominiums, row houses, co-operatives, and mobile homes. Don't just think of detached, single-family homes, though this is by far the largest category.) National data indicate that about 67 percent of all households are in owner-occupied units. This actually understates the pervasiveness of homeownership as an institution. A study by Jim Berkovec and Peter Zorn (1998) concluded that between 80 and 90 percent of Americans own a home at some time in their lives.

Nearly every study has shown that renters participate in local affairs in disproportionately low numbers compared to homeowners. In a national survey, 77 percent of homeowners said they voted in local elections during the period 1984-1992, while only 52 percent of the renters did (Rossi and Weber 1996, p. 23). Evidence from individual cities confirms the national data. A New Orleans referendum on homestead tax exemptions was examined by Pamela Moomau and Rebecca Morton (1992). They found that homeowners know and vote their interests. Renters did not participate much even when there appeared to be gains to them from doing so. And studies of apartment-rental differences among communities find that renters do not appear to pay close
attention to the quality of local public services (Carroll and Yinger 1994), in contrast to the overwhelming evidence that homeowners do (Martinez-Vazquez and Sjoquist 1988).

Low renter participation in politics is not confined to municipal governance structures. Most private homeowners associations, which regulate the affairs of condominiums and "planned communities," do not enfranchise renters in their governance structures. It is especially interesting, then, that the progressive-minded developers of Columbia, Maryland, one of the largest and most successful of the recent privately developed communities, did allow tenants to vote and permitted them to run for community-association offices. But as Lynne Burkhardt (1981, p. 27) documented, renters' participation in community affairs in Columbia remained much lower than that of owner-occupied units. Asset ownership matters.

4-7 Rent Control Is Rare Because of Homeowners

If renters lack political influence, why, my friends from New York ask me, do we have rent control? That policy certainly serves renters who already live in the city, even as it denies those not there access to the cheaper units (since with the lower rents, tenant turnover is much reduced). I choose to turn the question on its head and ask, why don't most cities have rent control? Stringent rent control is rare except in places like New York City, which in 1980 had 7.8 percent of the nation's rental stock and a supermajority (75 percent) of renter-voters.

As of 1983, a high point for rent control, only ten percent of all rental units in the U.S. were subject to rent control (mostly in New York City), and about half of those ordinances allowed market-rate rents to be charged to new tenants once the previous tenants departed (Kenneth Baar 1983). As of 1991, a little more than 200 municipalities had rent-control ordinances (Edgar Olsen 1991, p. 931). Although some states have constitutional constraints that prevent local governments from adopting rent control, 200 still seems like a tiny fraction of the more than 25,000 local governments with police-power authority under which rent control could be adopted.

Rent control's scarcity is a political puzzle. Even in the suburbs, renters greatly outnumber landlords. A local politician seeking votes could tip the balance in her favor by promising to enact rent control and related tenant-security legislation whose effect is to transfer at least some of the value of apartments from their nominal owners to the current tenants. It could be, of course, that landlords offer something even more valuable than votes to politicians: cash for their
campaigns. But the jingle of that voice is muted in smaller communities, in which the positions of the candidates are pretty clear to everyone. Yet rent control, at least its more stringent brand, is nearly absent in small communities even in states where its adoption is entirely a matter of local option. (Rent control is “stringent” if it is supplemented by regulations restricting conversion of apartments to other uses, thus foreclosing landlord exit, and if it keeps rents below market levels even when new tenants move in [Edgar Olsen 1991].)

Stringent rent control is rare, I submit, because it is usually bad for homeowners. There are two effects they might worry about. Rent control almost always results in some physical deterioration of buildings because owners have less incentive to maintain their structures if rents are low. Some excess depreciation is offset by informal tenant contributions and by the force of habitability laws, but the consensus is that the net effect of rent control on building quality is negative (Joseph Gyourko 1990; Moon and Stotsky 1993). Because this neighborhood blight might spill over to owner-occupied homes, homeowners have reason to oppose rent control.

Another reason that homeowners don't like rent control is that it shifts the burden of taxation from apartment owners to homeowners (Anthony Downs 1983, p. 141). Although moderate rent controls do not seem to reduce apartment house values by much, stringent rent control in Berkeley and Santa Monica clearly did so (Michael St. John 1990). Such reductions in value can have insidious consequences. A profile of Robert Moses, New York's highway builder of the 1950s, noted that his infamous demolition of the East Tremont neighborhood in the Bronx to make way for the Cross Bronx Expressway was financially rational. The apartment houses of East Tremont, in which thousands of tenants lived, were cheaper to purchase than nearby commercial property because the apartments were subject to rent control. Their landlords were eager to be rid of them (Robert Caro 1998, p. 48). As these examples suggest, the reductions in value of apartments by rent control mean that owners of other properties, chiefly owner-occupants, must shoulder more of the local property-tax burden.

4-8 Proposition 13 Promoted Rent Control

My view that homevoters restrain rent control is supported by the sudden increase in the number and stringency of local rent control laws in California after Proposition 13 (Jeffrey Chapman 1981). This famous 1978 voter initiative figures large elsewhere in the present book. It is the most important fiscal event at the state and local level since the Great Depression, so it is
worth two paragraphs to explain what it did. (Readable legal reviews of its background and consequences are Joseph Henke [1986] and Henke and Woodlief [1988].)

In a statewide election on June 6, 1978, the California constitution was amended, by a popular vote of nearly 2-1, so as to limit the *ad valorem* (monetary value) taxation of any property in the state to no more than one percent of assessed value. The only exception was to pay for previously adopted bond issues. No statewide property tax of any sort was allowed, but new local taxes not on the dollar value of property are permitted as long as they are approved by a two-thirds majority of the jurisdiction. The latter taxes are called “parcel taxes.” They typically tax each parcel the same amount and are most commonly used in affluent suburbs to provide modest supplements to local school spending (Brunner and Sonstelie 1997).

More critical for my argument about rent control is that Proposition 13 rolled back all assessed values to their 1975 levels. This by itself was a significant tax break, since nominal home values in California had grown by about 20 percent per year between 1975 and 1978. As long as the owner did not sell the property, her assessment could grow by no more than two percent per year. Upon sale of the property, it was reassessed at market value, but this assessment could then rise by no more than two percent per year. Homeowners who had purchased prior to Proposition 13's passage in 1978 and have not sold their homes often have tax liabilities of less than one-tenth of otherwise identical homes that have sold recently. The average California effective property tax rate (the ratio of taxes paid to true market value) in the early 1990s was a shade over one-half of one percent because so many homes were not sold (O'Sullivan, Sexton, and Sheffrin 1995, p. 137).

The spread of rent control among California cities after 1978 was widely attributed to the supposed promise by Proposition 13's garrulous leader, Howard Jarvis, that property tax reductions would benefit tenants as well as homeowners. This was seemingly made more credible by Jarvis's day job as lobbyist for an apartment owners' association in Los Angeles. When the rent reductions did not materialize, the story goes, cities were urged to enact rent controls to spread the benefits of the tax cut to tenants.

The holes in this story are gaping. Apartment owners had strenuously denied Jarvis's claims in full-page newspaper advertisements prior to the vote (*Sacramento Bee*, May 12, 1978). Jarvis himself was hardly a credible source. He claimed that a wide range of benefits would occur on
passage of Proposition 13 that were palpably untrue. For instance, he claimed that school funding would not be harmed by Proposition 13, despite the fact that the statewide reduction in property taxes just about equaled the sum of all school budgets for the entire state. And the theory also supposes that California rent-control activists had somehow been restrained prior to Proposition 13 by the notion that rent controls could not be adopted because rent levels were determined by property taxes. I never encountered a rent-control activist who thought that rents were determined by anything other than the greed of landlords.

A more logical explanation for the spread of rent control is that after Proposition 13 passed, homeowners had much less to lose by allowing tenant-activists to push for rent control. Under Proposition 13's assessment rules, property tax liabilities on individual homes no longer depended on the value of other property in the community. A reduction in the value of apartments no longer shifted the burden of taxation to homeowners, because homeowners' assessments were maxed out by the 1975-plus-two-percent rule. Even for homes that were sold and reassessed, the one percent maximum rate meant, in most communities, that additional funds could not be extracted from homeowners. Thus apartment-house owners lost their best allies — homeowners — to fiscal indifference, and the rent control debate took the lopsided form of tenants versus landlords.

I concede that California homeowners retained their anxiety about blighted apartments, and reductions in property-tax revenue from devalued apartment may have worsened local fiscal conditions, even if it did not raise homeowners’ taxes. But this only explains why rent control is not universal in California. It is the sudden uptick in rent control after Proposition 13 that was unusual. The spread of rent control after 1978 is consistent with my view that homeowners are the dominant political faction in most places and that local politics can be predicted to a large extent by a policy’s effect on home values.

4-9 The Commonwealth of the Property Tax Base

My account here is not simply a different story about rent control. It also shows that property taxes are a relatively sensible local source of revenue. (This section anticipates a theme I will expand on in section 8-2.) Rent control can be an enormously destructive force for part of the community, blighting areas much like placement of an unmanaged waste dump could. By making apartment values part of the community's commonwealth, normal ad valorem property taxation
makes the more extreme forms of rent control and other opportunistic transfers of wealth less attractive to homeowners. Proposition 13 tore down that commonwealth system, and policies such as rent control became more attractive.

I hesitate to make the following addendum about rent control, as I worry that it could be used out of context, sort of like the rare economic case against free trade. There is an economic case for rent control, though, that doesn't rely on what I regard as silly theories about the imbalance of power between landlord and tenant. (Silly because the tenant has at least as many ways to inflict extra-legal pain on an unfair landlord as vice versa.) The case is that rent control turns tenants into homevoters. One reason that tenants do not vote or participate in local affairs as much as homeowners is that renters don't have as much stake in the outcome. If schools get better or neighborhood amenities improve, it is nice, but it also means that landlords get to raise the rents (Timothy Bartik 1986). If the tenant is protected from rent increases, though, he gets to enjoy the local improvements without having to pay more, and he might therefore become a more involved citizen.

Two qualifications are in order. One is that most landlords have an implicit rent-control policy for seated tenants. Rents are seldom adjusted upward for them to market levels, at least in noninflationary times (Robert Ellickson 1991b, p. 951). The reason is that turnover of financially reliable, well-behaved tenants is the second-last thing the landlord typically wants. (Last is formal rent control.) Thus most long-term tenants do have some self-interested incentives to participate in local affairs, and that may account for why they do participate to some extent, even though their voting rates are well below those of homeowners.

The more important qualification is that it is not difficult for landlords to convert apartment buildings to condominiums, so that renters can become owners if there is demand for it. If we really think owner-occupancy makes better citizens, there are lots of ways to encourage it. But stringent rent controls almost always do the opposite. Among the most onerous burdens of stringent rent controls are regulations that prohibit condo conversion, even when seated tenants are protected from eviction. As I suggested in an article about regulatory takings and rent control (Fischel 1991b), such laws prevent the exit remedy that would ordinarily temper rent regulations, and, in such instances, the only protection for apartment owners may be the courts.
4-10 Does Homeownership Cause Unemployment?

I cannot not leave homeownership without mentioning at least one potential downside. Andrew Oswald (1996) has cross-country and cross-state evidence that high rates of homeownership seem to cause unemployment. This odd-sounding result is explained not so much by homeowners themselves becoming unemployed as by policies that discourage the rental market. Lack of rental apartments discourages migration from job-poor to job-rich areas because, apparently, out-of-region job-seekers have no place to stay during their search and trial periods.

Unemployed people who own homes are reluctant to leave because of the transaction costs of selling a home and attachment to their community. For example, L. F. Dunn (1979) found that permanently laid-off textile workers in a rural town required a 14 percent wage premium to induce them to move for work in another city. Reluctance to leave, however, seems less important than inability to find temporary quarters at the prospective destination. After all, the reluctance to leave is caused in part by something that many find admirable: loyalty to one's community and neighbors.

Scarcity of rental housing seems to have less worthy spillover effects. Among those policies that restrain the apartment market (and thus, by default, stimulate homeownership rates that are too high) is rent control. Developers of multifamily housing eschew the rental market when rent control is anticipated, and those that do brave it have to be rewarded for their risk-taking with higher rents (Avinash Dixit 1991; Fallis and Smith 1984). Thus Oswald's finding is not so much an indictment of homeownership — it's no great compliment, either — as it is yet another argument against rent control and similar legislation that restricts consensual exchange in the housing market.

We may at least conclude from Oswald's work that the fact that homeowners might be better citizens does not warrant a policy of encouraging ownership at the expense of rental units. Even if we put aside the financial difficulties that poor people have in purchasing a home, national and regional unemployment issues may warrant a more active rental market than any individual community might want. Newcomers often need rental units to get their feet in the job-market door. Sawing off the bottom rung on the housing ladder does not make it easier for people to climb to the top.
My discussion of municipal corporations in chapter 2 emphasized the active role of homeowners in governing municipalities. Business corporations do not have such active shareholders, I argued, in part because the divisibility of share ownership allows stockholders to spread their risks. With only a small stake in any given firm, business stockholders have little incentive to pay attention to their internal governance. Now it is time to defend my emphasis on the role of homeowners in municipal affairs.

The median-voter model of politics, which is the social-science name for majority rule, was first elaborated by Howard Bowen (1943). His hypothesis was that under majority rule, the household who had the median income, or, I would add, home value, in the community would get the public services and taxes he demanded. This would be true by definition if all residents simply voted on all issues that had an economic impact. But the median-voter model goes further and asserts that this result will hold even in representative governments. Elected officials select budgets and taxes “as if” they had been voted upon in a plebiscite. (To be precise, the model should be called the “median-income-voter” or the “median-home-value voter” model, but I will continue to use the economists’ shorthand and omit the precise economic characteristic along which voters are lined up.)

The median-voter model has been subjected to an extensive set of statistical tests in the economics literature, and most of these tests have involved samples of local governments. The consensus as I read it is that the median-voter model holds up quite well in comparison with its alternatives. The alternatives are (a) that bureaucrats expand the level of public services to increase their own wealth and power (William Niskanen 1971), (b) that concentrated economic interests lobby successfully for a set of goods of little interest to the median voter (George Stigler 1971) or (c) that some combination of bureaucrats and special interests set all-or-nothing voting agendas so that the median voter has to select more than she wants (Romer and Rosenthal 1979).

Thomas Borcherding and Robert Deacon (1972) and Ted Bergstrom and Robert Goodman (1973) were among the first to test whether the median-income voter actually got the level of public goods that Bowen hypothesized. Both studies used samples drawn from cross-sections of American local governments. They found that expenditures on various municipal services seemed to vary among them according to the economic characteristics of the median-income voter.
voter. Their results, appropriately hedged and qualified, indicated that the median-voter approach worked well. The level of public services seems to have been set “as if” a referendum among the voters had been held on every issue, even in jurisdictions in which referenda are never held.

The evidence since then is overwhelmingly in favor of the median voter at the local level. William McEachern (1978) found that the levels of bonded indebtedness of jurisdictions that voted directly on them and those in which the city council had the final say were not significantly different. Robert Inman (1978) examined 58 Long Island school districts and similarly found that the median voter accurately predicted differences in school spending. Bergstrom, Rubinfeld, and Shapiro (1982) found a similar result for Michigan school districts: Decisions by plebiscites closely matched those by elected representatives. Other studies were reviewed by Randall Holcombe (1989), who found the results sufficiently persuasive that he proposed the median voter as an appropriate benchmark for all government decisions, the analog to perfect competition in private markets.

Although the empirical evidence for the median voter is impressive, a nagging question remains: How does representative politics at the local level actually work to give the median voter what she wants? I submit that it works because of local government’s corporate template. Unlike the states and the national government, whose antimajoritarian institutions include bicameral legislatures, independent executives and judiciaries, and difficult-to-amend constitutions, municipal corporations are structured to give the majority what it wants (Robert Ellickson 1977, p. 405). Cities seldom have more than a single legislature, and many dispense with separately elected executives altogether. The most common governance structure in smaller cities is the council-manager form, in which voters elect a council and the council selects the city's chief executive officer (section 2-2 above).

Saul Levmore (1992) offers an explanation for the apparent lack of fear of majoritarianism at the local level: The threat of exit keeps government excesses in check, so there is less need for institutional constraints. The discipline of the market, of the smiles and frowns of the rest of the world, usually motivates homevoters in cities to forgo value-reducing behavior. The discipline of exit apparently influences the evolution of political institutions as well as ordinary politics. If exit is easy, majoritarian political institutions are easier to tolerate, and those forms come to dominate. This is why the median-voter model works so well at the local level.
4-12 Low Turnouts Can Be Signs of Satisfaction

Critics of the median-voter model note that few jurisdictions vote directly on public services. We have representative government in all but small New England towns. Even most town meetings are attended by only a small fraction of the eligible voters, and voters usually decide a carefully limited range of issues. And it is well established that voter participation is generally lower in purely local elections than in national elections (Verba and Nie 1972, p. 31).

Low political participation, however, could also be a sign of satisfaction by adult residents who, in nearly all cases, deliberately chose to live in a particular town. A national study of cities by Eric Oliver (1999) finds that more homogenous communities, both rich and poor, have lower rates of participation in voting and other local political activity than cities with heterogeneous populations. Oliver argues that the lower participation in homogenized communities is caused by having less conflict to be resolved. Tiebout sorting among preferred communities seems to induce lethargy in local politics. (Robert Dilger [1992, p. 140] reports similar lethargy among private homeowner associations.) To invert the conclusion, as Bill Niskanan suggested to me, higher participation at the national level reflects the lack of “exit” options from that jurisdiction.

Focus on average voting rates is misleading in any event. At the local level, there are many ways besides voting to influence public officials. Letter writing, button-holing, attending meetings and hearings, and organizing neighborhood groups are all more effective and frequent at the local level than at the state and national level (Verba, Schlozman, and Brady 1995, p. 453). Besides that, average voting rates mask the variation in local voting turnouts from year to year. For example, New England town-meeting attendance, which involves a larger time commitment than just voting, fluctuates according to the intensity of the issue involved (Joseph Zimmerman 1999). A serious controversy can easily double or triple the participation rate at the local level, while it seldom does more than make a slight jiggle in the state and national voting rates. Frank Easterbrook and Daniel Fischel (1983, p. 415) make the same argument in defense of voting in business corporations. Average participation in stockholder meetings is low, but it can rise dramatically when an important issue, such as a takeover, is on the table.

4-13 The Size of the Government Makes a Difference

Thomas Romer and Howard Rosenthal (1979) were not so impressed with the median-voter model. To them the econometric evidence was not convincing because the ideal level of public
spending could be some multiple of what the median voter actually prefers. An agenda-setting school administrator might offer an all-or-nothing proposal to voters that would force them to agree to a larger amount. Thus one could find statistically significant variation in spending according to median voter characteristics, but average spending might actually be fifty percent more than what the voters actually want.

Much of the controversy about the applicability of the median-voter model can be resolved by noting that the size of the jurisdiction seems to make a difference. Geoffrey Turnbull and Peter Mitias (1999) compared the median-voter model's predictions with an open set of alternative explanations for government tax and expenditure patterns. They found that the median-voter model dominated others in a sample of municipalities, but when applied to counties and state governments in the same region as the municipalities (the upper Midwest), no particular model consistently explained spending variations.

Another approach was employed by John Matsusaka (1995; 2000), who compared states that permitted voter initiatives, in which the median voter would seem to prevail by definition, with states that do not. (The split is about half-and-half, with most of the initiative states in the West.) He wanted to see if the initiative states had fiscal policies that were different from states whose legislatures made all the statewide laws. In the non-initiative states, the voters cannot second-guess their legislatures. If there was no difference between the two groups of states, then state legislatures might best be considered as faithful agents of the median voter. Matsusaka's extensive studies found, however, that the initiative states had smaller (1995) and more decentralized (1998) public sectors. This suggests that in normal, representative state politics, the will of the majority does not always prevail, which is why initiatives were adopted in the first place (Thomas Cronin 1989).

Other evidence about the influence of jurisdiction size comes from Howard Bloom and Helen Ladd (1982). They asked whether budgets of Massachusetts towns and cities were opportunistically increased after property assessments were raised. The median-voter model would predict that an increase in property assessments would simply cause tax rates to decrease, which would keep revenues constant. Most of the model's competitors would say bureaucrats or special interests would take advantage of the apparent windfall and spend more.
Bloom and Ladd found evidence for both ideas. In bigger cities, legislative councils did take some liberties with the nominally larger tax base and spend more, but in small towns, tax rates were dutifully cut. In small towns, the voters get what they want. One price of residence in a big city is greater slippage between want and get, in part because, as William Hoyt (1999) theorized, lack of capitalization makes voters careless about local government efficiency. Perhaps this explains why large cities continue to build fixed-rail transit systems in the teeth of evidence that they will not solve any urban problem except unemployment among construction workers (Kenneth Small 1992).

A result similar to Bloom and Ladd's was found by Dennis Holtz-Eakin and Harvey Rosen (1989). Their study of capital budgeting in New Jersey municipalities found that suburban and rural jurisdictions behaved as if governed by the rational median voter. The smaller towns used appropriate discount rates and time horizons, while large cities did not. And even Romer, Rosenthal, and Munley (1992), the first two of whom had cast doubt on the median-voter model, found that the median-voter model worked well in smaller New York State school districts, but not (as they expected) in the larger, urban districts.

**4-14 Bigger Cities Are Smaller Players**

The evidence in the previous section suggested that homeowning-shareholders have problems governing large municipal corporations. This is similar to the Berle and Means (1932) hypothesis, which says that large business corporations are imperfectly responsive to shareholders. The modern answer to Berle and Means is that the stock market takes care of the problem of managerial discretion by making firms run by managerial slackers ripe for takeovers (Easterbrook and Fischel 1991, p. 171). Here I suggest that the size problem is less important in municipalities because, unlike big businesses, big cities are not all that important, and because many big cities have adopted governance structures that protect homeowners.

As I mentioned in section 1-9 above, only about a quarter of Americans live in cities with more than 100,000 people. I regard that size as a rough threshold at which voters find it difficult to know what is going on in city hall. For larger places, the median voter model shades into the interest-group model. As a benchmark for academics, I note that Ann Arbor, Berkeley, and Cambridge are municipalities with about 100,000 residents.
The foregoing 25-percent statistic is a little misleading. About twenty percent of the U.S. population in 1990 lived in “unincorporated” areas of counties. Most of these people are nonetheless supplied with municipal services by county governments, and some of these counties have populations that exceed 100,000. Unincorporated areas, however, can become incorporated as new cities, or they can be annexed by existing cities, so it is not proper to count them as if their present status were immutable. Although the declining demographic importance of large cities is mostly caused by depopulation of central cities, some of it is also caused by the incorporation of new, smaller cities.

There are two complementary reasons for why homevoters have more influence in small rather than large jurisdictions. The more obvious is that smaller size itself makes it more likely that voters will know what is going on in local government. The issues are fewer and political figures are more accessible in smaller jurisdictions. It is well established that political participation is greater in smaller cities, which offsets the lower participation caused by homogeneity (Eric Oliver 1999). More important, I believe, is that most voters in smaller jurisdictions are homeowners. They have an incentive to pay attention to politics: Good decisions will increase the value of their major asset, and bad ones will reduce it.

4-15 Big Cities Can Decentralize to Empower Residents

Unlike shareholders in large business corporations, the shareholders of big cities cannot deal with their agency problems by resorting to stock market diversification. Ownership in their homes cannot be divided into fractional shares. So city dwellers resort to political reforms that appear to make municipal operations different from those of business corporations. For example, almost all cities have laws requiring easy public access to the decision process of both elected officials (the “board of directors”) and hired managers. Sunshine laws, freedom of information, and open-meeting rules all promote shareholder information. Specialists in exploiting this information — local newspaper reporters, political gadflies and would-be office holders — reduce the cost of monitoring for the average citizen. While such openness can inhibit some otherwise efficient transactions, it should be seen as part of the process by which municipal corporations are made more responsive to their shareholders.

The voter initiative is another device by which large cities are made more responsive to their resident-shareholders. Although most scholarly writing about initiatives concerns their use in
dealing with statewide issues, the vast majority of cities larger than 50,000 permit voters to initiate laws independently of city councils and vote on them in a citywide election. As Tar Renner and Victor DeSantis (1993, p. 69) indicate, the initiative is most popular in the larger cities. All of the cities greater than 500,000 that responded to their extensive survey had the initiative.

A structural reform that makes big cities more responsive to homeowners is ward voting. Ward voting is most common in large cities, especially in the eastern and central U.S. It had been declining during the first two-thirds of the twentieth century as part of the municipal-reform movement that opposed big-city bosses and political machines (Renner and DeSantis 1993, p. 57). This trend reversed itself when federal enforcement of the Voting Rights Act of 1965 caused many cities to replace at-large election of city councils with elections by wards or districts. Tim Sass and Stephan Mehay (1995) found that adoption of electoral districts did increase council representation by minorities.

Ward representation also has quantifiable results on the land-use front. Evidence from Atlanta indicates that black neighborhoods were no longer peppered with unwanted commercial development after ward representation was adopted and blacks were elected to city council (Hinds and Ordway 1986). Ward-based cities behave more like suburbs in land-use decisions. Siting unwanted activities like group homes becomes everywhere more difficult in ward-based cities than in those with at-large councils (James Clingermayer 1994). Clingermayer (1993) also found that early zoning laws were adopted most frequently in cities with ward representation, which is consistent with the greater influence in ward-based systems of homeowners, who occupy the apex of the zoning pyramid. A survey of 1400 cities by Mark Schneider and Paul Teske (1993, p. 732) found that cities with ward representation were less prodevelopment than those which elected councils at large.

Election of city councils by wards in many ways turns the cities into collections of small towns, and homeowners become more influential. Ward-based politics means that each councilmember pays close attention to local issues. Describing the ward-based city of Los Angeles, Edward Banfield (1965, p. 84) quoted a local politician as saying, “By custom, the councilman is considered the administrator of the city services in his district.”
4-16 Logrolling and Special Districts Also Decentralize

I should not give the impression that neighborhood (ward) politics in big cities gives the wards and the cities the same fiscal incentives as independent suburbs. Tax rates must usually be uniform throughout the city, and this makes an important difference in their political economy. If a ward were an independent taxing district (like a separate municipality), its decision on whether to expand the size of the local library would have to account for both sides of the financial scale. The improved library would raise home values, but the increased property taxes would depress them. Only if the beneficial appreciation-effect exceeded the depressing effect of higher taxes would homeowners favor it. This would promote an efficient number and size of libraries. But in the big city, a neighborhood library is paid from taxes in all wards, not just in the one in which it is located. The benefits accrue to the neighborhood, but the costs are borne citywide.

The library example may overstate the differences between big and small cities. In big cities, political deals will be made to satisfy various neighborhoods. Larger cities may actually establish formal neighborhood associations (rather than wards) to broker public services (Berry, Portney, and Thomson 1993). Deals may involve spreading the libraries and parks and road improvements around or trading one for another — the park in this area, the library in that one. Thus even in relatively large cities it may be possible to obtain many of the efficiency advantages of property-tax financing of services. And submunicipal business- and neighborhood-improvement districts, which are rapidly growing in large cities, do restrict taxes and spending to particular areas (Richard Briffault 1997; Robert Ellickson 1998). Such areas should be treated as if they were smaller municipalities, at least for the services that they finance.

Business improvement districts are financing services in much the same way that special assessment districts finance capital improvements. My town has a “sidewalk district” for which urban property-owners are taxed and rural dwellers are not. Special assessment districts were common in the 1800s (Stephen Diamond 1983). They have become less prevalent since zoning and planning rules have permitted localities to oblige developers themselves to finance capital improvements (Heyman and Gilhool 1964). The transaction costs of setting up informal logrolling deals and formal improvement districts, however, seem higher in larger, multi-ward cities, so it would be Pollyannaish to suggest that bigger cities are just as efficient as the smaller units of government. I want only to suggest that the differences are not so great as to treat most larger cities as if they were states.
4-17 Conclusion: Tiebout Can Coexist with Politics

I submit that Tiebout's neglect of local government politics requires only modest amendment of his model. In most local governments one just has to replace Tiebout's invisible municipal managers with the median-voter model. The median voter will want to do most of the same things that an entrepreneurial private manager would want to do. The major difference is that the median voter cannot as easily accommodate major changes in the character of the community. Personal attachments and collective decision-making will make it harder to “take the money and run” when an apparently value-increasing change in the community is in the offing. This personal attachment is among the factors that, as I will explain in chapter 7, make a competitive “race to the bottom” in local environmental affairs among the least plausible scenarios.

Homeowners are clearly the dominant political faction in the communities in which the great majority of Americans reside. Because majority rule, rather than rule by special interests, seems to apply in most local governments, the prospect of capital gains and losses to homeowners is the most consistent motivator of local government activity. The normative aspects of the homevoter hypothesis depend also on the applicability of the Tiebout model to actual government structures. I think the fit is better, at least, than the view that treats local government as scaled-down state governments.

The novelty of my presentation is to take the capitalization of home values out of the sideshow and display it on the midway. In a sense, I am turning the capitalization studies upside down. It is not just that local taxes, schools, and zoning affect home values. It is that this fact makes homeowners organize to be the masters of taxes, schools, and zoning.

A few researchers, most prominently Jan Brueckner (1982; 1983; Brueckner and Joo 1991) and Jon Sonstelie and Paul Portney (1978; 1980b) have developed this connection and shown its relevance with clever empirical studies. But their work has been neglected in much of the policy arena, in part because it has been subjected to economic theory's enervating perfectionist criteria. Harold Demsetz (1969) has derided the criteria as the “Nirvana” condition: Because it might be possible for an all-knowing planner to deal with some spillover effect or uncertainty, either of which upset efficiency conditions, the institution in question must be given a failing grade. (For an example, see Truman Bewley [1981] on the theoretical failings of the Tiebout model when compared to the outcomes that might be achieved by an all-knowing central planner.)
Caroline Hoxby (1999) has indirectly addressed this criticism. In the context of a Tiebout-Oates model, she asks whether home-value capitalization by itself generates enough information for voters to choose the efficient level of local services compared to the information that a centralized agency could realistically acquire. She demonstrates with a theoretical model that centralized agencies would have to be nearly omniscient about local demands for services in order to match the performance of housing markets in providing relevant information. The reason that housing markets work better is that they are not subject to the free-rider problem. If you don’t pay for the house, you don’t get the house and all of the local public services and amenities that are tied to it. Centralized administrators cannot recreate that information because residents have no incentive to reveal it, given that the service will be provided regardless of their inclination to pay.

Even without Hoxby’s elegant theoretical argument, my view has been that localism's performance should be compared to the likely performance of the same tasks by national, state, or metropolitan-area bodies. For this comparison, we do not need much theory, since there is an ongoing experiment in replacing local financing with larger-government financing under the rubric of school finance reform. The next two chapters explore the evidence for this modern twist in fiscal federalism.