

Regional Cooperation Strategies and Incentives for Global Competitiveness and Urban Reform

Theodore Hershberg

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When historians render their judgments on the last quarter of the twentieth century, they will conclude that its defining phenomenon was the emergence of a global economy. Driven by free trade, international capital markets, and extraordinary changes in communications and information technologies, this new economy will make the future very different from the past. In every field of endeavor, strategic thinkers are now asking how best to adapt to these changes, how to position their businesses, institutions, and organizations to take advantage of the new world marketplace. What should those of us interested in the future of America's cities learn from the remarkable transformations underway?

The first lesson of the global economy is that regions -- not cities nor the suburban counties that surround them -- will be the units of economic competition. As Neal Peirce, Kenichi Ohmae, and many others have argued, only regions have the necessary scale and diversity to compete in the global marketplace.¹ Only regions have an asset profile capable of projecting overall strength to compensate for the clearly less attractive profiles of individual counties or cities which lack either essential infrastructure or a sufficiently skilled pool of labor.

Regions, moreover, are the geographic units in which our goods and services are created. We hire from a regional labor force. We count on a regional transportation system to move the people and the materials involved in their production. We rely on a regional infrastructure to keep the bridges and roads intact and our sewers and pipelines functioning. We live in a regional environment where water and air do not recognize political boundaries.

If regions are the units of economic competition, the second lesson of the global economy is that cities and their neighboring suburban counties must embrace strategies of regional cooperation. To compete effectively regions have to be cohesive -- that is, they have to be capable of solving problems and seizing opportunities in a timely fashion. In a nation with precious few examples of regional government, this means that cities and suburbs have to find ways to work together for their mutual benefit.

The Global Economy Poses Three Regional Challenges

The good news in the global economy is that markets are enormously larger. There will be six billion people in the world in 2000 -- more than twenty times the size of America's population. The bad news is that the competition will be fierce as our firms vie for profits and market share with their counterparts across the globe.

To succeed, regions must respond to three major challenges posed by the global economy. First, regions must develop their human resources because human capital will be the source of comparative advantage in the future. Between 1973 and 1992, while per

capita GDP grew 25 percent (adjusted for inflation), only the top 20 percent of American male workers saw their real wages rise; the next 20 percent were stagnant, and the bottom 60 percent actually experienced a decline. Our standard of living did not fall at the same time largely because women entered the labor force in record numbers. But since 1989, even median household income has fallen despite the fact that Americans now work longer hours and a greater proportion now hold at least two jobs than in the last half century.

Inequality in the distribution of income and wealth, according to Lester Thurow, is also growing.² Among men working full time, the earnings gap between the top and bottom quintiles doubled in the last 25 years. Between 1979 and 1994, while the bottom three-fifths of American families lost ground in terms of real income, the second fifth gained 6 percent, the top fifth gained 25 percent, and the top five percent gained 44 percent. The share of wealth held today by the top one percent of the population now exceeds 40 percent, a proportion last observed in the late 1920s.

Why the sharply diverging trends in inequality? An informal poll of 18 prominent economists, conducted at the Federal Reserve Bank in New York at the end of 1994, concluded that 10 to 20 percent of the growing wage disparity was due to international trade; 10 percent came from declining union memberships and 9 percent from the erosion of the minimum wage. But almost half of the increases in income inequality resulted from technological changes that benefit the better educated.³

To counter these trends, regions should adopt rigorous, internationally benchmarked, academic standards and assessments for their students, expand greatly post-secondary training, make admission to their colleges and universities far more demanding, and increase the availability of advanced on-the-job training in the work place. Regions that respond to the human capital challenges brought by the global economy and rapid technological change will close the wage gap, ensure social stability, and improve the quality-of-life for all their inhabitants.

Second, regions must lower the cost of their goods and services to be competitive. The inefficiencies embedded in the configuration of local, state, county, and federal governments -- duplicated personnel, facilities, and services, limited management incentives, and tax structures that distort the most efficient location for economic activities -- lead to increased business costs. In a domestic economy, these higher costs did not matter very much because businesses passed them on to their customers in the form of higher prices, leaving their profit margins unaffected. Since all domestic producers did the same thing, no one derived competitive advantage.

But when the competition grows increasingly international -- and, for whatever reasons, prices for foreign goods and services come in lower than our own -- inefficiencies that spring from domestic practices undercut our competitiveness. In *World Class: Thriving Locally in the Global Economy*, Harvard Business School professor Rosabeth Moss Kantor illustrates the nature of global competition through the experience of a small American envelope manufacturer.⁴ The company learns that the contract it has

long held with a large local corporation has just been won by a Taiwanese competitor who provided a quality product at a lower price. After streamlining its internal operations, the local company reviews further options to stay competitive: it can reduce its profits; it can lower the wages of its workers; or it can look outside the firm to find ways to lower its costs.

When voters -- workers and their families -- understand the choice they will increasingly face to maintain the competitiveness of American goods and services in a global economy is either to lower their wages or to find other ways of reducing costs, they will not surprisingly choose the latter. Government practices considered sacrosanct today will change far more rapidly than most people now appreciate because politicians will quickly grasp that Americans are more committed to their pocket books than to traditional governance structures.

Regions should be asking what size "service shed" is appropriate for individual services and, for that matter, whether government should produce the service or contract it out to the private sector. The issue is not structural -- requiring the consolidation of governments into larger units, but functional -- offering services at the most efficient geographic scale. Efforts to tackle this politically sensitive subject are underway in several regions, including promising starts catalyzed by SUNY Buffalo and the Rockefeller Institute of Government at SUNY Albany.⁵

Third, regions must use scarce investment capital more productively. When crime, drugs, homelessness, and other social problems spill over into adjacent suburban communities, the response of those who can afford it has been to move even farther away to more pristine areas at the peripheries of our regions. This process is embedded in the concentric rings of growth that emanate outward from our central cities.

Very troubling signs in the older, inner-ring suburbs suggest that the pace of out-migration and other indicators of deterioration -- job loss, housing depreciation, drugs, crime and related social problems -- are accelerating faster than in the central cities they surround. The reason is that these small communities lack the basic resources big cities rely on to slow down and mediate the process of decline. These inner-ring communities do not have large central business districts generating substantial tax revenues to underwrite essential services in the neighborhoods; they do not have large police forces to maintain safety and a sense of social order as the crime rate climbs; and they do not have the sizeable public and not-for-profit social service agencies to address the needs of the poor and disadvantaged.

This out-migration from the cities and the inner-ring suburbs leads to new development in the exurbs, requiring new roads and highways, water mains and sewer lines, schools and libraries, homes and shopping centers, office and sport complexes. When this happens, our scarce investment dollars are spent redundantly because we are essentially duplicating an infrastructure that already exists in older suburbs and central cities. Such growth also often represents a highly inefficient use of our land. In

Southeastern Pennsylvania between 1970 and 1995, for example, while population declined by 140,000, one-quarter of the region's prime farmland was lost to development.

This redundant spending imposes heavy opportunity costs because these dollars are not available for vital investments in productivity -- while we build shopping centers, the Japanese are investing in R&D. To improve our competitive position in the global economy, America's regions would be far wiser to undertake more cost-effective development by adopting metropolitan growth rings, increasing residential and job densities in existing suburbs and cities, and investing the savings in research and development, plant and equipment and human capital. America should not behave in the 2000s as it did in the 1960s. The current practice of redundant spending is akin to eating our seed corn. The nation can ill afford public policy that leads to throw-away cities, throw-away suburbs, and throw-away people.

The Search for Solutions

Regions whose cities and suburbs succeed in finding ways to work together will fare better than those whose constituent governments choose to go-it-alone. Whatever the direction of causality, cities and suburbs are linked together through the integration of their regional economies. Whether they like it or not, or even whether they are aware of it or not, cities and suburbs are their region's primary stakeholders.

Unfortunately, one of the partners is not doing well. Most of America's cities are on greased skids, and what distinguishes one from the other is the angle of descent. Our political leaders act as if America will be a stronger nation and our regions will be more competitive in the future if we lose our cities and are left not simply with our current social problems, but ones far worse because they will have festered unattended. They behave much like the proverbial ostrich that sticks its head in the sand rather than contend with the dangers at hand. The presidential campaigns treat cities like tar babies -- mention them and you're bound to get stuck in unpopular or costly solutions.

Yet there are credible responses to the urban question that involve neither significant outlays of cash nor failed policies. My colleagues at University of Pennsylvania's Wharton Real Estate Center are now engaged in an important study quantifying the costs to suburbanites of decline in the central cities they surround. Last year, for example, they calculated a conservative estimate for the value of taxable and exempt real estate in ten of the nation's largest cities: \$1.6 trillion.⁶ A 10 percent decline in value would represent a loss of \$160 billion -- roughly what the savings and loan scandal cost Americans. Who are the big losers? Not city residents. Since the value of urban real estate is dominated by the large concentration of commercial office buildings in the downtowns, and these are owned by banks, insurance companies and pension funds, the losers turn out to be shareholders in these institutions, who not surprisingly live largely outside cities (along with 75 percent of the nation's population and a disproportionate share of our better-off citizens).

I look forward to the results of this research and the publication of more such examples of how urban decline affects the fortunes of suburban residents. These

empirical findings are welcome as more weapons in the fight against the folly of disregarding the plight of our cities and their residents. But while these new data are necessary, they will not prove sufficient. To explain why the continued deterioration of our cities and the serious long-term consequences they pose for the nation are ignored we have to look elsewhere.

Greater Philadelphia First, an organization of over thirty chief executive officers of the area's largest corporations, recently undertook an annual tracking survey to gauge public attitudes in a scientific sample of the region's population. In 1994 and 1995, roughly three-quarters "of suburban residents acknowledged a symbiosis between the city and the suburbs."⁷ They appear to understand the economic consequences and the spillover of social problems into the adjacent inner-ring suburbs that inevitably follow the decline of the central city. These attitudes resemble those found by my graduate students in two dozen informal focus groups held in the last several years.

The reason suburbanites have not supported further efforts to aid urban centers, I suspect, is not the absence of empirical evidence documenting the negative effects on the suburbs, but widespread distrust and cynicism about what can be done to save our cities. There is an all-pervasive sense that taxpayers have been generous in the past, just about everything has been tried with at best limited success, and there is no sense throwing good money after bad.

The work of a research team led by my Wharton School colleagues, Anita Summers and Joseph Gyourko, addresses these concerns. Their conclusion is that cities are beset by three major structural problems: the loss of jobs and population that undermined their tax base; a mismatch between the limited resources they possessed and the much larger set of social problems from which their residents suffered disproportionately; and the misuse of the available resources to address these problems.

Their New Urban Strategy argues that the federal government should accept responsibility for the costs of national problems -- poverty and immigration -- that are now borne disproportionately by cities. While there would be no net change in aggregate intergovernmental aid, they propose an "Urban Audit" that would first determine the extent of unfunded burdens that cities are bearing for the nation and then divide the pool of intergovernmental funds so that those bearing the largest burdens would receive the most aid.

The second component of the Urban Audit is intriguing and pregnant with potential for catalyzing urban reform: the federal government would adopt a rational incentive system that would define the road to "good government" and then reward cities which engage in reform and punish those which do not.⁸

Consider the experience of Philadelphia. In 1992, at the brink of bankruptcy, the city faced an accumulated deficit of \$250 million. Working together, Mayor Ed Rendell, who is white, and City Council President John Street, who is African-American, produced a labor agreement that did not give away the store, consolidated health and

related benefits that saved megabucks, and won back significant management prerogatives bargained away by previous administrations more interested in union support for the next election than in the day of fiscal reckoning another mayor would inevitably face. By 1996, the pursuit of reform policies produced an \$80 million surplus. Under a rational incentive policy, cities like Philadelphia would receive more funding from the federal (and state) government, while cities which refused to make the tough political decisions would receive less.

Which cities would get rewarded and which cities would get punished would be determined not by politics, but by the empirically derived "Urban Audit" noted above. At this stage, the mechanism is incomplete and certain to be controversial. To be sure, the "devil is in the details," but the concept of a rational incentive system for the nation's cities is the right direction in which to move.

Cities cannot save themselves with their own resources and most will not save themselves given a deeply entrenched political culture which makes sustaining reform over the long term impossible. Cities lack sufficient funds to deal with the vast array of problems now concentrated within their borders, and scores of studies chronicling efforts over the last century prove that reform is at best temporary. As the energy of the reformers diminishes, the returning pols restore business as usual.

A rational incentive system -- in crude terms, money for reform -- could leverage and sustain good government. While there is no guarantee that suburban support will follow, there is also no doubt that suburban residents will refuse to provide further urban aid as long as the evening news remains filled with stories of mismanagement and corruption. Putting aside posturing and partisanship will not be easy either for urban or suburban politicians. The former, especially minorities, will fear a loss of power, and the latter will fear the strident opposition of suburban residents who dislike central cities, which in metropolitan Philadelphia is estimated in the 25 to 33 percent range.⁹ But the large majority of urban and suburban residents understand the economic and social stakes of continued urban decline, and they can be mobilized by effective political leadership under a banner of rational incentives.

It is time for suburban Republicans to sit down with urban Democrats. Both sides would come to the table aware of shared interests. City politicians would recognize that the dollars they need depend upon political support from the suburbs. Suburban politicians would acknowledge their economic stake in the city, knowing that its decline will not destroy them as if by atomic blast, but realizing they would suffer from the fallout.

What is the basis for a new quid-pro-quo? Under what circumstances are the suburbs prepared to help the cities? What behaviors are expected from cities to demonstrate that they are in fact sustaining reform? If the cities live up to their part of the bargain, what are the suburbs prepared to provide in return? We need concrete answers to these questions. Advocates of regional cooperation need to help specify the "urban audit" and define the "road to reform."

The other missing ingredient -- effective political leadership -- will be more likely to emerge if the sign posts on the road to reform are spelled out in terms of coherent public policy. Ed Rendell, "America's Mayor," could articulate this agenda as well as anyone in public life today if he put his mind to it. So could Indianapolis' Steven Goldsmith. Finding suburban counterparts is always difficult. The sheer number of municipalities precludes productive collaboration among local governments and complicates even county-level partnerships. Republican Governors could play these roles effectively.

To get the job done, of course, would require what most of us would associate with statesmanship. Politicians would have to want to solve the problems of the cities rather than position themselves for the next election. They would have to believe that partisanship is a luxury America can ill afford in the fiercely competitive global economy.

States have a pivotal role to play. The "devolution revolution" Richard Nathan has written about affords an opportunity to help cities as well as improve the competitiveness of regions in the global economy. States may soon receive large amounts of money in the form of block grants. Instead of disbursing these funds entirely to each county according to formulas hammered out in state capitols, governors and state legislatures could set aside a pot of dollars -- perhaps 20 percent of the total. While each county would get its share of the 80 percent, the reserved portion of block grants funds would be available only to contiguous counties which come forward as regions with strategic plans demonstrating how resources could be better deployed on a regional than a purely county basis. Duplicated facilities, personnel and services abound within regions, and these regional proposals could identify new "service sheds" and rational allocations that would minimize costs and maximize service delivery. The plans submitted would have to contain real cost-benefit analysis so counties would not come together as regions simply to win the funds and then divvy them up among themselves.

The public policy that undergirded the Intermodal Surface Transportation Efficiency Act suggests how this might work. Funds were earmarked for highways and mass transit, but metropolitan planning organizations were given authority to spend an additional pot of "flex" dollars according to the unique circumstances of the region. "Regional allocation agencies," as Tony Downs refers to them, would similarly determine the best configuration of funds and delivery systems for health care, welfare, job training, education, environment, and the like.¹⁰ These decision-making groups could be popularly elected as in Portland, Oregon, or appointed by the Governor and the state legislature as in the Minneapolis-St. Paul area, or chosen by local governments.

In sum, success in the global economy requires cohesive and competitive regions. The future of the nation's cities is tied to the health of their regions, and the success of regions in the global economy depends in large part on the health of their central cities. Cities and the suburban counties that surround them should be working together to develop their human resources, lower the costs of their goods and services, and invest their scarce capital productively. A rational incentive system agreed to by city and

suburban politicians and embedded in national and state policies can provide aid to cities and sustain them on the road to reform. The devolution of power from the federal to state governments and the wise allocation of new block grant funds can stimulate regional strategic planning and result in more cost effective service delivery and more cohesive and competitive regions. The growth of regional thinking over the last decade is succeeding in clarifying the policy directions in which the nation must move to save its cities and ensure the competitiveness of its regions in the global economy. The critical next phase depends upon recruiting a generation of political leadership capable of recognizing the trends, the real policy options, and the possibilities.

NOTES

1. Neal R. Pierce with Curtis Johnson and John Stuart Hall, *Citistates: How Urban America Can Prosper in a Competitive World* (Washington, D.C.: Seven Locks Press, 1993); Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies* (New York: Free Press, 1995); Theodore Hershberg, "The Case for Regional Cooperation," *The Regionalist* (September, 1995).
2. Lester Thurow, "How Much Inequality Can a Democracy Take?" *The New York Times Magazine* (November 19, 1995).
3. Jason DeParle, "Class is No Longer a Four-Letter Word," *New York Times Magazine* (March 17, 1996).
4. Rosabeth Moss Kantor, *World Class: Thriving Locally in the Global Economy* (New York: Simon and Schuster, 1995).
5. "Assessing Regionalism in Erie County," from *Governance in Erie County: A Foundation for Understanding and Action*, The Governance Project: State University of New York at Buffalo (January, 1996); "Growing Together within the Capital Region," from *The Draft Report of the State Commission on the Capital Region* (February, 1996).
6. Joseph Gyourko and Anita Summers, "Wharton Research Impact Conference Summary: A New Urban Strategy," *Real Estate Research Bulletin*, The Wharton School, Spring, 1995).
7. *The Attitudes and Opinions of Residents of the Greater Philadelphia Region*, conducted for Greater Philadelphia First by Response Analysis of Princeton, N.J., in 1994 and 1995.
8. Anita Summers, "A New Urban Strategy for America's Large Cities," *Association for Public Policy and Management* (Chicago, 1994).
9. This estimate is based on the proportion of suburban residents who would not "be willing to see a greater share of current state tax dollars directed to the region's urban problems" (see note seven above); and a proprietary marketing survey done for a regional newspaper several years ago that concluded that "33 percent of those sampled had anti-Philadelphia attitudes."
10. Anthony Downs, *New Visions for Metropolitan America* (Washington, D.C. and Cambridge, MA: The Brookings Institution and the Lincoln Institute of Land Policy, 1994).

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