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## **Tirana's Sub-Municipalities: Has All Been Considered?**

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*"Democracy is the worst political system, with the exception of all the others"*

*Winston Churchill*

### **ABSTRACT**

Extensive political and fiscal decentralization is now underway in almost all countries in Central and Eastern Europe and the former Soviet Union. Faced under the apparent political pressures to decentralize and the potential economic advantages of doing so, Albanian government has been allocating significant efforts into the design and implementation of a reasonable decentralization law. This paper calls for the Albanian government to be cautious. Design of decentralization schemes that are inspired mainly by electoral and political processes without considering the fiscal and institutional dimensions cannot produce efficient results. Political decentralization is associated with the devolution of power to sub-national political entities. However, if decentralized entities in Albania are to execute the responsibilities passed to them, they will also require a suitable level of financial resources to cover the costs of providing local public goods and services. The issues are complex, technically, financially, and politically. How alternative policies impact local economic development is often difficult to assess and studies have some times shown contradictory results depending on the specific local contexts. Much more concrete analysis, based on sound local knowledge and data is needed to improve the design of the systems that are being put into place.

### **INTRODUCTION**

During the last decades, the trend of government decentralization observed in many nations of Central and Eastern Europe has also been occurring in Albania. Advocates of local autonomy often claim they want to shift government authority "closer to the people." This transfer of authority to regional, state, and local entities has, to some extent, gained a reputation

as the "fix-it-all" for a variety of political and economic problems. In theory, decentralization may strengthen democratic participation and improve the quality and delivery of local services, but success is dependent also on the fiscal and economic fundamentals associating this decentralization.

Understanding the underlying intent of central government is therefore an essential element in analyzing any decentralization endeavor. Design of decentralization schemes that are inspired mainly by electoral and political processes without considering the fiscal and institutional dimensions cannot produce efficient results. The purpose of this paper is to examine the recent Law "On Organization and Functioning of Tirana Municipality".

The first part of the paper provides background information on Albania's political and economic situation. The second part provides information on the current legislation concerning decentralization and on the law of subdividing Tirana in sub-municipalities. Third, it is presented a description of the factors that should have been considered when drafting the Law, but still important to be considered for the future. Fourth, the paper provides a list of recommendations on decentralization. The final section summarizes the major findings and draws conclusions.

## **BACKGROUND INFORMATION**

Apart from providing Albanians the long-dreamed democracy, the sudden change of Albania from a centralized to a market-oriented economy has been also accompanied by a series of actions which some times have purely followed the western models, without thoroughly considering Albania's specifics. The results of these actions on how they would affect the Albanian society in the short- and long-term are yet to be seen. After first accepting the theory of shock therapy of some "ingenious" economists who managed to deny any existing systems by labeling them "communist", Albanians were found also ready to embrace every reform that was presented to them as "western". Decentralization makes a good example of the above.

Tirana, the capital of Albania, has been growing at an annual rate of 7% since 1990. Such growth has resulted in higher densification around the city center and an extreme expansion in the suburbs. While many studies have proven the current lack of institutional capacities to manage this growth, the short-term future seems to be even worse. Although Albanian government and Tirana municipality, assisted also by foreign experts, are trying to find a way of lessening the negative effects of such rapid growth, many theories which work well elsewhere

have failed to provide appropriate solutions in Tirana's context. In an effort to reduce the inefficiencies caused by this rapid growth, the Albanian Parliament approved in July of 2000 the Law No. 8654, "On Organization and Functioning of Tirana Municipality". Before discussing the details of this law, I believe it is important to briefly present a description of the current situation in Albania.

***Situation Analysis: Pessimistic View.*** Ten years ago Albanian students marched in the streets of Tirana to protest against one of the strictest Stalinist systems in Eastern Europe in pursuit of a better life. Shortly thereafter democracy won. Many thought they were already on the plateau of democracy but quickly realized they had just entered the road to democracy. The "assured" success of the market economy soon became an illusion. George Soros (1997) makes a strong case for the idea that a market economy, if left alone, will be destructive of national development. While it would be hard to deny apparent successes in Albania during these ten years, failures in some areas support a pessimistic view as well. Market processes, by their nature, yield random outcomes (Heilbroner 1993). Random outcomes over time, if not stabilized by well-functioning institutions, lead to opportunistic exploitation of both people and environment and subsequently produce chaos, just as in the Albanian case (Felstehausen 1999). Unfortunately, urban development in Albania has been one of the chaotic areas.

Arguably the most fundamental reform within the public sector has been privatization (Dale 1999). Eastern Europeans quickly learned that privatizing land, buildings, and businesses was a prerequisite to joining the community of nations. In Albania, two large privatization programs of agricultural land and buildings/apartments, which finished in time record, caused only negligible concerns and were considered successes. Four million newly created properties are now in the ownership of about 3 million Albanians. These dramatic changes in land ownership structure, associated with free migration from rural to urban areas, have produced new scenarios Albanian cities should face. While existing institutions and government bodies dealing with urban development should assume new roles, it has been hard for them to fully understand what those roles are.

Developing countries have traditionally sought to learn from other countries. While I appreciate the importance of such exercise, I am also convinced that urban development issues are particularly dependent on country's specifics. However, creativity and the ability to adapt good solutions in specific context of Albania become crucial and key to success.

Following, there is a list of facts that I consider will influence the urban development in Albania and the success of decentralization process:

- There has been internal political instability in Albania since 1992. On average, governments have changed hands every other year. Turmoil happened in March 1997 after the collapse of the "make-rich-quick" schemes, in September 1998, because of political battles with opposition, and in March of 1999 during the Kosovo crisis.
- Located in Balkans, Albania has also been affected by a continuous instability characterizing the region. Unfriendly relations with Serbia and wary relations with Greece and Macedonia make the situation even more complicated.
- Involved with numerous problems which require immediate solutions, Albanian government has not yet been able to design a clear vision about the long-term strategy for Albania and the role of Tirana as the capital of the country.
- Although Albanian Government is working towards the creation of public order, success has been undermined by the number of criminal acts ranging from random shooting to family killing and from sporadic to organized crimes.
- While courts are usually considered the last resort for pursuing justice, Albanians sadly are realizing that much needs to be done to improve the quality of court system, in order to build public trust. Courts have failed to become independent of politics or misconducts inspired by financial benefits.
- Some Albanians, usually the nostalgic soldiers of the old system, claim that education system was one of the undeniable successes of the past. Working in academia for few years, I would also agree that quality of today's education system is unacceptable. The existing lack of funds and initiative could not produce different results.
- Because of total failure of the past system, a strong mistrust has been built in people's minds towards the efficiency of the government. Any initiative calling for more government control has high chances to fail because of lacking public support.
- Changes in the political system have produced drastic changes in Albania's demographics as well. Considerable migration has happened including: (a) people migrating abroad, a process which started in 1990 and still continues on a large scale; (b) people migrating from remote areas and villages into the major cities; and (c) people migrating from the city to suburban areas in search of a better quality of life.

- Finally, one needs to cite the misconduct of public officials as one of the biggest threats for Albanian society. The degree of corruption seems to increase despite the continuous calls made by the government to fight against it.

While all of the above might seem as a situation analysis conducted by a person having "dark glasses" on, I would argue this is not the case. Facing reality is often hard. However, in my opinion, it is the only way to provide reasonable solutions to complicated problems. Understanding such difficulties helps one to focus on real issues, determine priorities, and most importantly, build rational expectations about the outcomes. As Harris (1980) once elegantly put it, "most 'solutions' are compromises that offer the best prospects of getting farthest toward the desired end of a spectrum that extends from horrible to ideal".

## **CURRENT LEGISLATION ON DECENTRALIZATION**

As stated in Article 108 of the Albanian Constitution ratified in 1998, "Local Government in the Republic of Albania is founded upon the basis of the principle of decentralization of power and is exercised according to the principle of local autonomy." Many potential and necessary changes to the present governmental system in Albania are outlined in the National Strategy for Decentralization, an official policy document of the Government of Albania, which was approved by the Council of Ministers in January 2000.

On July 2000, the Law No. 8652, "On Organization and Functioning of Local Governments" was passed. In this Law, Albanian municipalities gained administrative authority to manage government structures, including the establishment, reform, and merger of these structures. Various types of delegated functions are now assigned or mandated in law by central government to a local government for implementation as determined by the central government. Thus, localities will be called upon to carry out functions that were formerly in the central government's sole jurisdiction, but will not have substantial decision-making power regarding these functions. Shared or "joint" functions are functions for which the local government unit has autonomous competencies but a share of responsibility remains with the central government. There are also "exclusive functions" of the local government outlined in the law. In those functions, the local government exercises full administrative, service, investment, and regulatory authority, within the standards generally accepted in law.

Also on July 31, 2000, the Parliament approved the Law No. 8654 "On Organization and Functioning of Tirana Municipality," which is the main subject of our analysis. According to this law Tirana is divided into 11 sub-municipalities, which assume the same rights as any other municipality of any other district. Each sub-municipality is said to have its own budget, although the Tirana Municipality provides the major part of the budget. Financial activities of the sub-municipality are subject to the control of the main municipality.

While, politically, decentralization reflects both a reaction from below to the extensive central control, it is hard to see that there has been an attempt expressed in the law for the center to transfer some authority over expenditure responsibilities and financing to sub-municipalities. Economically, decentralization should be motivated by the necessity to utilize public resources more efficiently, apparently missing in the current law. It seems that no other criteria other than geographic have been taken into account when subdividing Tirana. In addition, provided the current dynamics in Tirana, one would argue that timing of this law is also questionable. For all of the above, one would think that political rather than economic reasons might have motivated the creation of these sub-municipalities. In the following section, I have presented in detail issues that should have been considered when dividing Tirana in sub-municipalities.

## **DECENTRALIZATION: FACTORS TO CONSIDER**

Decentralization is a key dimension of the transition from a command to a market economy. Eastern European countries have found themselves under continuous pressure to decentralize. While they have been presented with the benefits of doing so, potential drawbacks have usually been either skipped or overlooked. Although Prud'homme's analysis assumes "pure" decentralization (i.e. a system in which pure local governments raise pure local taxes and undertake pure local expenditures without the benefit of central government transfers), I consider worth pointing it out in order for the sub-municipalities in Tirana to accurately evaluate the dangers of decentralization as well as its benefits. Prud'homme (1995) argues that decentralization can in fact (a) increase disparities; (b) undermine both allocative and production efficiency; (c) jeopardize stability; and (d) encourage corruption. The common mistake of undermining differences between countries seems to produce complexities in the case of decentralization as well.

Drafting the supporting legislation was only the first step on the long path of decentralization process. Walking that path will be difficult for Albanians. For a start, here is a list of constraints linked to decentralization process, compiled by Lawrence (2000): (a) scarce locally-managed resources; (b) limited capacity to collect taxes and fees; (c) no independent revenue sources; (d) inadequate incentives to carry out new policies; (e) political and legal uncertainty or varied interpretations of new policies and laws; (f) limited experience in local self-government; and (g) domination by criminal fractions or economic interest groups.

While it could have served the process of Tirana's decentralization better if a thoroughly analysis of the factors affecting decentralization would have been conducted before the approval of the law, I present below a list of these important factors with the hope that it would assist the Tirana municipality and sub-municipalities to select the best tools for their successful functioning in the future.

**Expenditure Assignment.** The primary economic role of sub-municipalities would be the delivery of local goods and services. Coming out of socialist economies operating under unified centralized budget, these sub-municipalities have extremely limited experience in self-government. On the other hand, while Law 8654 provides sub-municipalities with some spending responsibilities, it is not clear what the revenue sources are. Situation seems similar to recent legislation in Hungary and Poland, which gave local governments expenditure responsibilities in education, transportation, environment, and housing and related services, without specifying how these will be financed (Bird et al. 1994). The benefit area approach to local finance tells us that each function should be assigned to the lowest level of government that encompasses all or most of the service benefits (Clotfelter 1977). However, service standards should be administered by the central government, in order to appropriately provide the services even to poorer localities. Albania, for example, continues to centralize provision of services such as health and education.

**Financing Sub-Municipalities.** The era of "one-sack-for-all" intergovernmental revenue system inherited from the past should end. Too often, national tax reforms do not seem to have taken the fiscal needs of sub-national governments into account (Bird et al. 1994). Tirana municipality should soon investigate the adequacy of sub-municipalities "own source" revenues, in order to assign appropriate levels of financing from the center and to reduce the dependence of these sub-municipalities on the central tax sharing or governmental transfers.

**Financing through User Charges.** Governments in the command economies traditionally used fixed prices and wage controls as essential elements of their distributional tool-kit. Health services and education were nominally free. The benefit approach to local government finance suggests that, where possible, services should be paid for by those who benefit from them (Wasylenko 1997). For example, in Hungary, authority for setting sewer and water management fees has recently been transferred from the central government to municipal companies (Bird et al. 1994). While in Albania, water charges are set at nationwide uniform rates even though provision costs differ across districts.

**Sub-Municipality Taxes.** Where it is impractical to impose fees or levy user charges, theory tells us that services should be financed by taxes levied on local beneficiaries (Feldstein and Vaillant 1994). The question remains which taxes to assign? Value-added-tax, for example, is usually levied at uniform national rates. The corporate income tax is a central tax in most market economies. In the transition economies to set corporate tax rates might influence enterprise location decisions in perhaps undesirable directions. Much of the literature on tax assignment argues that the personal income tax should be retained by the central government, largely for redistributive and stabilization reasons. For transition economies, combining a uniform national base and national collection with locally set rates makes such "local" income taxes administratively feasible. Property taxes in some form have been introduced in Albania, although no implementation has taken place yet. In addition, the property tax rate in Albania is set by the central government, preventing any fiscal discretion on the part of the local government.

While many developing countries are devolving the power to tax and spend from central to local governments, the results have largely been disappointing. In a recent paper, Tanzi (1995) explains why. For a start, he argues, the economic logic of devolving fiscal powers assumes that central and local governments are equally efficient and democratic. In many emerging economies they are not. Corruption often gets worse at lower levels of government. Another problem is that many local authorities may not have enough officials capable of running budgets. A third difficulty is that decentralization can often make it harder for a country to balance its books. Not only in transition countries, but taxes do not appear to have a substantial effect on economic activity among states in the US either (Wasylenko 1997).

**Tax Sharing.** Tax sharing refers to a system in which one (central) government collects revenue from a tax and shares it with the other levels of government. Usually, such tax sharing



universally takes place on the basis of the geographic origin of the revenues (the so-called "derivation" basis). Tax sharing is designed to supplement the meager own revenue sources that are formally assigned to the sub-levels of government. Tax sharing has the advantage of simplicity and, if shares are transparent and fixed, sub-governments are guaranteed some degree of revenue certainty. A general disadvantage of tax sharing is that it does little to enhance local accountability or efficiency. The selection of appropriate tax sharing schemes should be the result of a well-thought process conducted by Tirana municipality, in order to encourage increase incentives for localities to spend efficiently.

**Intergovernmental Transfers.** Since it is expected that the revenue-raising capacity of sub-municipalities would not match expenditure needs, fiscal transfers from Tirana municipality to sub-municipalities will be required to close the resulting gap. Transfers may be preferable as they allow local governments to provide services and the central government to set standards. In 1993, tax sharing and transfers together accounted for 100% of sub-governmental revenues in Albania, and situation continues to be so. If in the future these transfer rates will differ among sub-municipalities, the process of making the transfers should be as transparent as possible.

**Inter-Municipality Competition.** There have been contrasting views about the detrimental and beneficial aspects of inter-jurisdictional competition. A survey of several theories conducted by Kenyon (1997) serves to show that each view has some elements of truth. In the appendix A, I have provided a list, compiled by Kenyon, of theories used in analyzing inter-jurisdictional competition, in order for Albanian readers and decision-makers to fully understand the strengths and weaknesses of each theory before applying it to Albanian situation.

**Regulatory Policy.** Regulations at all levels of government attempt to promote economic welfare primarily by correcting imperfections in private markets, such as monopolistic or oligopolistic practices, negative externalities generated in both production and consumption, imperfect information, and fraud. The impact of regulation is hard to predict. However, Tannenwald (1997) found that it is successful cities, which put more regulations, as they know companies will still stay there. This finding will be important for new mayors of poor sub-municipalities to be careful when drafting regulations that could harm the sub-municipality rather than help it.

**Tax and Spending Incentives and Enterprise Zones.** From a theoretical perspective, taxes and development incentives are a spatially variable business cost, and thus should influence location

and investment decisions at the margin. However, neither tax incentives, nor non-tax incentives, nor enterprise zone incentives operate to offset the effects of basic state-local tax systems (Fisher and Peters 1997). The locations that offer the highest returns without incentives are pretty much the locations with the highest returns after incentives are included. Therefore, the success of a sub-municipality should not fully be based on hopes of using tax incentives or enterprise zones to induce businesses to locate there.

**State and Local Public Services.** The relationship between public services, or at least government spending, and economic development in the jurisdiction providing those services, as measured by changes in population, employment, income, or the number of firms is an undergoing process, which has resulted in mixed conclusions. Fisher (1997) states that in many studies, government spending, public capital, or public services are estimated to exert a positive and statistically significant effect on economic development. But the results vary greatly. Perhaps the most that can be concluded is that *some* public services clearly have positive effect on *some* measures of economic development in *some* cases. The above conclusion should help Albanian decision-makers become more conscious about the difficulties of selecting the right public services to provide.

## **RECOMMENDATIONS**

Albanian government has been serious about the decentralization program. However, the process has just started. Changing the role of government in Albania will require several steps. Central government should first be transformed from governor of the people to servant of its citizens, a concept which would require much effort from both parties, citizens and government itself. Then, decentralization from central to sub-governments should take place, politically and economically. For example, law on the transfer of public properties to local governments has just been passed in February of 2001, but the transfer of those properties from center to local government should be conducted in a careful way in order to avoid chaos and competitive fights between local governments. Further, the central government should liquidate obsolete government agencies. Next, fundamental government systems should be redesigned. Finally, public finance and civil service should be reformed. This would be a road map for Albanian decentralization process. In pursuing the above steps, Albanians could make use of good and bad experiences from other countries, eastern and western. Nevertheless, the right choices will

depend on the similarities of Albania's specifics and the country being studied. University of Tirana should as soon as possible design a special curriculum for urban planners and urban economists, who will lead the process of decentralization by selecting the best policies and efficient practices. Finally, the more knowledgeable and stronger the Association of Mayors of Albania would become, the higher the chances for a successful decentralization process in Albania.

## **SUMMARY AND CONCLUSIONS**

Division of Tirana in sub-municipalities seems to have been motivated by electoral and political reasons rather than fiscal and/or economic reasons. As the process of decentralization has started, I strongly recommend that it should be associated with the appropriate fiscal and financial reform. Drafting the best policies for managing local governments is a long process. Results from other countries are mixed with successes and failures. Dangers of decentralization should be considered as well as its benefits. While experience from other countries and international aid would be helpful, it is Albanians who have to solve their own problem.

In a 1998 World Bank paper, Anwar Shah argues that "Decentralized fiscal structures are more suitable in developing countries than centralized structures are, especially when they are supported by strengthening the rule of law, an independent central bank, an independent judiciary, a charter of rights, appropriate limits on various levels of government, institutions for conflict resolution and the evaluation of government efforts at all levels, and mechanisms (including a free media) for listening and making government accountable to the citizenry."

Reading through Shah's lines and comparing it with the reality described in the situation analysis of this paper makes one realize how difficult this process would be. However, the author hopes to have provided a comprehensive list of issues to be considered for the successful continuation of the decentralization process in Albania.

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### Appendix XXX: Theories of Inter-jurisdictional Competition (IJC)

Assumptions	Type of IJC	Effects of IJC	Model Shortcomings
<p><b>Tiebout (1956)</b> Individuals vote with their feet; large number of communities; individuals fully mobile; no spillover effects.</p>	<p>Competition for individuals based on tax / service package; most applicable to IJC among suburbs in large metro areas.</p>	<p>Productive efficiency; allocative efficiency; taxes are benefit taxes.</p>	<p>Model does not include business firms; assumptions of perfect mobility and full information are heroic.</p>
<p><b>Oates/Schwab (1991)</b> Jurisdictions compete for mobile businesses using tax / service packages; full knowledge; large number of communities; no spillover effects.</p>	<p>Competition for businesses based on tax / service package; most applicable to IJC among suburbs in large metro areas.</p>	<p>Productive efficiency; no allocative efficiency; taxes are benefit taxes.</p>	<p>Model does not include competition among individuals; assumptions of full information and no bargaining power on the part of businesses are unrealistic.</p>
<p><b>McGuire (1991)</b> Jurisdictions compete for mobile individuals using tax / service packages; individuals have preferences for redistribution and governments rely on ability to pay taxes.</p>	<p>Competition for individuals based on tax / service package; most applicable to IJC among states.</p>	<p>Productive efficiency; no allocative efficiency; suboptimal level of public services or of taxes, or both; less mobile individuals will pay higher taxes; high-income taxpayers will benefit from selective tax relief.</p>	<p>Model could be clarified by being formalized; useful to separate out the roles of businesses and individuals.</p>
<p><b>Wolkoff (1992)</b> Jurisdictions use economic development subsidies to try to induce potentially mobile firms to stay; some firms are potentially mobile, others are not, but the jurisdiction cannot easily distinguish between types of firms; both jurisdictions and firms engage in strategic behavior</p>	<p>Competition for businesses based on package of economic development subsidies; applicable to states or cities large enough to conduct economic development programs.</p>	<p>Model does not address productive efficiency, allocative efficiency, or equity; model seeks to explain why some seemingly irrational economic development policies, such as providing subsidies to immobile firms, can be rational.</p>	<p>Model focuses on rationality of economic development policies from the perspective of a single jurisdiction, not from the perspective of the country as a whole; no consideration is given to the separate roles of individuals and businesses.</p>
<p><b>Besley/Case (1995)</b> Voters use information about neighboring jurisdictions to judge incumbents; elected officials are disciplined by voice; no mobility of individuals; politicians know more about costs of public services than voters; some politicians engage in rent-seeking.</p>	<p>Yardstick competition in which voice dominates exit; most applicable to IJC among states.</p>	<p>Model does not address allocative efficiency or equity; yardstick competition does not always guarantee productive efficiency.</p>	<p>Difficult to generalize from 19 different possible equilibria; government services not included in model; no role for businesses; assumption of zero mobility can be criticized.</p>
<p><b>Breton (1996)</b> A broad model of politics and public finance is developed, which emphasizes competition within and between governments at different levels; governments seek to maximize expected consent; individuals maximize utility.</p>	<p>Both implicit competition and yardstick competition play a role; model appears equally applicable to interstate or interlocal competition, in either a large numbers or a small numbers situation.</p>	<p>IJC can lead to efficient provision of publicly provided goods and services if competition is vigorous and the national government serves as an adequate monitor of competition among governments; but depending upon the circumstances, competition can also be unstable and inefficient.</p>	<p>The model is too broad to provide much insight into competition for economic development specifically; it does not separate out the roles of individuals and businesses.</p>

