Promoting Prosperity in Mississippi

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INSTITUTE FOR MARKET STUDIES

The Institute for Market Studies at Mississippi State University was created in 2015 to support the study of markets in order to provide a deeper understanding regarding the role of markets in creating widely shared prosperity.

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Preface

What creates prosperity? Why are some states rich and others poor? Why does Mississippi consistently rank as one of the poorest states in the nation? Can anything be done to move Mississippi 'out of last place'? These questions are often raised by our students and fellow Mississippians. This book addresses each of these questions by identifying areas in which Mississippi can improve its economic conditions.

In this book, we identify key areas for Mississippi economic policy reform. Twenty-one scholars, ten of which are from or work in Mississippi, have contributed original policy research. All twenty chapters were written specifically for Mississippi with a shared goal to promote prosperity in the state. While some of the chapters contain complex policy reforms, we have made every effort to present the concepts and ideas in a way that is understandable to the average citizen, the person who can benefit the most from this information.

The first three chapters of the text summarize the basic economic principles necessary to achieve economic prosperity. These three chapters present the principles behind the reforms proposed in the subsequent seventeen chapters. Each chapter was written independently and offers unique insight into different areas of state policy reform. While the topics covered range from tax reform, education reform, healthcare, corporate welfare, occupational licensing and business regulatory reform to criminal justice reform, and natural disaster recovery efforts, there is a clear unifying framework underlying the conclusions reached in each chapter. The theme throughout is that economic growth is best achieved through free market policies, policies which are based on limited government, lower regulations, lower taxes, minimal infringement on contracting and labor markets, secure private property rights, low subsidies, and privatization. Policy based on these principles allows Mississippians to have more rights and more choices in their lives.

We hope that readers come away with a better understanding of capitalism's true potential to generate the long-run economic growth necessary to make Mississippi more prosperous, as well as ideas for policy reforms that could accomplish it in our lifetimes. This book illustrates that if Mississippi embraces economic freedom, the state will experience more entrepreneurship, increased business and capital formation, higher labor productivity and wages, and overall economic growth. Our main goal is to provide the scholarly, academic research that can inform state policy decisions and open a much needed dialogue on growth-oriented policy reform in Mississippi.

We focus on long-run policy improvements. Thus, the analysis is not an assessment of any particular administration or political party. Instead, this book can be thought of as a blueprint of possible economic reform proposals that use scientific evidence as a guiding principle. We emphasize that our unifying framework, which shapes the conclusions drawn in each chapter, is based on economic science, not politics. All authors address their respective topics by relying on academic research. Topics and policy conclusions were not based on any particular political agenda, political party, or political expediency. Instead, the authors relied on cold, hard facts and data with references to published academic literature to develop policy reform suggestions specific for Mississippi. In fact, many reforms suggested may not be politically possible.

The inspiration for this book came from *Unleashing Capitalism*, a series of books using economic logic to improve state policy in West Virginia, South Carolina, and Tennessee. We owe thanks to more people

than we could possibly list. We are indebted to our colleagues and the Finance and Economics advisory board at Mississippi State University who helped review chapters and provide invaluable feedback. We thank Ken and Randy Kendrick, Earnest W. and Mary Ann Deavenport, and the Pure Water Foundation for the funding necessary to embark on a project of this magnitude. We also thank our friends and family for their support, and for putting up with the long working hours that went into conducting this research. Most importantly, we would like to thank the staff and supporters of the Institute for Market Studies at Mississippi State University for publishing this book. Without their support, this book would not have been possible.

Let's start promoting prosperity in Mississippi!

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Local Governments Run Amok? A Guide for State Officials Considering Local Preemption

Michael D. Farren and Adam A. Millsap

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Local Governments Run Amok? A Guide for State Officials Considering Local Preemption

Michael D. Farren and Adam A. Millsap

State governments often overrule local government ordinances. For example, Mississippi–along with Alabama, Louisiana, Tennessee, and fifteen other states–bars municipal governments from setting a minimum wage higher than the state's minimum. The act of overruling municipal law with state law is known as preemption, which is a legal doctrine asserting that state laws take precedence over local laws. The recent Mississippi laws preempting local control of minimum wages and Transportation Network Companies (TNCs) have reasserted the authority of state government to overrule local regulations. This raises the question: What circumstances should motivate the use of state authority to interfere with local rule-making?

This chapter provides a framework to guide state officials who are considering local preemption. We use this framework to analyze four issues that are relevant in Mississippi: 1. The sharing economy, including TNC regulations; 2. Labor market regulations, such as minimum wage laws; 3. Land use regulations; and 4. Tax and expenditure limits (TELs). We conclude that state preemption is warranted in situations where local governments enact non-general policies interfering with free exchange via price controls or similar restrictions.

To Preempt or Not to Preempt?

City officials tend to push back against preemption, arguing that those with local knowledge should determine local policy. This argument has some merit. Many advocates of free enterprise, such as Nobel Prize winning economist Friedrich Hayek, have also extolled the value of local knowledge.[1]

But a counter argument is that local policy makers and voters often fail to incorporate local knowledge into their decision making, implementing policies based on dubious economic reasoning. Furthermore, local influential special interest groups are often more interested in accomplishing their narrow goals rather than supporting broad economic growth. In order to appease them, local politicians—who are often focused on winning re-election—enact popular yet economically inefficient policies.

For example, the popular Fight for $15 campaign supports a $15 minimum wage in cities from San Francisco to Minneapolis despite the differences between local labor markets. Even economists who support higher minimum wages, such as Arindrajit Dube, caution that they should be based on local conditions, yet this is rarely acknowledged by sympathetic policymakers at the local level.[2] The result is ill-fitting policy that creates unintended consequences.[3]

Mississippi's preemption of local minimum wage laws and its more recent preemption of local ride-sharing ordinances, along with similar preemption in other states, raises the question of when state preemption of local authority is appropriate. In the next section, we explore the legality of state preemption.

State Sovereignty Over Local Government

In the United States, government generally operates at three levels: federal, state, and local. Each layer of government provides certain goods and services for its constituents, and most people believe that the different layers, while perhaps not completely separate, are largely distinct from one another. Using cake as metaphor, this depiction of government would take the form of a layer cake, with the federal layer at the top and the local layer at the bottom.

But in reality, the layers are not so well-defined. Both the federal and state government play some role in providing local goods and services. For example, Medicaid is largely a federally-funded program that is administered by the states (see Chapter 14). Federal and state governments also provide resources to local governments for K–12 schools, road construction and repair, police and fire provision, and parks and public housing. Instead of a layer cake with three distinct layers, government in the United States is better imagined as a marble cake in which the upper layers often overlap the lower layers.

More importantly, only the federal and state governments have governing authority according to the U.S. constitution, which is the supreme law of the land. Well-established legal precedents have declared local governments, whether they be counties, cities, villages, school districts, etc., to be creations of the state and ultimately subject to state control. This relationship is clearly exemplified in county governments, which were created for state government administrative purposes.[4] In short, local governments wield power only at the state's discretion and have no independent authority.

However, the administrative decentralization of state authority gives the *illusion* of local autonomy, stemming from local governments exercising rulemaking authority such as levying taxes and implement-

1 See Hayek (1945).

2 See Dube (2014) and Matthews (2013).

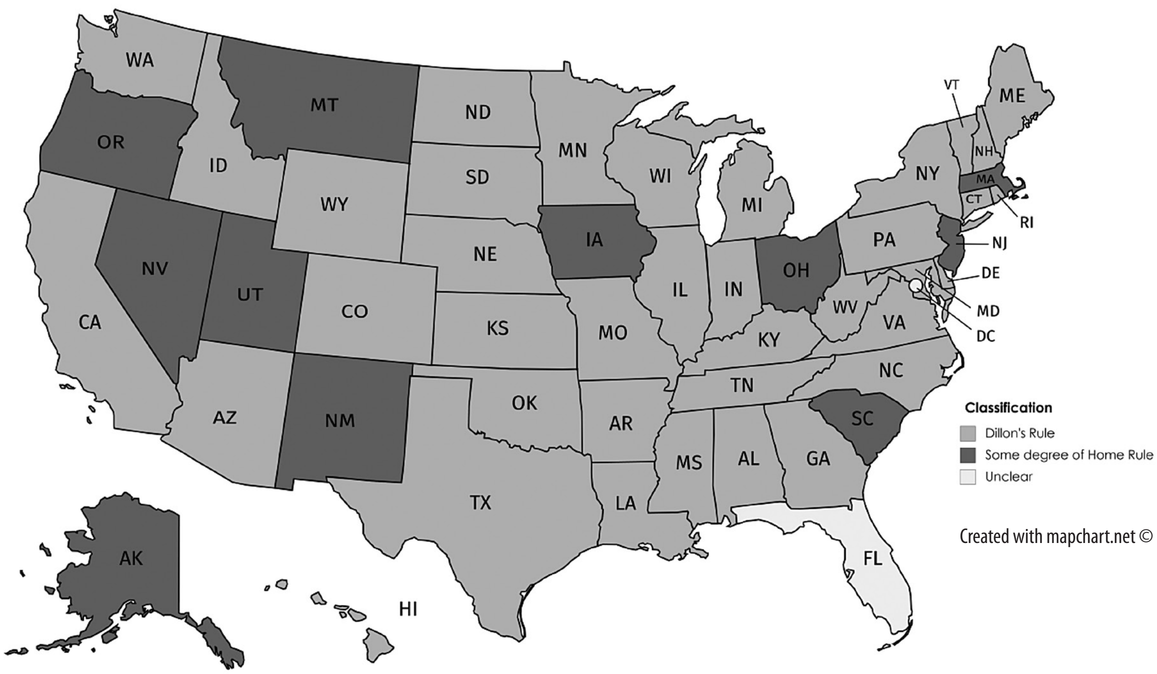
3 Refer to Chapter 3 for a detailed discussion of how seemingly good policies can lead to unintended, negative consequences.

4 See Marando and Reeves (1991).

ing economic regulations. Additionally, in many cases this quasi-independence is established by state legislation or by a state constitutional amendment.

While all local governments in all states are ultimately subservient to state law, states that follow "Dillon's Rule" adhere to a strict interpretation of state authority. Under Dillon's Rule local governments only have the powers expressly granted to them by the state. The map below shows which states follow Dillon's Rule.

Figure 12.1: Map of U.S. States Using Dillon's Rule



Source: Richardson, Gough, and Puentes, (2003)

The alternative to Dillon's Rule is a spectrum of policies combining the strict interpretation of state authority with various degrees of what is commonly called Home Rule. Home Rule grants local governments greater freedom to determine policy as long as local laws and regulations do not contradict state law. There is wide variability in how Home Rule is granted: Some states grant Home Rule to counties but not cities, others grant Home Rule to large cities but not small ones, as well as other arrangements.

Mississippi is typically categorized as a Dillon's Rule state, though the state legislature has granted municipal governments some degree of local discretion.[5] Relative to other states, however, Mississippi grants local governments little power to set policy.[6] As stated by Mills:

> "While the 1985 passage of the "home rule" statute did away with the general legal principle that a specific grant of power was necessary for a municipality to take an action,

5 In 1985 the Mississippi Legislature granted municipalities limited home rule with the adoption of § 21-17-5 of the Mississippi Code of 1972. See Mills (2014).

6 See Richardson, Gough, and Puentes (2003).

> it contained numerous exceptions as set out above. With regard to the levy of taxes, issuance of bonds, procedures for elections, change of municipal boundaries, change in the form of government, sale of alcoholic beverages, donations, or rent control, the rule remains the same. In each of these instances, state law must be followed."[7]

Furthermore, as is standard in states with even the most laissez-faire Home Rule, municipal ordinances in Mississippi must not clash with state law. In a 2010 ruling, the Mississippi Supreme Court stated that:

> "If a county or municipality passes an ordinance which stands in opposition to the law as pronounced by the legislature, the ordinance, to the extent that it contradicts state law, will be found void by this Court, as the laws of this state supersede any and all local ordinances which contradict legislative enactments."[8]

In practice, the difference between "Home Rule" and "Dillon's Rule" is often not clear cut. However, it is clear that Mississippi's state government ultimately decides which powers to grant local governments and can supersede local ordinances with state law. In the next section we discuss how the state should exercise such power. Most importantly, under what conditions and to what degree should it exercise local preemption?

Two Principles to Guide State Preemption: Generality and Free Exchange

When making decisions about local preemption, state officials in Mississippi should keep the principles of 'generality' and 'free exchange' firmly in mind. These principles serve as guardrails: if municipal policy bumps up against either guardrail it should be scrutinized and perhaps preempted by the state.

The first principle, "generality," is similar in definition to the rule of law—the same laws and regulations should apply to all persons engaged in the same activity or living under the same government. Any deviation from generality likely constitutes governmental granting of privilege to some people over others.[9] Such privileges often arise from lobbying by special interest groups for political favoritism.

While public condemnation is the common reaction to such lobbying, it's important for policymakers—as well as the public—to understand that seeming perversions of government authority are an inherent aspect of all forms of government. James Madison recognized this in Federalist No. 10 when he said that "the latent causes of faction (special interests groups) are thus sown in the nature of man" and that "the *causes* of faction cannot be removed [...] relief is only to be sought in the means of controlling its *effects*."[10]

In other words, it is precisely the unavoidable problem of special interest groups lobbying for privileges that requires government to put limiting structures on itself. Because municipal governments serve as local wardens of state authority—and because it can be easier for special interest groups to sway local policymakers[11]—it's appropriate for state government to limit the ways in which municipalities can grant privileges.

The argument in favor of restrictions on government-granted privilege can be made on the basis of equality and fairness, but such favoritism also harms economic growth, as described in Chapters 2 and 3. Giving some industries or businesses a competitive advantage in the marketplace through subsidies,

7 See Mills (2014).

8 Ryals v. Bd. of Sup'rs of Pike County, 48 So. 3d 449 (Miss. 2010) from Mills (2014, 48).

9 For a discussion of government-granted privilege, see Mitchell (2015).

10 See Hamilton, Jay, and Madison (2001).

11 See Farren (2017).

beneficial tax treatment, or regulations that raise their rivals' costs reduces customers' ability to decipher which companies serve their needs best.[12]

Under a system of free enterprise, competition to attract customers pushes businesses to provide the best value-for-cost product, and customers reward those companies with repeat business and word-of-mouth advertising. These incentives lead to long-run economic growth as companies constantly seek to find new ways to provide better products for lower cost. But government-granted privileges throw sand in the gears of this system because they protect businesses from competition, removing some of the focus to satisfy customers. As a result, regulations that violate generality decrease long-run economic growth.

The second guiding principle, "free exchange," emphasizes the importance of creating an environment that encourages people's natural inclination to "truck, barter, and exchange."[13] This includes developing effective contract law and providing public safety to support market transactions. However, this principle also means that governmental interference in individual market transactions should be minimized. The extent to which people can trade determines the degree of specialization in the economy, and greater specialization makes people more productive. Therefore, economic growth is directly tied to people's ability to freely exchange.

Economist and historian Deirdre McCloskey describes the amazing growth in living standards over the last 200 years as the result of "trade-based-betterment," emphasizing that both current and future generation's well-being is dependent on social and legal rules facilitating exchange.[14] Furthermore, the ability of entrepreneurs to experiment with new ideas in order to discover innovative ways to satisfy customers and solve social problems is critical for achieving the greatest possible growth, as discussed in Chapter 3.

Cities, which are simply clusters of people living and working in proximity, are the result of such specialization and trade and thus are the drivers of economic growth. However, when cities pass laws or regulations that inhibit free exchange, they limit the degree of economic growth that can occur by limiting the degree of specialization. In the following sections we discuss the ways that government policies can violate the principles of generality and free exchange and provide a framework public officials can use to avoid these problems.

Violations of Generality and Free Exchange

Violations of generality and free exchange can be grouped into three general types: barriers to entry, price controls, and business practice mandates. The same policy can fall into multiple categories, however, because some kinds of business practice mandates can create barriers to entry or price controls, and some price controls can create barriers to entry.

Barriers to entry limit who can offer goods and services to other people. A common example of a barrier to entry is Jackson, Mississippi's requirement that a taxi company obtain a Certificate of Public Necessity and Convenience (CPNC). CPNCs require new companies to demonstrate that there is unmet customer demand before they can legally start providing service. Furthermore, it allows existing companies to try to keep out new competition by testifying to regulators that they are providing sufficient service.[15]

Price controls are restrictions on the terms of exchange between customers and producers. They limit how much the producers of goods and services can charge, and how much customers are allowed to pay

12 See Chapters 5 and 6 for additional discussion of tax policy and "crony capitalism."

13 See Smith (1976).

14 See McCloskey (2006).

15 The harm caused by occupational licensing is further discussed in Chapter 9.

for those goods and services. Continuing the taxi example, a customer who is late to a job interview would likely be willing to pay a premium for priority service, but Jackson, like most cities, sets a maximum legal fare. This decreases the incentive to supply taxi service, meaning less service is available to those who value it the most. Similarly, price minimums prevent prices from falling *below* the mandate, limiting customer access to low-cost goods and services.

As described in Chapter 2, prices are important in a market economy since they reflect the relative scarcity of resources and incentivize entrepreneurs to alleviate such scarcity. For example, a high price of housing in one neighborhood relative to another sends a signal to developers that housing is relatively scarce in the high-price neighborhood and incentivizes developers to build there. Rent control, which is a type of price control, interferes with the proper functioning of the housing market and prevents resources, in this case building materials, from being used where they are valued the most, hindering economic growth.

Other policies create implicit price controls by mandating a certain quality or quantity of a good. For example, land-use regulations that mandate a minimum lot size increase the price of housing.[16]

Business practice mandates are restrictions on how, when, or where goods and services can be offered to customers. Common examples of such mandates are the regulations that many cities have regarding the color, quality, and age of taxicabs (and sometimes even the dress code of the driver!). In 2013, Washington, D.C. mandated that all taxicabs be painted in a new red and gray color scheme, costing upwards of $600 per vehicle. Regulations like these increase the cost of providing service, which can eliminate low-cost service to low-income neighborhoods. Similarly, mandated practices preclude entrepreneurs from experimenting with new products and services in the regulated area, reducing innovation and long-run economic growth.

Framework to Guide Policymakers in Preempting Local Authority

In order to maximize economic growth, and the higher quality of life that comes with it, state policymakers should consider preempting local policy in situations where it violates generality or free exchange. The framework discussed below (and summarized in Figure 12.2) can help guide officials' decisions on whether to preempt.

The first step is to start with a blank slate. State officials should explicitly approach the situation from the perspective of a blank slate to avoid status quo bias from influencing their thinking. This is important because the economy and society are constantly changing due to new entrepreneurial discoveries or shifting social preferences. Regulations are often an implicit attempt on the behalf of special interest groups to freeze the current state of the world in place, intrinsically limiting the potential for economic growth. Starting from a blank slate makes it more likely that state officials will consider solutions that are unlikely to be enacted at the local level due to the influence of local special interests.

The second step is to define the nature of the problem. State officials should explicitly identify what the local policy is trying to accomplish. Importantly, they should determine whether this goal lies within the purview of local government. If it does not, then there may be reason for the state to preempt the policy. Alternately, the problem might be better addressed by entrepreneurs because social problems often create profit opportunities for those who can solve them. Lastly, in some cases *ex post* solutions via the

16 See our case study on local housing regulations later in this chapter for a more detailed discussion on how regulations can create implicit price controls.

courts are a more effective and less intrusive way of addressing a situation that might or might not cause future problems.

Step three is to determine whether the policy violates generality or free exchange. State officials can use the litmus test of asking whether the policy imposes barriers to entry, affects prices via strict or implicit controls, or creates business practice mandates. However, local policies can violate these principles in other ways than these three main avenues, so state officials should be alert to any policy which appears to go outside the guardrails of generality and free exchange.

The final step is to decide to preempt or require revisions. State officials should preempt existing local policies or require them to be revised when they violate generality or free exchange. In cases where policies would inherently violate generality or free exchange, as in the case of strict price controls, state officials should proactively preempt them. For example, Mississippi precluded municipalities from implementing rent control in 1985. State officials should also consider proactive preemption when there is good historical evidence that local policy tends to violate these principles. Taxi regulations are an example of this because their history is rife with examples of regulatory capture and subsequent anticompetitive regulations.[17]

Importantly, any regulations at the local *or* state level should focus on the goal to be achieved rather than mandating the method to solve the problem. This allows for innovation in compliance and encourages entrepreneurs to find better and lower cost means of satisfying the regulation, leading to greater economic growth.

Figure 12.2: Framework to Guide Local Preemption

Step 1: Start with a Blank Slate	State officials should explicitly approach the situation from the perspective of a blank slate to avoid status quo bias from influencing their thinking. This method helps state officials to consider solutions that are unlikely to be enacted at the local level due to the influence of local special interests.
Step 2: Define the Nature of the Problem	State officials should explicitly identify what the local policy is trying to accomplish. Importantly, they should determine whether this goal lies within the purview of local government.
Step 3: Determine Whether the Policy Violates Generality or Free Exchange	State officials should consider preemption when the policy violates generality or free exchange. They can use the litmus test of asking whether the policy imposes barriers to entry, affects prices via strict or implicit controls, or creates business practice mandates.
Step 4: State Preemption or Required Revisions	State officials should preempt existing local policies or require them to be revised when they violate generality or free exchange. Importantly, any regulations left in place should focus on the goal to be achieved rather than mandating the method to solve the problem.

17 See Farren, Koopman, and Mitchell (2016).

Applying The Framework To Mississippi

There are multiple ways in which state officials can apply this framework. The process of reviewing local policy can take place in the legislature itself or by a separate oversight committee. Importantly, there should be a process through which citizens can submit policies for review. To encourage transparency and accountability, any recommendations for preemption should be published in an official report justifying the determination. Additionally, regardless of the process used, it should be codified and clearly communicated to local officials and voters.

Approaching local policies that violate generality and free exchange on a case-by-case basis is a lesser hurdle than full state preemption of all municipalities. It also encourages experimentation since local officials often have the best information on problems facing their communities and therefore can craft properly nuanced policy. A case-by-case approach also limits the unintended consequences that arise from one-size-fits-all state policies and respects those municipalities which have not violated the key principles.

In order to demonstrate usage of the framework, we apply it to four policies of interest to Mississippi lawmakers: transportation network company regulations, local labor market regulation, local land use regulation, and local taxes.

Transportation Network Company Regulations

Transportation Network Companies (TNCs), like Uber and Lyft, entered the mainstream transportation services market in 2012 and 2013. TNCs use smartphones to connect passengers with drivers and manage the exchange, reducing the transaction cost[18] in multiple ways, thereby vastly expanding the potential market for transportation services. The emergence of TNCs motivated taxi special interest groups around the United States to try to use local governmental authority to protect their industry from this new competition. In response, Uber and Lyft lobbied state legislators to preempt local regulation of TNCs.

Mississippi enacted HB 1381 into law in 2016, creating a statewide regulatory standard for TNCs and preempting municipalities from enacting their own taxes, licenses, and regulations on TNC operations. This overruled Jackson, Mississippi, which had just passed an ordinance licensing and regulating TNCs, and other cities which had disallowed operations.

Taxi regulations are commonly enacted at the municipal level and are quite literally the textbook definition of how anticompetitive regulations harm customers.[19] They are a perfect example of local policy historically creating barriers to entry (through limits on taxicab licenses), price controls (through maximum and minimum legal fares), and mandated business practices (requiring specific costly equipment and service standards). Because the transportation service industry is rife with regulatory capture that violates generality and free exchange, starting from a blank slate is the only way that policymakers can hope to enact appropriate reform.

The largest problem facing transportation service markets is the anonymity between the driver and passenger. This anonymity in the past has created a public safety problem due to drivers extorting higher fares from passengers or else using the seclusion of a taxi ride to assault them. Similarly, though less emphasized, drivers are at the mercy of criminally-minded passengers, with the result that taxi drivers face the highest on-the-job murder rate for any profession in the U.S.

18 Transaction costs are the sum of monetary and non-monetary costs that must be paid to enable a transaction to take place. Examples include credit card processing fees, uncertainty of payment or product quality, and the distance (whether the distance is the result of physical or social separation) between the buyer and seller.

19 See Kahn (1988) and Viscusi, Harrington, and Vernon (2005).

Laws created in the interest of public safety are an appropriate function of local government. However, many times special interest groups use the guise of public safety to argue for regulations that protect them from competition. For example, although mandating that taxicabs have bulletproof partitions between the driver and passenger would protect the driver from thieves, they are a costly piece of equipment that can create a barrier to entry for entrepreneurs. Furthermore, many other taxi regulations have explicitly limited entry by new drivers or companies, as well as creating price controls and business practice mandates that have nothing to do with public safety. In short, there are many clear violations of the principles of generality and free exchange.

Because most taxi regulations violate generality and free exchange, there is good reason to believe that municipal-level TNC regulations would have the same effect. Thus, Mississippi appears to have acted correctly in preempting local regulation of TNCs. In fact, the argument could be made that Mississippi did not go far enough and should have preempted local regulation of taxis and limousines as well, following Michigan's example.

Local Labor Market Regulations

Since 2012, there has been an accelerating trend in municipalities enacting local labor market regulations. By 2017, 39 different cities and counties had passed minimum wage laws. Similarly, by mid-2016, twenty cities had passed ordinances mandating that employers provide employees a minimum amount of paid leave.[20]

Simultaneously, states began explicitly preempting local governments' ability to set minimum wages or create other labor market regulations. By early 2017, at least 24 states had preempted the possibility of local minimum wages either by explicit legislation or implicitly via Dillon's Rule legal constraints. Seventeen states have passed legislation limiting how local governments can otherwise regulate the labor market, in particular by preempting municipal mandates on paid leave requirements. In addition, ten states have preempted local regulations on other kinds of employment benefits.[21] Mississippi proactively preempted local governments from implementing these labor market regulations in 2013 via HB 141.

It should be fairly easy for Mississippi policymakers to start from a blank slate on minimum wages because Mississippi is one of five states which does not have a state-specific minimum wage—the only minimum wage in effect is the federal minimum wage. Similarly, Mississippi does not have any state-level mandates requiring employers to offer paid leave as part of a worker's compensation.

The problem addressed by labor market regulations, as it relates to the core functions of government, is uncertain. Rather, labor market regulations appear to be an attempt by special interest groups to ensure a better quality of life for low-skilled workers. While this goal is laudable, minimum wage and paid leave mandates are a blunt instrument and are poorly targeted to achieve this end. More importantly, government interventions into the prices of goods and services inherently distort the economy, leading to less economic growth and therefore decreased quality of life for future generations.

Minimum wages are explicit price controls, while paid leave requirements are a business practice mandate that requires part of a worker's wage or salary be converted into guaranteed paid leave. As such, these labor market regulations violate free exchange, since they preclude some compensation options which both workers and employers would find agreeable. Therefore, restricting local governments' authority to affect the cost of employing a worker is an appropriate use of preemption.

20 Paid leave includes vacation, sick, family, and medical leave.

21 See DuPuis et al. (2017), Doroghazi (2017), and Center for Labor Research and Education (2017) for local and state ordinances.

Local Land Use Regulations

Mississippi grants local governments the power to construct a comprehensive plan to guide economic development and maintain some influence over an area's quality of life.[22] Such plans are implemented via zoning and other land-use regulations, most of which violate both generality and free exchange.

Zoning commonly divides an area into residential, commercial, and industrial uses, prohibiting the land from being used in ways that do not conform to its designated use. Zoning violates free exchange by preventing property owners from fully utilizing their land, thereby artificially decreasing its value.[23] For example, home-based businesses often violate zoning ordinances because they are located in areas zoned for residential but not commercial use. In such cases, zoning creates a barrier to entry that inhibits new economic activity.

Zoning ordinances also violate free exchange because they create implicit price controls. Common restrictions such as minimum lot sizes, maximum building heights, minimum parking requirements, and restrictions on the number of dwelling units combine to limit the supply of housing and lead to correspondingly higher prices.[24]

The restrictions created by zoning ordinances are generally recognized and local governments often attempt to maintain flexibility in order to deal with unforeseen circumstances. Rezoning, which amends the existing zoning ordinance to allow uses previously prohibited, and spot zoning, which rezones a single property, are two ways of modifying a zoning ordinance. Variances and special uses are additional ways of dealing with peculiarities and are determined on a case-by-case basis.

However, relying on case-by-case discretion, spot zoning, variances, and special uses can result in a government-granted privilege by violating generality. Because of the potential for abuse, Robert Barber, Sr., Hernando, Mississippi's city planner, argues that officials should explain the rationale behind any special-use or spot-zoning accommodation.[25] Making the rationale public and subject to scrutiny can reduce the danger of favoritism, but unfortunately it cannot eliminate it.

In his book *Zoning Rules!*, economist William Fischel persuasively argues that zoning is largely the result of a bottom-up process that starts because locals demand it.[26] Local residents, especially homeowners, want zoning because it protects their enjoyment of their neighborhoods and their home values. For example, in 2011 Jackson's city council changed an industrial zone to a mixed-used zone despite the current industrial tenant's concerns about the effects on its business. One council member who voted for the change cited the wishes of nearby residents who "don't want the kind of dust and noise that comes with expanded industrial use."[27]

Because only current residents—not future or potential residents—can vote in local elections, it is difficult to get local politicians to internalize the broader costs that zoning imposes on the state economy. Starting from a blank slate enables state officials to consider policies that local governments typically dismiss due to the influential interests of local homeowners/voters.

22 See Barber, Sr. (2014).

23 See Ihlanfeldt (2007).

24 Jackson's zoning ordinance includes many of these restrictions. Also see Ikeda and Washington (2015) and Zabel and Dalton (2011).

25 See Barber, Sr. (2014).

26 See Fischel (2015).

27 See Lynch (2011).

Zoning attempts to address the problem of urban disorder so that a city does not become an unpleasant place to live, but state officials need to balance the desire of residents who favor zoning as a means of controlling their environment with the widely held desire for a thriving state economy.

Since many zoning policies violate free exchange and generality via barriers to entry, implicit price controls, and case-by-case exceptions, further scrutiny from the state is warranted.

Local land-use regulations take a variety of forms and some provide more flexibility for residents and businesses than others. Therefore, the best preemption approach might be to overrule specific ordinances on a case-by-case basis. Also, once local government officials see examples of the kind of land use ordinances the state is preempting, they may proactively change their policies to be in compliance.

Municipal Tax and Expenditure Limits

State intervention should always be exercised with caution, and it should be done to promote rather than hinder economic freedom. So far, we have discussed examples where some degree of state preemption is warranted, but there are instances where local control is best. One such instance is local government spending and taxation.

Some states interfere with local government finances by imposing tax and expenditure limits, or TELs, on municipalities. Proposition 13 in California, which limits property tax rates and the growth of assessments, is one notable example.

Mississippi grants municipalities the power to raise revenue through various fees and an ad valorem tax on property. It also imposes a modest TEL on property taxes, which limits revenue growth to no more than 10% over prior year tax collections, with some exceptions.[28]

In terms of our framework, local property taxes usually do not violate free exchange or generality. As long as the tax is levied on all property of the same type in a consistent manner, it is sufficiently general. And as long as the tax is not so high as to essentially prohibit an activity, it does not violate free exchange.

TELs are also different than the previous case studies of justifiable preemption because taxes are largely the result of residents' demand for public goods and services, especially at the local level. Municipal taxes fund many public and quasi-public goods and services such as roads, police and fire protection, schools, and parks. The quantity and quality of these goods is a function of the preferences of the local population, and while no level of government can have complete information about the preferences of its constituents, local officials are likely better informed than state officials.

Since local knowledge is important for making effective decisions about the proper amount of public goods and services, local funding mechanisms should not be curtailed by state policymakers who lack such knowledge. Restrictions on both property tax rates and assessments are a common feature of local TELs, and they force communities that want to improve or expand public goods and services to employ alternative, often less efficient means of funding.

For example, there is evidence that local governments circumvent TEL prohibitions on property tax increases by raising revenue via higher user fees, short-term debt, or asset securitization.[29] Thus, instead of limiting taxes, TELs instead may simply change the revenue-raising mechanism. More importantly, this change likely degrades local economic efficiency.

28 See Smith (2014).

29 See Jimenez (2017).

In some cases, property taxes and other local taxes may have a negative effect on local economies—as discussed in Chapter 4—but this burden is largely shared by all members of the community. In contrast, minimum wage laws, land-use regulations, and restrictions on the sharing economy tend to disproportionately affect certain groups, such as less-skilled, lower-income people. If citizens want to restrict government spending, a locally imposed TEL is more appropriate than a state-level TEL since the local polity is collectively choosing to bind its own spending.

Conclusion

The growth in state preemption has made it a popular topic for discussion and research. Unlike the federalist relationship between the federal and state governments that is enshrined in the Constitution, local governments are creations of the state, meaning the state can preempt local authority. The degree to which state governments preempt local governments varies across states, and in this chapter we presented two guiding principles and a framework to help state officials decide when preemption is appropriate.

State officials should consider preemption when local rules violate generality or free exchange. Specifically, officials should preempt local policies that impose price controls, create barriers to entry, or mandate business practices, since these are common means of violating these principles. We have discussed three examples where preemption is appropriate from the perspective of our framework: TNC regulations, labor market regulations, and land-use regulations. Such policies violate one or both guiding principles and have harmful effects on economic growth because they inhibit economic activity and the efficient allocation of resources. Humans' natural inclination to trade means local government officials can best promote prosperity by providing public safety, maintaining local infrastructure, and enforcing contracts, rather than interfering with the local economy.

However, state-level preemption needs to be done prudently. Local knowledge is important for effective governance, and thus some authority is best left in the hands of local officials. We provided one such example regarding local tax and government expenditure limits (TELs).

Ultimately, the nature of state preemption is the prerogative of each state's officials and voters. We hope that the principles and framework presented in this chapter will serve as a useful guide for state officials considering preemption and for reevaluating prior preemption.

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Summary of Chapter Conclusions

PART 1. Introduction: The Role of Government and Economic Growth

Chapter 1: The Case for Growth—Russell S. Sobel, The Citadel, and J. Brandon Bolen, Mississippi State University

- Mississippi is the poorest state in the United States in terms of per capita income. Mississippi underperforms economically relative to all of its bordering states.
- Focusing on policies that generate economic growth is the most viable pathway to alleviating Mississippi's weak economic condition.
- Very small changes in economic growth rates may yield vast positive changes in the quality of life for Mississippi residents within as little time as one to two generations.
- Focusing on economic growth does not mean that other important policy goals such as improving health and education and reducing crime are neglected.

Chapter 2: The Sources of Economic Growth—Russell S. Sobel, The Citadel, and J. Brandon Bolen, Mississippi State University

- The economic activity of a state necessarily occurs within that area's institutional context, including the legal, regulatory, and tax environments, as well as the degree of private property rights. The quality of these institutions affects the output of economic activity.
- Capitalism is an economic system based on the private ownership of productive assets within an economy.
- Abundant evidence demonstrates that areas with institutions that allow capitalism to thrive experience much higher levels of prosperity relative to areas that do not rely upon capitalism.

Chapter 3: Why Capitalism Works—Russell S. Sobel, The Citadel, and J. Brandon Bolen, Mississippi State University

- The prosperity of an area is determined by the total quantity of production and quality of goods and services that individuals value. This prosperity is influenced by factors such as the degree of specialization of labor, capital investment, and entrepreneurship.
- Capitalism is an economic system that generates prosperity because its decentralized nature supports the specialization of labor, capital investment, and entrepreneurship.
- Government policies, even when well-intentioned, often create harmful unintended consequences. This is often due to the more centralized nature of government decisions.

PART 2: Promoting Prosperity One Issue at a Time

Chapter 4: Why are Taxes so Taxing? —Brandon N. Cline and Claudia R. Williamson, Mississippi State University

- High taxes can be extremely costly. In addition to the cost of the tax itself, taxes create indirect costs including enforcement costs, administrative costs, and costs incurred from distortions of the market economy.
- Mississippi has a higher tax burden compared to its bordering states. This may negatively affect the location decisions of businesses and individuals, causing them to leave the state.
- Empirical evidence demonstrates that high tax rates significantly damper rates of economic growth.

Chapter 5: Make Business Taxes More Competitive—Brandon N. Cline and Claudia R. Williamson, Mississippi State University

- State and local taxes represent a significant cost for businesses. These tax costs affect the location decisions of businesses and deter them from operating in Mississippi.
- In addition to corporate income taxes, there are a myriad of other taxes businesses pay, such as property taxes and inventory taxes. Some taxes such as the inventory tax and intangible property tax do not exist in the majority of other U.S. states.
- To generate more prosperity within the state, Mississippi should consider reducing its tax burden upon businesses.

Chapter 6: "Selective Incentives," Crony Capitalism and Economic Development—Thomas A. Garrett, University of Mississippi, and William F. Shughart II, Utah State University

- This chapter evaluates the costs and benefits of targeted tax incentives designed to lure new private business enterprises to Mississippi.
- Our analysis demonstrates that Mississippi is poorer, not richer, by funding incentive programs.
- Reasons that incentive packages fail include no new employment since many individuals hired were previously employed, the additional tax cost to accommodate the new population growth, and resources allocated to funding the subsidies could have been spent on better schools, roads, or used to finance a reduction in tax rates for all.
- The funds now being spent to benefit a handful of private business owners could be used to finance broad-based reductions in tax rates and lightening the regulatory burden on all Mississippians.

Chapter 7: Incentive-Based Compensation and Economic Growth—Brandon N. Cline and Claudia R. Williamson, Mississippi State University

- Incentive based compensation is a payment method where an individual's pay is in some way tied to their performance. Economic literatures studying incentive based pay for executives show that use of incentive based pay improves company performance and by extension state economies.
- Empirical data shows that firms in Mississippi use incentive-based compensation less than similar firms in other states.
- Mississippi can help improve its economic position by restructuring parts of its tax code to allow for greater use of incentive based executive compensation.

Chapter 8: Mississippi Shadow Economies: A Symptom of Over-Regulated Markets and Measure of Missed Opportunities—Travis Wiseman, Mississippi State University

- This chapter discusses Mississippi's regulatory environment and the state's cumbersome habit of maintaining outdated and burdensome regulation, far longer than other states.
- Several sensible and low-cost reforms are introduced that can help curtail unwanted shadow economic activity, and promote prosperity in Mississippi.
- A case study of one industry that Mississippi over-regulates – the brewing industry – is discussed.

Chapter 9: Occupational Licensing in Mississippi—Daniel J. Smith, Troy University

- Occupational licensing, the regulation of individual entry to a profession, enables industry practitioners to restrict entry to their profession and raise prices on consumers.
- The effects of occupational licensing fall heaviest on low-income residents who must pay higher prices or resort to lower-quality home-production or black market provision.
- Mississippi has at least 118 different occupational categories with licensing, representing nearly 20 percent of Mississippi's labor force.
- The total estimated initial licensing costs in Mississippi exceed $48 million and the estimated annual renewal costs add up to over $13.5 million.
- Mississippi policymakers can promote prosperity in Mississippi by removing unnecessary and overtly burdensome licensing laws.

Chapter 10: Prosperity Districts: A Ladder Out of Last Place—Trey Goff, Out of Last Place Alliance

- Prosperity districts are geographically self-contained areas that reduce or eliminate unnecessary government restrictions on business activity, including regulation, taxation, and private subsidization
- Prosperity districts can be a unique and promising solution to the state's economic woes by allowing specific areas to be exempt from unproductive policies.
- Prosperity districts allow experimentation to determine which policies work best.
- Real world examples of the potential success of prosperity districts can be seen in the closely related concept of special economic zones, which have seen tremendous economic growth and development in places such as Singapore.

Chapter 11: Promoting Prosperity in Mississippi through Investing in Communities—Ken B. Cyree, University of Mississippi, and Jon Maynard, Oxford Economic Development Foundation

- We investigate the impact of investing in community livability and the relation to the change in total employment to promote prosperity in Mississippi.
- We document the decline in Mississippi employment, on average, from 2007-2016, and especially the decline in manufacturing employment.
- Our analysis shows that increased employment is significantly related to better school rankings, higher changes in wages, and higher changes in per capita retail sales. New business creation is not statistically related to employment.
- Our results suggest that in order to promote prosperity in Mississippi, we should invest in quality of life for the community.

Chapter 12: Local Governments Run Amok? A Guide for State Officials Considering Local Preemption—Michael D. Farren, George Mason University, and Adam A. Millsap, Florida State University

- Local governments sometimes implement regulations and ordinances that stifle economic growth.
- Preemption is a legal doctrine asserting that state law takes precedence over local law. In some cases it should be used by state governments to overrule local governments.
- State officials should consider preemption when local rules violate the principles of generality or free exchange. Such policies often involve barriers to entry, price controls, or business practice mandates.
- Violations of generality and free exchange harm economic growth because they inhibit economic activity and the efficient allocation of resources. Conversely, preempting such policies promotes economic growth.

Chapter 13: School Choice: How To Unleash the Market in Education—Brett Kittredge, Empower Mississippi

- The United States has fallen behind other countries in K-12 education. One study found that American students ranked 38th out of 71 countries when tested in math, reading, and science.
- A government monopoly has existed in our delivery of education in the United States. Students are assigned to a school based on their zip code and the year they were born.
- Because students are assigned to a school based on a district line, real estate prices naturally rise in neighborhoods within a desirable school district. This has the effect of pricing out many families and forcing them to live in areas with less desirable schools.
- To improve quality, our education system should be student centered and market based. Parents should have options available to craft a custom education for their child based on their specific learning needs.
- The legislature can adopt a market based education through a universal school choice program that has broad eligibility, autonomy for all schools, and level funding across the various educational sectors.

Chapter 14: Medicaid: A Government Monopoly That Hurts the Poor—Jameson Taylor, MS Center for Public Policy

- State health care policy revolves around Medicaid, which is a government-subsidized insurance program consuming one-third of Mississippi's budget.
- Health outcomes for Medicaid insurance patients are very poor; patients with no insurance at all fare better.
- Medicaid's number one problem, like that of many American insurance plans, is that it incentivizes the over utilization of health care while insulating recipients from the financial consequences of poor lifestyle choices.

- Medicaid is crowding out the development of innovative products and policy ideas.
- Reforms aimed at unleashing the power of health care pricing including large HSAs, direct surgical care, and comparative shopping incentives can begin to disrupt Medicaid's monopoly.

Chapter 15: Tipping the Scales: Curbing Mississippi's Obesity Problem—Raymond J. March, San Jose State University

- Widespread obesity has serious health and financial consequences in Mississippi.
- Government policy, although well intended, is associated with increased levels of obesity especially for lower-income households.
- State-led efforts to reduce obesity are costly and unlikely to succeed because they fail to address the underlying causes of why less healthy food options are consumed.
- Private and local solutions are more effective in promoting health and reducing obesity.
- The most effective way to combat widespread obesity is the market, not the government.

Chapter 16: Criminal Justice Reform in Mississippi—Trey Goff, Out of Last Place Alliance

- Despite decreasing rates of both violent and property crime since 1996, Mississippi incarceration rates have steadily increased.
- Mississippi has an incarceration rate that is among the highest in the world, most due to incarcerating non-violent crimes.
- The economic drain from this level of mass incarceration is extremely detrimental for the state economy in terms of both the cost of maintaining incarceration and the negative effects of incarceration upon individuals in the labor market.
- Reevaluating and restructuring the criminal justice system in Mississippi to reduce incarceration rates would be an extremely effective tool to increase the economic strength and wellbeing of the state.

Chapter 17: Property Takings: Eminent Domain and Civil Asset Forfeiture—Carrie B. Kerekes, Florida Gulf Coast University

- Secure private property rights provide incentives for individuals to undertake investments and make capital improvements to their property and businesses. To promote prosperity, Mississippi policy makers should continue to improve laws and policies to restrict property takings.
- Following reforms passed in 2011 to protect against development takings, property owners in Mississippi are reasonably protected from eminent domain takings.
- Citizens are significantly less protected in the case of civil asset forfeiture. Civil asset forfeiture laws in Mississippi provide incentives for law enforcement agencies to seize private property.

Chapter 18: The Small-Dollar Loan Landscape in Mississippi: Products, Regulations, Examples, and Research Findings on Interest Rate Caps—Thomas (Tom) William Miller, Jr., Mississippi State University

- The best fuel for economic growth and prosperity is free market prices, including interest rates.
- Despite the goal of improving consumer welfare, interest rate caps often harm the very people legislatures intend to help—especially users of small-dollar loan products.
- Despite their well-known harmful effects on consumers, laws continue to fetter consumer credit markets with interest rate caps.
- Setting good rules governing how legitimate businesses provide access to consumer credit is important for everyone living in Mississippi.
- The Mississippi legislature can greatly help consumers by eliminating, or greatly raising, interest rate caps in all small-dollar loan markets.

Chapter 19: Natural Disasters and Prosperity in Mississippi—Daniel Sutter, Troy University

- Extreme weather poses a severe financial risk for a state economy. Mississippi is particularly exposed to the threat of damage from natural disasters.
- Free market practices often perform better at meeting the challenges posed by natural disasters rather than government policies. Removal of harmful policies such as occupational licensing and building codes during disaster may better allow the market to speed disaster recovery.
- Some government policies such as flood and wind insurance may exacerbate exposure to natural disasters. Other policies slow recovery time by creating uncertainty after the occurrence of a natural disaster.

Chapter 20: Learning from Disasters in Mississippi—Stefanie Haeffele and Virgil Henry Storr, George Mason University

- This chapter examines disaster recovery in Mississippi and how policies that foster entrepreneurship might help spur disaster recovery going forward.
- Entrepreneurs can spur disaster recovery by providing needed goods and services, restoring disrupted social networks, and acting as focal points around which other residents can coordinate their recovery efforts.
- To promote prosperity in Mississippi, officials should develop policies that ensure that entrepreneurs have the space to act in the wake of disaster.

About the Institute for Market Studies at Mississippi State University

The Institute for Market Studies (IMS) at Mississippi State University, created in 2015, is a nonprofit research and educational organization conducting scholarly research and providing educational opportunities to advance the study of free enterprise.

The IMS's mission is to support the study of markets and provide a deeper understanding regarding the role of markets in creating widely shared prosperity. This includes advancing sound policies based on the principles of free enterprise, individual liberty, and limited government. The IMS pursues its mission by bringing together leading scholars to conduct timely research on current economic and financial issues.

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