

CITIES AND HOMEOWNERS ASSOCIATIONS

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In his recent article, *The City as a Legal Concept*,¹ Professor Gerald Frug compared the city and the business corporation as possible vehicles for the exercise of decentralized power. In the course of his analysis, Frug asserted that American law is deeply biased against the emergence of powerful cities and, by implication, is less restrictive on corporate power.² Joining the circle of critical legal scholars who want to "rethink" and "restructure" American society, Frug suggested as a modest first step that cities be empowered to engage in banking and insurance operations.³ Frug believes that if cities were to manage enterprises of this sort, individuals would be better able to influence the decisions that affect their lives. According to Frug, citizen control through participatory democracy leads to "public freedom,"⁴ a form of human fulfillment that the critical legal scholars think an impersonal market economy suppresses.⁵

Despite his prodigious research, Frug never directed his attention at a third candidate for the exercise of decentralized power: the private homeowners association. The association, not the business corporation, is the obvious private alternative to the city. Like a city, an association enables households that have clustered their activities in a territorially defined area to enforce rules of conduct, to provide "public goods" (such as open space), and to pursue other common goals they could not achieve without some form of poten-

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¹ Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1059 (1980).

² See *id.* 1062-67.

³ See *id.* 1128, 1150-51.

⁴ *Id.* 1068 (footnote omitted).

⁵ See *infra* text accompanying notes 180-267 for an extended critique of Frug's article.

tially coercive central authority.⁶ Although they were relatively exotic as recently as twenty years ago, homeowners associations now outnumber cities. Developers create thousands of new associations each year to govern their subdivisions, condominiums, and planned communities.⁷

American law currently treats the city and the homeowners association dramatically differently. One is "public"; the other, "private." In law, as Frug correctly points out, much now turns on this distinction.⁸ Frug emphasizes the relative "powerlessness" of cities, a legal phenomenon he discovers not so much by observation as by logical deduction from the "dualities" of "liberal thought."⁹

This Article compares the legal status of cities and homeowners associations. In contrast to Professor Frug, I generally rely on empirical methods to identify legal phenomena. Part I of the Article examines the fundamental characteristics of cities and homeowners associations. Although cities are considered "public" and homeowners associations "private," I discern only one important difference between the two forms of organization—the sometimes involuntary nature of membership in a city versus the perfectly voluntary nature of membership in a homeowners association. I assert that this difference explains why cities are more active than associations are in undertaking coercive redistributive programs. Parts II, III, and IV describe, and normatively analyze, three rather disparate puzzles in the current legal treatment of associations and cities. The first puzzle is that courts are more vigorous in reviewing the substantive validity of regulations adopted by established homeowners associations than regulations adopted by established cities. Considering the "private" nature of the association, one might have expected exactly the opposite judicial treatment. The second puzzle is that a city must allocate voting rights to its con-

⁶ Pioneering explorations of why and how people organize to produce collective goods include J. BUCHANAN & G. TULLOCK, *THE CALCULUS OF CONSENT* 43-62 (1962); M. OLSON, *THE LOGIC OF COLLECTIVE ACTION* 5-16 (1965).

⁷ See Reichman, *Residential Private Governments: An Introductory Survey*, 43 U. CHI. L. REV. 253, 256 (1976).

This Article will ignore the often subtle distinctions between the various forms of private residential associations. These nuances are explored in Krasnowiecki, *Townhouse Condominiums Compared to Conventional Subdivisions with Homes Associations*, 1 REAL EST. L.J. 323 (1973), and Schreiber, *The Lateral Housing Development: Condominium or Home Owners Association?*, 117 U. PA. L. REV. 1104 (1969).

⁸ See Frug, *supra* note 1, at 1099-1109 (discussion of the emergence of this distinction).

⁹ See *infra* text accompanying notes 186-94.

stituents according to a formula that homeowners associations are forbidden to use, and vice versa. Why should one-resident/one-vote be the required method for cities and one-unit/one-vote the required method for associations? The third puzzle is the one Frug concentrated on: the limitations on the power of cities to engage in business enterprises. I argue that Frug exaggerated city "powerlessness" and failed to mention the many legal advantages—particularly tax advantages—a city now has when it competes with a private organization.

I have deliberately tailored this Article to fit the symposium. Because homeowners associations do many things that cities also do, my subject promises to be an unusually fertile one for exploring the public/private distinction. I also developed my major theses with the other symposium participants in mind. The editors have recruited several of the leading critical legal scholars to serve as commentators. At the risk of becoming cannon fodder, I have deliberately adopted provocative positions on a series of important, middle-level legal issues. My main theses, I hope, will be both meaty enough to inspire the commentators and focused enough to forestall an excessively abstract debate. For example, will the commentators join me in criticizing the Supreme Court's constitutional decisions that force cities to adhere to the one-resident/one-vote rule?¹⁰ Do they support my call for repeal of the current exemption of municipal-bond interest from federal income taxation?¹¹ I hereby challenge those commentators who (unlike me) are not Prisoners of Liberal Thought to apply the insights of critical legal studies to some concrete, middle-level legal issues that currently confound policymakers.

I. DISTINGUISHING CITIES FROM HOMEOWNERS ASSOCIATIONS

Professor Frank Michelman, unquestionably the preeminent legal mind on community governance, has offered a characteristically useful one-sentence guide for identifying the existence of a "governmental" organization:

We know perfectly well, granting that there are intermediate hard cases, how to distinguish governmental from non-governmental *powers* and *forms of organization*: governments are distinguished by their acknowledged, lawful authority—not dependent on property ownership—to coerce a territorially defined and imperfectly voluntary

¹⁰ See *infra* text accompanying notes 159-79.

¹¹ See *infra* text accompanying notes 263-67.

membership by acts of regulation, taxation, and condemnation, the exercise of which authority is determined by majoritarian and representative procedures.¹²

Although this particular quotation was an aside in an article mainly addressed to other issues, a scholar as careful as Michelman no doubt crafted the sentence to encapsulate insights gained through years of puzzling over the essence of governmental organizations.

The homeowners association, although certainly one of Michelman's "intermediate hard cases," is currently viewed by both ordinary and legal observers as a "private" organization, not a "government."¹³ In fact, it is sufficiently "private" that it has rarely been granted any intermediate legal status that a hard case might be thought to deserve, but instead has been treated much like any other private organization. This is so even though the modern homeowners association has virtually all of the indicia that Michelman would have us associate with a government. First, a homeowners association rules a "territorially defined" area, and, in the usual case, obtains its power to do so through no form of property ownership. For example, when the members of a condominium association own the common areas as tenants in common, the association itself owns no real property at all.

Nor does Michelman's list of the tell-tale governmental powers do much to distinguish a homeowners association from a city. An association is typically entitled to undertake acts of both regulation and taxation, as those terms are ordinarily used. Associations, for example, may restrict to whom a member may sell his unit,¹⁴ prohibit certain kinds of conduct (not only in common areas but also within the confines of individual homes),¹⁵ and tightly control the physical alteration of a member's unit.¹⁶ An association's "taxation" takes the form of monthly assessments on members. Assessments can be raised without the unanimous consent of the membership.

¹² Michelman, *States' Rights and States' Roles: Permutations of "Sovereignty" in National League of Cities v. Usery*, 86 YALE L.J. 1165, 1167 (1977) (emphasis in original).

¹³ *But see infra* notes 153-54 and accompanying text (scattered authorities supporting the notion that homeowners associations should be treated as public actors in some legal contexts).

¹⁴ *See, e.g., O'Connor v. Village Green Owners Ass'n*, 132 Cal. App. 3d 178, 183 Cal. Rptr. 111 (1982) (upholding reasonableness of restriction limiting occupancy of condominium units to persons over 18 years of age).

¹⁵ *See Dulaney Towers Maintenance Corp. v. O'Brey*, 46 Md. App. 464, 418 A.2d 1233 (1980) (sustaining house rule barring second pets).

¹⁶ *See Note, Promulgation and Enforcement of House Rules*, 48 ST. JOHN'S L. REV. 1132, 1136-39 (1974).

Payment of an assessment is secured by a lien on a member's unit, making the assessment almost as hard to evade as a municipal property tax is. To be sure, association powers are not as extensive as those possessed by "public" bodies. The regulations of a homeowners association in sum are likely to be less intrusive and comprehensive than what one finds in a typical municipal code. Cities have far more ways to raise revenue than associations do. Lastly, it would be highly unusual for an association to have the power to condemn a member's unit—the third governmental power Michelman lists. Some homeowners associations do have the power to expel members for misbehavior—a power that comes close to the power of condemnation.¹⁷ But even if they did not, exercise of eminent domain power by a local government is rare; it would be remarkable if the presence of this power were a necessary condition for the use of the adjective "public" in ordinary or legal language.

Nor does one stretch ordinary language out of shape to describe an association as having "majoritarian and representative procedures." Much as citydwellers choose a city council, association members elect a board of directors to manage association affairs.¹⁸

Only one part of Michelman's description of a government remains: its "imperfectly voluntary membership." Public entities have involuntary members when they are first formed. For example, the statutory procedures for incorporating a new city invariably authorize a majority (perhaps only concurrent or extraordinary majorities) to coerce involuntary minorities to join their organization.¹⁹ By contrast, membership in a private organization is wholly voluntary.²⁰ A central thesis of this Article is that the presence of *involuntary members* is both a necessary condition for the use of the adjective "public" in ordinary language, and also a powerful explanation for the different legal treatment currently accorded public and private organizations.²¹

¹⁷ See, e.g., *Kennedy v. Electric Heights Hous. Ass'n*, 61 Pa. Commw. 348, 433 A.2d 639 (1981) (affirming cooperative housing association's expulsion of misbehaving member).

¹⁸ *But cf. infra* text accompanying notes 85-103 (describing differences between the electorates of cities and associations).

¹⁹ See generally F. MICHELMAN & T. SANDALOW, *GOVERNMENT IN URBAN AREAS* 612-21 (1970).

²⁰ Or, more precisely, a decision to join an association is as voluntary as a human decision can be. See *Tentindo v. Locke Lake Colony Ass'n*, 120 N.H. 593, 419 A.2d 1097 (1980) (emphasizing voluntary nature of a member's commitments to an association). *But see* Frug, *supra* note 1, at 1133-36 (membership in a private organization is not much more voluntary than membership in a public organization).

²¹ Although the presence of involuntary members is a necessary condition for the existence of a "public" organization, it is hardly a sufficient condition. For

This distinction begets an important corollary on the role of public and private organizations in carrying out coercive redistributive programs. Because cities, like other governments, have involuntary members, they can potentially compel redistributions of wealth from captive members.²² Voluntary private organizations, by contrast, are inherently ill-suited to undertake coercive redistribution. If a voluntary organization's intended redistributive policies are known to all from the outset, the policies are not being *coercively* imposed on the members who eventually lose wealth because of those policies. For example, when markets are competitive, universities and hospitals that transfer wealth among various of their patrons are carrying out consensual, not coercive, redistributive policies. If an ostensible loser from those policies objected to them, the loser could patronize other institutions that did not redistribute.

In the case of a homeowners association, *ex ante* redistributive policies are unlikely to succeed. Suppose a condominium association's initial assessment policy would systematically favor owners of low-rise dwelling units over owners of high-rise units, and that high-rise owners would gain nothing from being on the losing end of this redistribution.²³ If aware of the skewed assessment policy, persons bidding on high-rise units would bid less than otherwise, and persons bidding on the low-rise units would bid more. Market forces would thus capitalize the *ex ante* coercive redistributive policy into the initial sales prices of the units,²⁴ offsetting the thrust of the intended coercive redistribution.

example, a "private" labor union usually has involuntary members, and moreover has some authority to regulate and tax its members. See M. OLSON, *supra* note 6, at 66-97; Jaffe, *Law Making by Private Groups*, 51 HARV. L. REV. 201, 234-35 (1937). However, a labor union lacks a "territorially defined membership" (to use Michelman's phrase). Thus, that factor also appears to be a necessary condition for a "government" to exist.

Powers of regulation and taxation also seem to be necessary elements. Without his consent, the Sierra Club can place James Watt's house within the territory of its Metropolitan Washington Group, but because it cannot regulate or tax him, Watt does not regard the Sierra Club as one of his governments.

²² However, most public-finance theorists would in fact assign local governments little or no role in redistribution. See *infra* text accompanying notes 139-51.

²³ Cf. *Thiess v. Island House Ass'n*, 311 So. 2d 142 (Fla. Dist. Ct. App. 1975).

²⁴ Cf. *infra* text accompanying notes 121-23 (on capitalization of local taxes and services into land values).

The contractarian model of a homeowners association works best if, especially at the time of their entry decisions, all households have full information about community attributes. This assumption is obviously optimistic. Information is often costly, and information about some community attributes (for example, the friendliness of immediate neighbors) may be obtainable only through experience. Nevertheless, several considerations justify my reliance on the contractarian model. First, because a home purchase dwarfs a household's other expenditure decisions,

Once inveigled to join, however, a member of an initially voluntary private organization becomes vulnerable to subsequently adopted redistributive policies. *Ex post* redistributive policies can have bite whenever the member either (1) faces high transaction costs of exiting; (2) is obtaining irreplaceable surplus value (perhaps as a result of a long-lived membership); or (3) cannot avoid a redistributive tax because, if the member were to leave, the tax would be capitalized into a lower value of the member's share of the organization. As illustrations, consider a Scrabble® club director who announces, just before a tournament is to begin, that all competitors must contribute to a prize kitty to be awarded the winner; a college that imposes huge tuition increases only on students entering their senior year to finance scholarships for freshmen; and a homeowners association that shifts its assessment policies simply to exploit the political weakness of certain owners.

Although these illustrations show that a voluntary organization could conceivably accomplish some *ex post* coercive redistribution among members, the examples also hint why an organization's promoters would want a legally enforceable rule prohibiting the *ex post* adoption of policies solely aimed at coercive redistribution. First, prospective members would be apprehensive about joining an organization that could later tax them for purely redistributive reasons. A prospective member could reduce this uncertainty by spending resources to obtain information about the views of other potential members, the decisionmaking processes of the organization, and so on. But information is costly. As a result, elimination of *ex post* redistributive risks would encourage more people to drive to a Scrabble® tournament, enroll in college, and buy into a homeowners association. Second, aside from information costs, most prospective members could be expected to have an aversion to the risk of unformulated redistributive programs. Third, and perhaps most important, because of the administrative costs of adopting and administering redistributive programs, redistribution is a negative-sum game.²⁵ Losers lose more than gainers gain. Thus even an entrant who would expect to fare about average in redistribution

households tend to shop carefully for housing units. Second, in some situations at least, a market will work efficiently even for consumers who do *no* comparison shopping; a nonshopper can sometimes rationally decide to freeload on the shopping efforts of other households that have tastes similar to his. See Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979). Third, the contractarian model encourages individuals to improve their abilities to make decisions for themselves.

²⁵ Yoram Barzel deserves credit for recognizing that rent-seeking by association members would give rise to deadweight losses.

wars would favor a peace treaty barring that form of warfare because the treaty would enable him to save on defense expenditures.

To maximize the initial value of memberships, therefore, the promoters of a voluntary organization would want an *ex ante* rule (contractual, statutory, or judge-made) prohibiting the *ex post* adoption of policies solely aimed at coercive redistribution among members. This corollary helps explain several current features of the law of homeowners associations.²⁶

II. JUDICIAL REVIEW OF PUBLIC AND PRIVATE REGULATIONS

Both cities and homeowners associations regulate the conduct of residents. Both may have rules requiring that dogs be kept on leashes, that residential structures be built in a Colonial style, or that external noise from social gatherings cease at 8:00 p.m. Nevertheless, courts rightly use different standards in reviewing the substantive validity of public and private rules.

In the case of public rules, the basic federal constitutional constraints arise from the due process and equal protection clauses of the fourteenth amendment. More often than not, the constitutional issue is whether the contested regulation is rationally related to a legitimate state interest. In the hands of most state and federal courts, this test now usually proves undemanding.²⁷

Because the fourteenth amendment only applies when state action is present, one might expect even greater judicial deference to the substantive validity of private regulations. In fact, however, courts are more vigorous in their examination of the validity of certain types of private regulations. Prevailing common-law and statutory rules ask courts to scrutinize the "reasonableness" of private regulations—an apparent invitation to Lochnerian activism. This active judicial review is inappropriate when the provisions contained in an association's original governing documents are at issue, but it is fully appropriate when litigants challenge amendments to those documents.

A. *Judicial Review of the "Constitution" of a Private Association*

The initial members of a homeowners association, by their voluntary acts of joining, unanimously consent to the provisions

²⁶ See *infra* text accompanying notes 51-53 & 97-103 (discussing unanimity rules for wealth-shifting amendments and the practice of allocating votes according to economic stake).

²⁷ See generally Bice, *Rationality Analysis in Constitutional Law*, 65 MINN. L. REV. 1 (1980).

in the association's original governing documents.²⁸ In the language of Buchanan and Tullock, this unanimous ratification elevates those documents to the legal status of a private "constitution."²⁹ The original documents—which today typically include a declaration of covenants, articles of association (or incorporation), and by-laws—are a true social contract.³⁰ The feature of unanimous ratification distinguishes these documents from and gives them greater legal robustness than non-unanimously adopted public constitutions, not to mention the hypothetical social contracts of Rousseau or Rawls.

In most instances, familiar principles of contract law justify strict judicial enforcement of the provisions of a private constitution. Strict enforcement protects members' reliance interests. By allowing the establishment of, and subsequently protecting the integrity of, diverse types of private residential communities, courts can provide genuine choice among a range of stable living arrangements.³¹ Proper legal nourishment could enable private associations to supply quasi-public goods, such as local parks and security services, that in the past have been more frequently supplied by cities. This could lead in turn to a reduced role for the city—the more coercive (less consensual) form of residential organization.³²

²⁸ I assume throughout that an association is created through a fair contracting process—that is, one not tainted by fraud, duress, gross inequality of bargaining power, and so on.

²⁹ J. BUCHANAN & G. TULLOCK, *supra* note 6, at vii (a constitution is a set of rules, unanimously adopted in advance, within which subsequent action is to be conducted); see also *Developments in the Law—Judicial Control of Actions of Private Associations*, 76 HARV. L. REV. 983, 995-97 (1963) [hereinafter cited as *Judicial Control*].

³⁰ URBAN LAND INST., *THE HOMES ASSOCIATION HANDBOOK* 342-45 (1964) explains the interrelationships among these documents.

³¹ See also Chafee, *The Internal Affairs of Associations Not for Profit*, 43 HARV. L. REV. 993, 1027 (1930):

The value of autonomy is a final reason which may incline the courts to leave associations alone. The health of society will usually be promoted if the groups within it which serve the industrial, mental, and spiritual needs of citizens are genuinely alive. Like individuals, they will usually do most for the community if they are free to determine their own lives for the present and the future.

For contractarian perspectives on nonterritorial private associations, see Ellman, *Driven from the Tribunal: Judicial Resolution of Internal Church Disputes*, 69 CALIF. L. REV. 1378, 1402-05 (1981); *Judicial Control*, *supra* note 29, at 1001-02. The purely contractarian view of the nonterritorial association is criticized in Jacobson, *The Private Use of Public Authority: Sovereignty and Associations in the Common Law*, 29 BUFFALO L. REV. 599, 602, 612-15 (1980) (emphasis should be on fiduciary relationships); see also Chafee, *supra*, at 1001-10 (association's misconduct is better analyzed by applying tort doctrine).

³² See *supra* text accompanying notes 12-21.

External legal norms of course constrain the contracting process, and in some instances should lead to the judicial invalidation of offensive "constitutional" provisions, such as those that would regulate the racial characteristics of association members.³³ Nevertheless, because original membership in an association is more voluntary than original membership in a city, an association's constitution should be allowed to contain substantive restrictions not permissible in a city charter. For example, if a group of orthodox Jews set up a condominium and stipulated by original covenant that males were required to wear yarmulkes in common areas on holy days, a court should enforce that original covenant in deference to the unanimous wishes of the original members. An identical "public" regulation would, of course, violate the first amendment's ban on the establishment of religion, and perhaps a number of other constitutional guarantees.

The pattern of judicial decisions tends to honor the suggested principle of greater private associational autonomy. Although the Supreme Court has recently held that age is not a suspect classification,³⁴ lower courts perceive municipal zoning by age as posing serious constitutional questions.³⁵ By contrast, homeowners-association regulations that limit the age of dwelling occupants have tended to survive legal challenge.³⁶ As a second example, private associations have successfully defended design controls (dealing with exterior paint colors and so on) whose public counterparts would make city attorneys squirm.³⁷

In sum, as a Florida appellate court has perceived, the "reasonableness" standard that courts apply to an association's post-forma-

³³ See, e.g., *Shelley v. Kraemer*, 334 U.S. 1 (1948) (judicial enforcement of racially discriminatory covenants would violate the equal protection clause).

³⁴ See *Massachusetts Bd. of Retirement v. Murgia*, 427 U.S. 307 (1976) (per curiam).

³⁵ See, e.g., *Adrian Mobile Home Park v. City of Adrian*, 94 Mich. App. 194, 288 N.W.2d 402 (1979) (age restriction attached to special use permit held unconstitutional); see also Doyle, *Retirement Communities: The Nature and Enforceability of Residential Segregation by Age*, 76 MICH. L. REV. 64, 89-97 (1977) (older persons may have constitutional right to live with younger family members). But cf. *Taxpayers Ass'n v. Weymouth Township*, 71 N.J. 249, 364 A.2d 1016 (1976) (sustaining constitutionality of age classification in zoning ordinance).

³⁶ See *O'Connor v. Village Green Owners Ass'n*, 132 Cal. App. 3d 178, 183 Cal. Rptr. 111 (1982); see also *Riley v. Stoves*, 22 Ariz. App. 223, 526 P.2d 747 (1974) (court finds state action is present but holds that age restriction is rationally related to a legitimate objective); *White Egret Condominium v. Franklin*, 379 So. 2d 346 (Fla. 1979) (although reasonable restrictions on age of occupants might be valid, condominium association was estopped from enforcing its restrictions). See generally Note, *The Enforceability of Age Restrictive Covenants in Condominium Developments*, 54 S. CAL. L. REV. 1397 (1981).

³⁷ See, e.g., *West Hill Colony, Inc. v. Sauerwein*, 138 N.E.2d 403 (Ohio Ct. App. 1956) (enforcing association rule that all houses be painted white).

tion actions should not apply to provisions of the association's original constitution:

[The original] restrictions are clothed with a very strong presumption of validity which arises from the fact that each individual unit owner purchases his unit knowing of and accepting the restrictions to be imposed. . . . [A]lthough case law has applied the word "reasonable" to determine whether such restrictions are valid, this is not the appropriate test, and to the extent that our decisions have been interpreted otherwise, we disagree. Indeed, a use restriction *in a declaration of condominium* may have a certain degree of unreasonableness to it, and yet withstand attack in the courts. If it were otherwise, a unit owner could not rely on the restrictions found in the declaration of condominium, since such restrictions would be in a potential condition of continuous flux.³⁸

B. *Judicial Review of a Private Association's Actions to Implement Its "Constitution"*

When courts are asked to rule on the validity of an association's actions to flesh out and apply its original constitution, they currently apply the previously mentioned test of "reasonableness." The association's governing documents³⁹ or a state statute⁴⁰ may call for application of the reasonableness standard; if not, courts imply the standard as a matter of law into the original constitution.⁴¹ The reasonableness standard applies to several types of association actions. It constrains all administrative actions—for example, an association's decision to expel a member, to veto the transfer of a membership, or to deny approval of architectural plans.⁴² In addition, it constrains the substance of all "legislation"

³⁸ *Hidden Harbour Estates, Inc. v. Basso*, 393 So. 2d 637, 640 (Fla. Dist. Ct. App. 1981) (emphasis in original).

³⁹ *See, e.g., Hidden Harbour Estates, Inc. v. Norman*, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975) (governing documents empowered condominium association's board to adopt "reasonable rules and regulations").

⁴⁰ Ten statutes of this sort are cited in Note, *Judicial Review of Condominium Rulemaking*, 94 HARV. L. REV. 647, 652 n. 29 (1981).

⁴¹ *See, e.g., Justice Court Mut. Hous. Coop., Inc. v. Sandow*, 50 Misc. 2d 541, 270 N.Y.S.2d 829 (Sup. Ct. 1966); *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Civ. App. 1977).

⁴² *See, e.g., Kennedy v. Electric Heights Hous. Ass'n*, 61 Pa. Commw. 348, 433 A.2d 639 (1981) (expulsion of member); *Laguna Royale Owners Ass'n v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981) (transfer of membership); *Rhue v. Cheyenne Homes, Inc.*, 168 Colo. 6, 449 P.2d 361 (1969) (en banc) (architectural review). *See generally Scavo, Dispute Resolution in a Community Association*, 17 URB. L. ANN. 295 (1979).

that an association adopts by procedures less cumbersome than the association's procedures for a constitutional amendment.⁴³ "Legislation" would include, for example, house rules that a board of directors might adopt under an express grant of authority in the original declaration.

"Reasonable," the most ubiquitous legal adjective, is not self-defining. In reviewing an association's legislative or administrative decisions, many judges have viewed the "reasonableness" standard as entitling them to undertake an independent cost-benefit analysis of the decision under review⁴⁴ and to invalidate association decisions that are not cost-justified by general societal standards. This variant of reasonableness review ignores the contractarian underpinnings of the private association. As some courts have recognized, respect for private ordering requires a court applying the reasonableness standard to comb the association's original documents to find the association's collective purposes, and then to determine whether the association's actions have been consonant with those purposes.⁴⁵ To illustrate, the reasonableness of a board rule banning alcoholic beverages from the swimming pool area⁴⁶ cannot be determined in the abstract for all associations. So long as the rule at issue does not violate fundamental external norms that constrain the contracting process, the rule's validity should not be tested according to external values, for example, the precise package of values that would constrain a comparable action by a public organization. Rather, the validity of the rule should be judged according to the enacting association's own original purposes.

C. *Procedures for, and Judicial Review of, "Constitutional" Amendments*

Some provisions of a private constitution are likely to become outmoded as time passes. Architectural controls, for instance, may

⁴³ See generally Note, *supra* note 40; Note, *Condominium Rulemaking—Presumptions, Burdens and Abuses: A Call for Substantive Judicial Review in Florida*, 34 U. FLA. L. REV. 219 (1982).

⁴⁴ See, e.g., *Baum v. Ryerson Towers*, 55 Misc. 2d 1045, 287 N.Y.S.2d 791 (Sup. Ct. 1968); *Justice Court Mut. Hous. Coop., Inc. v. Sandow*, 50 Misc. 2d 541, 270 N.Y.S. 2d 829 (Sup. Ct. 1966).

⁴⁵ See, e.g., *Laguna Royale Owners Ass'n v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981); *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632, 636 (Tex. Civ. App. 1977). Because an association's original governing documents may be vague about the association's purposes, this will often not be an easy task.

⁴⁶ Cf. *Hidden Harbour Estates, Inc. v. Norman*, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975) (rule prohibiting use of alcoholic beverages in clubhouse and adjacent areas held reasonable).

become passé. Recognizing this, drafters of both condominium statutes and association documents usually establish explicit procedures for "constitutional" amendments. In designing an optimal amendment procedure, drafters must reconcile two sharply conflicting interests. On the one hand, because members unanimously approved the original constitution, to authorize constitutional amendments by less than unanimous vote would imperil the contractual nature of association membership. As the Swedish economist Knut Wicksell first pointed out, only a unanimity rule assures that a collective choice will result in a Pareto-superior outcome.⁴⁷ On the other hand, a requirement that amendments be unanimously approved would often thwart worthy efforts to free association members from imprisonment in their original constitution. If each member could veto amendments, some might withhold their consent in hope of receiving a side-payment. Transaction costs, partly arising from strategic behavior of this sort, might then doom unanimous member approval of an amendment that would meet Paretian criteria (or, less ambitiously, the Kaldor-Hicks criterion⁴⁸) for efficiency.

To resolve this dilemma, the drafter might consider what decision rule for amendments a member would want to have when he first joined an association. Before the member knew what specific amendments would later be considered, the member plausibly would want an amendment process that would minimize the sum of the present value of three different types of costs: (1) the opportunity costs the member would incur when amendment procedures prevented an association from adopting amendments that would benefit the member; (2) the losses the member would suffer from harmful amendments adopted over the member's dissent ("victimization costs"); and (3) the member's share of the admin-

⁴⁷ See J. BUCHANAN & G. TULLOCK, *supra* note 6, at 8 (acknowledging Wicksell's contributions). A policy meets Paretian criteria when it would make no one worse off, and at least one person better off. A policy meets the Kaldor-Hicks criterion—"potential Pareto-superiority"—when the gainers gain more than the losers lose. Readers unfamiliar with these concepts might consult the fuller treatment in Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221 (1980). Richard Posner defends the Kaldor-Hicks criterion for social decisionmaking in Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 491-97 (1980). For critical appraisals of Posner's position, see Bebchuk, *The Pursuit of a Bigger Pie: Can Everyone Expect A Bigger Slice?*, 8 HOFSTRA L. REV. 671 (1980); Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509 (1980); Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641 (1980).

⁴⁸ For a description of the Kaldor-Hicks criterion, see *supra* note 47.

istrative costs of the amendment procedure.⁴⁹ What this calculus would suggest to any individual member would depend partly on whether the member anticipated being in the majority or minority on most issues, and on how averse the member was to the various risks, particularly the risks of victimization.⁵⁰ This *ex ante* calculus would cause most entrants to prefer *different decision rules for different types of amendments*.

1. Unanimity Rules for Wealth-Shifting Amendments

In a prior section, I concluded that a person voluntarily joining a private association would prefer that the association be barred from subsequently adopting a coercive program whose sole aim was to redistribute wealth among members.⁵¹ Current law recognizes an entrant's *ex ante* distaste for *ex post* redistributions. State condominium statutes, as well as the Uniform Condominium Act, typically require unanimous member ratification of any amendment that would alter members' (1) voting rights, (2) shares of ownership of the common elements, or (3) shares of common expenses.⁵² The initial allocation of these three types of rights would be capitalized into the initial sales prices of the various units. Members proposing to change shares of either voting power or ownership would virtually always be simply attempting to increase their wealth at the expense of other members. By barring these redistributions, these statutory provisions (and contractual provisions like them) reduce members' costs of joining and managing associations.⁵³

⁴⁹ Cf. J. Buchanan & G. Tullock, *supra* note 6, at 63-84 (discussing tension between member's interests in minimizing "decision-making costs" and in obtaining benefits from programs that control externalities); Michelman, *Politics and Values or What's Really Wrong with Rationality Review*, 13 CREIGHTON L. REV. 487, 494-95 (1979) (economics-minded drafter might want to minimize the sum of a member's costs of "market failure" and "political failure"). Other discussions of the relative advantages of unanimity rules and majority rules include R. ABRAMS, FOUNDATIONS OF POLITICAL ANALYSIS: AN INTRODUCTION TO THE THEORY OF COLLECTIVE CHOICE 13-26 (1980); D. MUELLER, PUBLIC CHOICE 28-49 (1979).

In a subsequent discussion of voting systems, I propose a slightly different (but not inconsistent) list of considerations a drafter would take into account. See *infra* text accompanying notes 78-80.

⁵⁰ See Michelman, *supra* note 49, at 498 (noting particular anxieties of "discrete and insular minorities" who might be subject to systematic exploitation by a majority).

⁵¹ See *supra* text accompanying notes 22-26.

⁵² See UNIF. CONDOMINIUM ACT § 2-119(d); UNIF. PLANNED COMMUNITY ACT § 2-117(d); statutes cited in Note, *supra* note 40, at 652 n.28.

⁵³ See *supra* text accompanying notes 25-26.

2. Nonunanimity Rules for Wealth-Creating Amendments

Members may seek to amend their constitution not only for purely distributional reasons, but also to improve the efficiency of their living conditions and fiscal arrangements. An amendment is "wealth-creating" if it meets the Kaldor-Hicks criterion for efficiency, that is, if gainers gain more from the amendment than losers lose.⁵⁴ *Ex ante*, a member would not want his association to have a unanimity rule for wealth-creating amendments. A unanimity rule would often either thwart change helpful to the member (resulting in high opportunity costs) or make helpful change procedurally expensive (resulting in high administrative costs). To reduce those expected costs, an entrant would therefore be willing to risk incurring victimization costs—the losses that losing members incur from a wealth-creating amendment.

However, for a risk-averse entrant, to shift from a unanimity rule to a mere *majority rule* for passage of wealth-creating amendments might unduly increase risks of victimization. A drafter can only try to approximate the optimal decision rule—that is, the rule that would minimize the sum of the three costs. The current compromise, evident in both statutes and association documents, is to require that members approve potentially wealth-creating amendments by some intermediate extraordinary majority. Although this approach is sound, it should be supplemented with another method of accommodating majority and minority interests; the drafter should insert, or a reviewing court should imply, a "taking clause" (similar to the constitutional clause that restricts public entities) into the association's original governing documents.

a. *Extraordinary Majorities*

The Uniform Condominium Act generally forbids a membership from amending its original declaration of covenants by less than a sixty-seven percent vote.⁵⁵ Moreover, the Act states that the declaration can itself call for an even larger majority.⁵⁶ Some creators of condominium associations have accepted this invitation and required ninety percent approval of amendments proposed during the first twenty years of association operations and seventy-five percent approval thereafter.⁵⁷ This particular formula pre-

⁵⁴ See *supra* note 47.

⁵⁵ See UNIF. CONDOMINIUM ACT § 2-119(a) ("The declaration may specify a smaller number only if all of the units are restricted exclusively to nonresidential use."); see also statutes cited in Note, *supra* note 40, at 652 n.27.

⁵⁶ See UNIF. CONDOMINIUM ACT § 2-119(a).

⁵⁷ See P. ROHAN, REAL PROPERTY 11-23 (1981) (illustrative declaration).

supposes, probably with good reason, that entrants would perceive the opportunity costs of a ninety percent approval rule as increasing with time.

Even if his association had an express taking clause promising compensation of objective losers from an amendment,⁵⁸ an entrant in his *ex ante* calculation probably would still want to require amendment approval by extraordinary majority. To avoid reliance on victims' self-interested testimony about losses, legal damages are usually measured by diminutions in market value. This measure of damages can be unfair to victims with atypical tastes. For example, if most elderly people dislike the presence of dogs, an amendment banning dogs in a retirees' condominium association where dogs had originally been explicitly allowed would probably raise the market value of all units.⁵⁹ However, a member who loved dogs might nevertheless suffer a deep subjective loss and be skeptical of the adequacy of damage remedies.⁶⁰ In his *ex ante* calculation, this member might therefore favor supplementing the taking clause with an extraordinary-majority rule for constitutional amendments.⁶¹

⁵⁸ See *infra* text accompanying notes 62-77.

⁵⁹ Cf. *Winston Towers 200 Ass'n v. Saverio*, 360 So. 2d 471 (Fla. Dist. Ct. App. 1978) (bylaw prohibiting new pets, including pets acquired to replace prior pets already licensed with the association, held void as an attempt to impose retroactive regulations).

⁶⁰ The member could be skeptical for another reason. Administrative-cost considerations may excuse an association bound by a taking clause from indemnifying even the objective victims of an amendment. See *infra* text accompanying note 65.

⁶¹ Business corporations make less use of extraordinary majority rules than homeowners associations do. The greater diversity of interests of association members explains this pattern. Business shares are generally homogeneous in quality. (When there are different classes of stock, separate majorities of each class may be required for approval of an amendment that affects the classes differently.) Moreover, business shareholders tend to have a single common purpose: maximizing the value of their shares. A business shareholder's subjective valuation of a share (reservation price) tends not to deviate much from market price because a shareholder has numerous fungible investment opportunities. See Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982) (criticizing Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RESEARCH J. 69, 112-18). Because shareholders of a widely held corporation tend to have common interests, a majority of shareholders cannot easily enrich itself at the expense of a minority. Therefore corporate shareholders have relatively little need for either extraordinary-majority voting rules or for judicial review of the reasonableness of majority-approved actions. (In a close business corporation, where an owner-employee is not unlikely to value his shares at greater than their market value, extraordinary majority rules are more common. See generally W. CARY & M. EISENBERG, *CORPORATIONS* 448-65 (5th ed. 1980).)

By contrast, because of the uniqueness of real estate and the emotional ties that bind one to one's residence, an association member may have a reservation price well above market price. The member will thus consider the effect of an amendment not only on the market value of his unit, but also on his subjective

b. *Taking Clauses*⁶²

Although an entrant into an association would be chary of a rule requiring unanimous member approval of wealth-creating amendments, he would also fear being regularly on the losing end of the amendment process. A taking clause in the original constitution that entitled losers from amendments to compensation would appear to be an attractive way to resolve the entrant's dilemma. If an amendment would indeed be wealth-enhancing, then the gainers would still favor it even if they had to compensate the losers. A policy of full compensation of losers also ensures the Pareto superiority of amendments.⁶³

There is, of course, a catch: the potentially high administrative costs of rendering accurate compensation. Administrative-cost considerations may explain why, to my knowledge, drafters of association constitutions have never included express taking clauses, and why condominium statutes do not impose a taking clause as a matter of law. Nor have courts and commentators discussed the compensation possibility; they seem to perceive the only alternative to be property-rule⁶⁴ protection of either the majority or minority.

Private taking clauses nevertheless have great promise in reconciling majoritarian flexibility and minority rights. As I would apply it, a private taking clause would give any objective loser from an amendment a *prima facie* entitlement to compensation. An association would be freed from liability only if it could

valuation of the unit. More importantly, every unit has a unique location and almost certainly other unique features as well. These two heterogeneities—in owners' valuations and in quality of units—make it more likely that an association's amendments (compared to a business corporation's amendments) will seriously dis-gruntle a minority.

Cities understandably make sparing use of extraordinary majority procedures. In contrast to an association's declaration, a municipality's charter was not unanimously approved. If the charter was approved by (say) majority vote, there is no reason to subject amendments to a stiffer approval requirement.

⁶² The discussion in this section owes much to Frank Michelman's classic article, Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

⁶³ Although a unanimity rule also ensures the Pareto superiority of amendments, a unanimity rule is likely to unloose destructive strategic behavior. See *supra* text accompanying note 48. Members prone to hold out for strategic reasons can do much less damage if an association protects minorities only by means of an extraordinary-majority rule coupled with a taking clause.

⁶⁴ See Calabresi & Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972) (distinguishing property rules that protect entitlement-holders with injunctions from liability rules that protect entitlement-holders with the remedy of damages).

make out a defense derived from the Michelman fairness test.⁶⁵ This defense would place on the association the burden of proving both (1) that the challenged amendment was indeed wealth-enhancing, that is, that it met the Kaldor-Hicks criterion; and (2) that the losers should be able to see why the failure to compensate would fit into a consistent compensation practice that would be in their own long-run self-interest (for example, by lowering otherwise insuperable administrative-cost hurdles to the adoption of wealth-enhancing amendments). To reduce adjudication costs, an express taking clause included in a private constitution could specify that taking disputes between associations and members were to be decided by compulsory arbitration.

Alternatively, legislatures and courts could imply a taking clause as a matter of law to help association members resolve their conflicts. Partly because lawmakers and judges would be hard put to order use of a system of compulsory arbitration, an express clause in the declaration is preferable. If the drafter failed to insert a taking clause, however, a court could invoke the common-law "reasonableness" standard for association actions to entitle the victim of an association amendment to taking-clause protection. Where an association could not make out its fairness defense, a court would condition its validation of an amendment on the association's compensating the losers.

A brief review of some actual amendment disputes will demonstrate the promise of a private taking clause—whether express or implied. In a first class of cases, the association majority has sought to "rezone" a subarea of the association's territory. An amendment like this may be wealth-creating. For example, freeing a few association lots from original covenants that prohibit non-residential uses could expedite the opening of conveniently located neighborhood stores.⁶⁶ A relaxation of this sort, however, is apt to injure a few association homeowners who own immediately adjacent lots. Responding to the pleas of these neighbors, courts in three appellate cases have flatly banned all subarea amendments as a matter of common law.⁶⁷ Had they instead implied a taking clause as a matter of law, these courts could have protected the neighbors without placing association restrictions in a strait jacket.

⁶⁵ See Michelman, *supra* note 62, at 1218-1224.

⁶⁶ Cf. *Ridge Park Home Owners v. Pena*, 88 N.M. 563, 544 P.2d 278 (1975) (association cannot selectively remove covenant barring commercial uses).

⁶⁷ See *Riley v. Boyle*, 6 Ariz. App. 523, 434 P.2d 525 (1967); *Ridge Park Home Owners v. Pena*, 88 N.M. 563, 544 P.2d 278 (1975); *Montoya v. Barreras*, 81 N.M. 749, 473 P.2d 363 (1970).

Takings jurisprudence has even more obvious relevance when an association majority has voted to *impose* new restrictions on selected lots. In *Bay Island Towers, Inc. v. Bay Island-Siesta Association*,⁶⁸ a Florida court upheld severe new restrictions on the ground that the restrictions were "reasonable"; the court, however, failed to consider whether the reasonableness standard also required the association to compensate the victimized lot owners.

In a second class of cases, a majority of association members has approved amendments imposing user fees for certain services that the association had previously financed out of general assessment revenue. As with a municipal fiscal system, a switch from general financing to benefits financing can be wealth-creating.⁶⁹ Nevertheless, a shift like this inevitably inflicts some immediate disadvantage on the members who had particularly benefited from the previously "free" provision of the service in question. Two reported decisions involve the earthshaking issue of washing-machine finance. In one, a New York court upheld an association's imposition of a two-dollar-per-month user-charge (for extra water consumed) on members who had installed washing machines at a time when all water was paid for as a "common expense."⁷⁰ A Florida decision, *Thiess v. Island House Association*,⁷¹ involved the validity of an amendment affecting formerly communal laundry machines. The amendment gave the owners of the two units on each floor of the association's high-rise buildings the exclusive right to use the machines on their floor, but also required that those owners thereafter maintain the machines at their own expense. The court, interpreting Florida statutes, held that the amendment would affect the members' shares in the common surplus and expenses and that the amendment could therefore only be adopted by unanimous vote. In neither of these cases did the reviewing court consider conditioning its approval of the association's new fiscal policy on the compensation of the objective losers.

In the third class of cases, a majority of the membership has approved an amendment to the land-use restrictions applicable to *all* units, but the uniform change aggrieves a minority of unit owners. A dramatic example would be an amendment prospectively prohibiting occupancy by children, adopted to the dismay of

⁶⁸ 316 So. 2d 574 (Fla. Dist. Ct. App. 1975) (amendment forbade multi-family uses permitted by original covenants).

⁶⁹ See generally PUBLIC PRICES FOR PUBLIC PRODUCTS (S. Mushkin ed. 1972).

⁷⁰ *Vernon Manor Coop. Apartments v. Salatino*, 15 Misc. 2d 491, 178 N.Y.S.2d 895 (Sup. Ct. 1958).

⁷¹ 311 So. 2d 142 (Fla. Dist. Ct. App. 1975).

fertile young couples who had joined the association in reliance on an express policy allowing children.⁷² An analogous situation arose in *Warren v. Del Pizzo*,⁷³ where the original covenants applicable to a rustic residential subdivision in Oregon limited the height of buildings to one story. After a few lots had been sold to purchasers relying on these covenants, owners of over seventy-five percent of the lots (most of them unsold lots held by a successor developer) voted to repeal the height restriction. The Oregon court sustained the validity of the amendment despite the early purchasers' protests that the amendment imperiled their views of Mt. Hood. As in the other cases just discussed, the Oregon court never adverted to the possibility of compensation.⁷⁴

A taking clause invariably carries a "just compensation" clause in its train. In some of the foregoing examples, diminution in market value would be an adequate measure of compensation. It would work for fiscal amendments and in cases like *Bay Island* where the losers were investors unlikely to have a reservation price much above market price.⁷⁵ Using diminution in market value as the exclusive measure of a loss would be troublesome, however, when a unit owner could be expected to have considerable surplus value in his unit. An amendment prospectively banning children might not reduce the market value of a unit owned by a fertile yet childless couple, but the amendment might indeed wipe out much of their surplus, and even induce them to move. Therefore, a claimant should be entitled to recover not only for any diminution in market value, but also an amount equal to what a "reasonable person" in the claimant's particular life situation would lose in irreplaceable surplus.⁷⁶ The latter figure would of course be a crude estimate, but nevertheless probably better than awarding nothing. As always, a claimant would have a duty to mitigate

⁷² Cf. *Ritchey v. Villa Nueva Condominium Ass'n*, 81 Cal. App. 3d 688, 146 Cal. Rptr. 695 (1978) (sustaining legality of a prospective ban on children).

⁷³ 46 Or. App. 153, 611 P.2d 309, *modified*, 48 Or. App. 237, 616 P.2d 1186 (1980).

⁷⁴ See also *Harrison v. Air Park Estates Zoning Comm.*, 533 S.W.2d 108 (Tex. Civ. App. 1976) (blanket amendment to covenants; possibility of compensation not discussed).

⁷⁵ Cf. the provision in UNIF. CONDOMINIUM ACT § 2-119(a), *quoted supra* note 55, that authorizes amendments by less than 67% vote when an association's units are exclusively devoted to nonresidential uses.

⁷⁶ Cf. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Controls*, 40 U. CHI. L. REV. 681, 735-37 (1973) (proposing that victims of nuisances be entitled to recover bonuses to compensate them for lost surplus) [hereinafter cited as *Alternatives to Zoning*].

damages, a duty that might occasionally be interpreted as requiring him to move.⁷⁷

III. VOTING RIGHTS IN LOCAL COMMUNITIES

Current law often compels cities and homeowners associations to allocate voting power to their members—indeed, to define their memberships—in dramatically different ways. After describing this legal pattern, this Part summarizes recent developments in economic theory that are relevant to the issue of voting rights. I conclude that these theoretical developments support a major overhaul of current voting law.

Evaluation of a voting system requires attention to several competing considerations. First, unless an organization's members are indifferent to risks of impoverishment, they would want to devise a voting system that would tend to lead to the adoption of policies that met (at least) the Kaldor-Hicks criterion for efficiency.⁷⁸ This concern will be referred to as the goal of "allocative efficiency." Second, members would want to keep down the administrative costs of operating their voting system. Third, and loosely stated, if the members desired their organization to redistribute wealth, they would want voting rules conducive to the proper types of redistribution. Fourth, if members shared the critical legal scholars' view that participation is to be valued for its own sake,⁷⁹ they would pay attention to the relative "participation benefits" of competing voting systems.⁸⁰ The complex and usually contradictory nature of these goals makes it unlikely that any particular voting system will be best in all situations.

⁷⁷ Because of the homogeneities described *supra* note 61, business corporations are not likely to need taking clauses. *But cf.* Hetherington & Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 45 (1977) (advocating enactment of a statute that would entitle a minority shareholder in a business corporation to demand that the corporation or the remaining shareholders purchase his shares at a court-determined market value).

⁷⁸ See *supra* note 47.

⁷⁹ See, e.g., Frug, *supra* note 1, at 1068. The seminal statement is H. ARENDT, ON REVOLUTION 115-16, 120-29 (1963).

Scholars with widely diverse outlooks are attracted by the notion that a person who devotes time to group decisionmaking may not necessarily be incurring a cost, but rather may be securing a benefit. I am, and so are, e.g., Brest, *The Fundamental Rights Controversy: The Essential Contradictions of Normative Constitutional Scholarship*, 90 YALE L.J. 1063, 1101-02 (1981); Michelman, *supra* note 49, at 506-10.

⁸⁰ Some commentators might add as a fifth criterion the symbolic value of a voting system—for example, its success in reflecting democratic ideals of political equality and majority rule. See Still, *Political Equality and Election Systems*, 91 ETHICS 375 (1981); Note, *The Right to Vote in Municipal Annexations*, 88 HARV.

The weights accorded these competing considerations affect the crucial decision of who should be entitled to vote. When a university holds an election to choose a sobriquet for its athletic teams, the electorate might conceivably include all trustees, faculty, staff, students, alumni, and donors, or might include only some of these subgroups. If one favors "representation-reinforcing" rules,⁸¹ one might be inclined to include in the electorate all affected persons, even though some are less affected than others.⁸² The redistributive goal certainly suggests giving the vote to the beneficiaries of desired redistributive policies. However, considerations of both allocative and administrative efficiency often suggest exclusion from the electorate of persons with little stake in substantive political decisions.

The following discussion emphasizes two models for allocating voting rights in residential communities. The first model is to allocate voting rights to *residents* (usually subject to some additional qualifications based on age, citizenship, and so on). The second model is to allocate votes according to *economic stake in the community* (perhaps subject to similar qualifications). A rough approximation of a person's economic stake in community affairs is the value of his interests in real property located within community boundaries;⁸³ community decisions can affect the value of real property, but rarely the value of moveable assets.⁸⁴

A. *The Current Legal Position*

To simplify a bit, current legal rules direct cities to allocate votes according to residency and homeowners associations to allocate votes according to economic stake. Tenants are residents, but they may lack a significant economic stake in local policymaking, especially if they value their leaseholds at the contract rent.⁸⁵

L. REV. 1571, 1575 (1975). I have not included this fifth criterion on the ground that political equality and majority rule are presumably not valued in and of themselves, but as instruments to advance some or all of the four goals listed in the text.

⁸¹ See generally J. ELY, *DEMOCRACY AND DISTRUST* (1980).

⁸² This has been the general effect of the Supreme Court's decisions on voting rights in local elections. See Note, *State Restrictions on Municipal Elections: An Equal Protection Analysis*, 93 HARV. L. REV. 1491, 1502-05 (1980).

⁸³ Dollar values are of course an imperfect measure of individual utilities. "A ten thousand dollar house to one person may mean more to that person than a hundred thousand dollar house to another." *Stewart v. Parish School Bd.*, 310 F. Supp. 1172, 1179 (E.D. La.), *aff'd mem.*, 400 U.S. 884 (1970). But economists have not yet developed any technique for measuring individual utilities.

⁸⁴ For a fuller discussion, see *infra* text accompanying notes 119-38.

⁸⁵ See *id.*

Owners of undeveloped land, nonresidential buildings, or rental housing usually have a major economic stake in community decisions, but may lack residency. Thus the two voting paradigms tend to identify rather different electorates.

1. Voting Rights in Local Government Elections

The one-person/one-vote rule that the Supreme Court has found emanating from the equal protection clause now tightly constrains the allocation of voting power at the local level of government. In a line of cases beginning with *Avery v. Midland County*,⁸⁶ the Court has required proof of a compelling state interest before it will sustain a voting classification that restricts the local franchise on grounds other than residence, age, or citizenship.⁸⁷

In its post-*Avery* decisions, the Court confronted a variety of local voting rules that conjoined the residency model and the economic-stake model by extending the franchise only to (1) residents who (2) also had an identifiable economic stake in local affairs. In *City of Phoenix v. Kolodziejski*,⁸⁸ for example, the Court considered an Arizona constitutional provision (similar to those in eleven other states)⁸⁹ that gave residents who paid property taxes the exclusive right to vote on a city's general-obligation bond issues. In *Kolodziejski*, as in a variety of analogous decisions,⁹⁰ the Court held that the equal protection clause required that the franchise be extended, on an equal per capita basis, to the landless residents who had challenged the voting system.

A city might mix the two voting paradigms in another way. Instead of limiting the vote to persons who meet *both* residency and economic-stake criteria—a system the Court has explicitly forbidden—a city might extend voting rights to persons who met *either* criterion. Such a system gives a vote not only to resident landowners—the only group enfranchised under the forbidden *Kolodziejski* approach—but also to both landless residents and nonresident

⁸⁶ 390 U.S. 474 (1968).

⁸⁷ See generally Note, *supra* note 82.

⁸⁸ 399 U.S. 204 (1970).

⁸⁹ *Id.* 213 n.11.

⁹⁰ See *Hill v. Stone*, 421 U.S. 289 (1975) (invalidating system that restricted votes in bond elections to resident owners of taxable real or personal property); *Cipriano v. City of Houma*, 395 U.S. 701 (1969) (residents who pay property taxes cannot be the only persons entitled to vote in elections on municipal revenue bonds); *Kramer v. Union Free School Dist. No. 15*, 395 U.S. 621 (1969) (votes in school district elections cannot be restricted to residents who either own or lease property, or are parents of school children).

owners of city land. A few pre-*Avery* decisions in fact sustained the constitutionality of this either-or system.⁹¹ Since it issued *Avery*, the Court has not had a system like this before it, perhaps because few cities have tried this mixed form. If the Court were to honor the reasoning in the *Avery* line of cases, any municipal attempt to expand the electorate in this way would be unlikely to survive an equal protection challenge. The Court's explicit concern in its city voting cases has been to protect and equalize the voting rights of city residents.⁹² Many Justices undoubtedly joined in this endeavor in part because they believed that imposition of a one-resident/one-vote rule would increase progressive redistribution at the local level. The per capita equalization of political coin can plausibly be thought to lead to somewhat more equal distribution of economic coin.⁹³ Because enfranchising nonresident landowners would cut against the Court's redistributive goal in *Avery*, this second type of hybrid voting system is also constitutionally suspect.⁹⁴

Although the Court's one-resident/one-vote rule unquestionably applies to general-purpose local governments such as cities, the Court has exempted from the rule's application special districts that serve narrow purposes. An irrigation district, for example, may allocate voting rights according to assessed valuation of land—an

⁹¹ See *Glisson v. Mayor of Savannah Beach*, 346 F.2d 135 (5th Cir. 1965); *Spahos v. Mayor of Savannah Beach*, 207 F. Supp. 688 (S.D. Ga.), *aff'd per curiam*, 371 U.S. 206 (1962). On the other hand, nonresident landowners who have asserted that they have a constitutional right to vote in local general elections have not met with success. See *Reeder v. Board of Supervisors*, 269 Md. 261, 305 A.2d 132 (1973).

⁹² See, e.g., *Avery v. Midland County*, 390 U.S. 474, 484-85 (1968) ("We hold today only that the Constitution permits no substantial variation from equal population in drawing districts for units of local government having general governmental powers over the entire geographic area served by the body."); see also *Holt Civic Club v. City of Tuscaloosa*, 439 U.S. 60 (1978) (equal protection clause does not require that vote be extended to residents of area beyond city limits even though city exercises extra-territorial powers there).

⁹³ See A. DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* 198 (1957); see also *infra* note 140.

⁹⁴ See *Curtis v. Board of Supervisors*, 7 Cal. 3d 942, 963, 501 P.2d 537, 551, 104 Cal. Rptr. 297, 311 (1972) (dictum: "It is open to question whether the state can give nonresidents a vote equivalent to that of residents"). *But cf.* Note, *supra* note 80, at 1595-98 (although entitling nonresident landowners to vote in annexation elections would probably not violate constitutional strictures, their enfranchisement might be legislatively undesirable). See also *infra* note 130.

Of course, this second hybrid system does not necessarily lead to less redistribution than would occur under the *Kolodziejski* scheme. While the second system is less progressive than the *Kolodziejski* scheme to the extent that the second system enfranchises nonresident landowners, the second system is *more* progressive to the extent that it enfranchises tenants. A redistribution-minded Court, therefore, could conceivably uphold the second system without overruling *Kolodziejski*.

obvious proxy for economic stake.⁹⁵ The Court has yet to identify a persuasive reason for this exception.⁹⁶ This failure suggests that the Court does not have a consistent theory for why local electoral systems should follow particular paradigms.

2. Voting Rights in Homeowners Associations

Although there are thousands of private homeowners associations, I know of none with an electoral structure that comports with the one-resident/one-vote principle. As in business corporations, voting rights in community associations tend to be apportioned according to share ownership, a rough approximation of economic stake. State statutes governing condominium associations sometimes provide that voting rights *must* be allocated according to a particular formula, such as one vote per unit,⁹⁷ or in proportion to floor area.⁹⁸ Most statutes, however, allocate votes according to the ownership interests set out in the original declaration, a system that gives developers some initial flexibility.⁹⁹ The statutory intent seems to be that a unit purchaser should be able to know at the time of purchase what fraction of total voting power attaches to his unit. A one-resident/one-vote rule would violate this statutory intent because relative voting power would fluctuate with the vagaries of household composition. Thus almost all state condominium statutes forbid the voting system that the Supreme Court required in *Avery*.

A consumer would presumably be willing to pay more to purchase a condominium in an association with a "better" political system than competing associations have. If the condominium statutes were preventing developers from maximizing profits, one might expect developers to seek passage of statutory amendments authorizing voting by residency in private associations. I am aware of no evidence that either developers or entrants into new private

⁹⁵ See *Salzer Land Co. v. Tulare Lake Basin Water Storage Dist.*, 410 U.S. 719 (1973); see also *Ball v. James*, 451 U.S. 355 (1981) (large water reclamation district that sells electricity falls within *Salzer* exception). But cf. *Hadley v. Junior College Dist.*, 397 U.S. 50 (1970) (*Avery* applies to junior college district).

⁹⁶ See L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 13-11, at 765; § 16-56, at 1132-34 (1978); Note, *supra* note 82, at 1496-97.

⁹⁷ See, e.g., CONN. GEN. STAT. ANN. § 47-70a (West 1978); see also CAL. ADMIN. CODE tit. 10, § 2792(18) (1981); URBAN LAND INST., *supra* note 30, at 209, 259, 368-87.

⁹⁸ See, e.g., KY. REV. STAT. § 381.810(9) (1979); see also MICH. COMP. LAWS ANN. § 559.154(7) (1982 Supp.) (votes can be allocated either by unit value or one per unit).

⁹⁹ See, e.g., ALA. CODE § 35-8-7(6) to (7) (1977); ARIZ. REV. STAT. ANN. § 33-551(8) (1974); MD. REAL PROP. CODE ANN. §§ 11-101(h), -107 (Supp. 1981).

communities are unhappy with the prevailing system of voting by economic stake. This is a clue that one-resident/one-vote does not have much consumer appeal as a *private* voting system.

Regardless of the precise formula used, in virtually all condominium associations, absentee landlords can vote, but their tenants cannot.¹⁰⁰ The owner of multiple units can cast multiple votes (assuming votes are allocated one per unit). Professor Krasnowiecki's influential model legal documents go even farther. To prevent early purchasers from taking control before the developer has marketed most of the units, Professor Krasnowiecki would effectively grant the developer *three* votes for every unsold unit during the initial stages of a development.¹⁰¹ Could one flout the principle of one-resident/one-vote any more openly?

Voting systems in private associations seem primarily designed to advance efficiency goals, not the redistributive goals the Supreme Court was arguably pursuing in the *Avery* line of cases. Because the intensity of a voter's interest in a community matter is likely to be positively correlated with the voter's economic stake in the community, voting by economic stake appears to be a surer route to allocative efficiency than voting by residency would be.¹⁰² If so, efficiency-minded entrants into an association would prefer one-unit/one-vote to one-resident/one-vote. Moreover, members of a homeowners association can be expected to prefer that the association *not* engage in coercive redistributive programs.¹⁰³ If political power were to be allocated in proportion to economic stake, there would likely be less redistribution than there would be if political power were allocated more progressively. The current private voting rules also seem to reflect members' interests in minimizing administrative costs. The economic stake of an owner depends on the *current* market value of his unit (not its value at its creation), and also on any subjective surplus value he might have in the unit. Tenants, especially those who value their units at above contract rent, also have some economic stake. Association voting formulas almost never reflect these nuances, but instead opt for rules that are easier to administer—such as one-unit/one-vote.

¹⁰⁰ There are exceptions. Tenants are entitled to vote (one vote per dwelling unit) in village-level elections held in Columbia, Maryland. See Note, *Democracy in the New Towns: The Limits of Private Government*, 36 U. CHI. L. REV. 379, 390-91 (1969).

¹⁰¹ See URBAN LAND INST., *supra* note 30, at 241, 386-87.

¹⁰² See *infra* text accompanying notes 106-118 & 173-76.

¹⁰³ See *supra* text accompanying notes 22-26.

B. *The Relevance of Economic Theory to the Question of Who Votes*

The homeowners-association market's apparent rejection of one-person/one-vote rules does not necessarily cast doubt on the wisdom of *Avery*. Cities are inherently different from associations in at least two critical ways. First, cities have involuntary members who never consented to the local electoral system.¹⁰⁴ Judges and legislators might well take it upon themselves to look out for the political interests of these minorities, but defer to private voting arrangements out of respect for freedom of contract. Second, because only cities can coerce membership, cities, but not associations, undertake coercive redistributive programs.¹⁰⁵ These two differences could justify the current divergence between public and private voting rules.

Economic theory sheds light on the power of these distinctions, and on the soundness of current voting law. This section briefly reviews three strands of relevant economic theory that have yet to be incorporated in legal analyses of voting rights. The first strand is the "public-choice" literature, which is primarily relevant in appraising the allocative efficiency of various voting systems. The second strand involves the Tiebout Hypothesis of competition among local governments and the ensuing literature on the effects of public-sector characteristics on rents. This theoretical strand helps one identify the persons most inextricably affected by community decisions. The third strand is the public-finance literature that explores how the various levels of government in a federal system should share responsibility for progressive redistributive programs. This has obvious relevance because *Avery* and its progeny may have been aimed at redistributive ends.

1. The Public-Choice Literature

Publication of Kenneth Arrow's impossibility theorem sparked new efforts by economists to apply their tools to problems traditionally viewed as falling within the realm of political science.¹⁰⁶ Subsequent interdisciplinary scholarship led to the emergence of a new field called "public choice." This field has spawned a special-

¹⁰⁴ See *supra* text accompanying notes 12-21.

¹⁰⁵ See *supra* text accompanying notes 22-26.

¹⁰⁶ Arrow, *A Difficulty in the Concept of Social Welfare*, 58 J. POL. ECON. 328 (1950).

ized journal¹⁰⁷ and several college textbooks¹⁰⁸ and has begun to influence the legal literature.¹⁰⁹

Public-choice theorists have demonstrated the extraordinary difficulty of constructing mechanisms that will unerringly assure that collective decisions promote allocative efficiency—the main goal with which these theorists seem to be concerned. They, like James Madison before them,¹¹⁰ are troubled by voting systems that do not permit voters to register the intensity of their preferences.¹¹¹ Outcomes under the most common voting systems will often not meet the Kaldor-Hicks criterion (much less Paretian criteria) for efficiency. In a majoritarian system, for example, a majority can approve a program that helps its members less than the program damages the losing minority.¹¹² If voting power were to be allocated not by headcount, but by economic stake in the issue being voted on, these inefficient outcomes would be less likely.¹¹³

Public-choice theorists have striven to develop new voting mechanisms that are more likely to result in efficient policy decisions. These mechanisms—the best known of which is the Groves-Ledyard mechanism¹¹⁴—need not be described here.¹¹⁵ The salient feature of the new mechanisms is that they usually ask affected persons to reveal their preferences by voting with *dollars*.¹¹⁶ However, the theorists have so far only developed mechanisms for selecting among program alternatives, not candidates for office. The administrative costs of their systems also often appear to be un-

¹⁰⁷ PUBLIC CHOICE, edited at the Center for Study of Public Choice, Virginia Polytechnic Institute and State University.

¹⁰⁸ R. ABRAMS, *supra* note 49; A. FELDMAN, WELFARE ECONOMICS AND SOCIAL CHOICE THEORY (1980); D. MUELLER, *supra* note 49.

¹⁰⁹ See Easterbrook, *Ways of Criticizing the Court*, 95 HARV. L. REV. 802 (1982); sources cited *id.* 814 n.33.

¹¹⁰ See THE FEDERALIST No. 10, at 53, 60-61 (J. Madison) (Modern Library ed. 1941) (expressing fear that a majority will execute "plans of oppression").

¹¹¹ See J. BUCHANAN & G. TULLOCK, *supra* note 6, at 125-30; A. DOWNS, *supra* note 93, at 64-66, 184-94; see also R. DAHL, A PREFACE TO DEMOCRATIC THEORY 90-123 (1956).

¹¹² Political bargaining (logrolling) of course may reduce the frequency of inefficient outcomes.

¹¹³ The commentators who criticize voting systems that fail to account for intensity of preference imply this result. However, to my knowledge it awaits both formal and empirical proof.

¹¹⁴ See Groves & Ledyard, *Optimal Allocation of Public Goods: A Solution to the "Free Rider" Problem*, 45 ECONOMETRICA 783 (1977), discussed in A. FELDMAN, *supra* note 108, at 129-34.

¹¹⁵ For descriptions of some proposed mechanisms, see E. CLARKE, DEMAND REVELATION AND THE PROVISION OF PUBLIC GOODS (1980); D. MUELLER, *supra* note 49, at 68-89.

¹¹⁶ D. MUELLER, *supra* note 49, at 88-89.

acceptably high. But who knows what they will concoct in the future? The important point for present purposes is that current law generally prohibits *both* cities and homeowners associations from experimenting with these types of voting systems. For its part, *Avery* generally forbids voting by economic stake in city elections.¹¹⁷ For their part, the condominium statutes require fixed allocations of voting strength for all voting matters, and thus also forbid voting with dollars.¹¹⁸

2. The Tiebout Hypothesis and the Effect of Community Characteristics on Rents

Since the publication of a seminal article by Charles Tiebout in 1956,¹¹⁹ urban economists have tended to conceptualize balkanized metropolitan areas as markets in which residential communities compete for residents. Each municipality tries to attract households by developing an appealing package of taxation and expenditure programs. Households choose among these competing environments by "voting with their feet." A household moves into the community that offers it the best overall deal; if the deal turns sour, the household moves to a more enticing community.¹²⁰ Tiebout's model assumed, among other things, (1) that households are fully mobile, (2) that households have full knowledge of community characteristics, (3) that a city's policies have no effect beyond city boundaries, and (4) that markets for communities are perfectly competitive. If these conditions prevailed, competition among municipalities would provide urban residents with an appropriate variety of packages of public goods.

Urban economists have developed a corollary to the Tiebout Hypothesis. If households indeed shop for communities, the value of any positive community attribute should be reflected in higher rents.¹²¹ For example, a residential tenant with children should be willing to pay a higher rent to live in a jurisdiction with an outstanding school system. By extension, the market value of a

¹¹⁷ See *supra* text accompanying notes 86-96.

¹¹⁸ See *supra* text accompanying notes 97-103.

¹¹⁹ Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956), critically appraised in D. MUELLER, *supra* note 49, at 125-47.

¹²⁰ A member dissatisfied with the performance of one of his organizations may choose not to exit from it, but rather to stay and, by voicing his objections, try to reform it. See A. HIRSCHMAN, *EXIT, VOICE AND LOYALTY* (1970). The Tiebout model emphasizes the exit option, not the voice option.

¹²¹ See, e.g., Sonstelie & Portney, *Gross Rents and Market Values: Testing the Implications of Tiebout's Hypothesis*, 7 J. URB. ECON. 102 (1980).

landlord's interest should reflect not only the capitalized value of local services, but also the capitalized burden of local property taxes.¹²² Empiricists have marshalled some support for these theoretical propositions.¹²³

Interestingly, urban economists have not yet directed their attention to the *private* provision of residential communities—that is, the market for homeowners associations. Producers of associations compete with one another, and potential entrants shop among the private alternatives. The Tiebout analysis suggests that this competition, and the related competition between cities and associations, tends to promote an efficient distribution of community types.

The Tiebout Hypothesis has potentially important implications for the design of voting systems in both public and private communities. The key insight is that, in a market where rents are not controlled, many of the benefits of local pro-tenant programs may be passed on to landlords in the form of higher rents. In fact, in Tiebout's idealized world, tenants would get little or no net benefit from new pro-tenant programs. Similarly, the burden of anti-tenant taxes (for example, taxes on consumption of utility services) would reduce prevailing rents and thus fall mostly on landlords. In short, *if markets for residential communities were to meet Tiebout's idealized assumptions, tenants would have little (conceivably no) economic stake in the substance of community policies.*¹²⁴

I will soon discuss four important qualifications to this provocative statement.¹²⁵ Subject to those qualifications, the Tiebout

¹²² See, e.g., Epple & Zelenitz, *The Implications of Competition Among Jurisdictions: Does Tiebout Need Politics?*, 89 J. POL. ECON. 1197, 1212 (1981); Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. POL. ECON. 957 (1969); Yinger, *Capitalization and the Theory of Local Public Finance*, 90 J. POL. ECON. 917 (1982).

¹²³ See sources cited *supra* notes 121-22; *infra* note 138.

¹²⁴ See Epple & Zelenitz, *supra* note 122, at 1212.

The finding that, in equilibrium, utility of residents of a jurisdiction is independent of its government's fiscal decisions is a startling result, one which highlights an important conceptual distinction between residents of a jurisdiction and its landowners. For residents who rent housing, the choices of tax rate and government spending level are matters of complete indifference in equilibrium. Housing prices will adjust to maintain their equilibrium utility level. By contrast, the wealth of landowners is directly affected by the choice of tax rates and level of government service. See also Bucovetsky, *Inequality in the Local Public Sector*, 90 J. POL. ECON. 128 (1982). But see *City of Phoenix v. Kolodziejski*, 399 U.S. 204, 210 (1970) (tenants bear all or a large part of burdens of local taxes); *Cipriano v. City of Houma*, 395 U.S. 701, 705 (1969) (same).

¹²⁵ See *infra* text accompanying notes 131-38.

model identifies owners of real property as the persons with the greatest economic stake in community decisions. Consider, for instance, the community decision on which voting system to adopt. In choosing among communities, knowledgeable shoppers would consider a community's political structure along with other community characteristics. Suppose a community in Tiebout's idealized world were to disenfranchise tenants. If all tenants detested that policy, they would offer less for housing in that community, and end up paying lower rents. In this hypothetical situation, the burdens of the political discrimination against *tenants* would thus ultimately be borne mostly by *landlords*.

If tenants actually have relatively little at stake in local affairs, one would expect their turnout rate to be comparatively low at city elections held on dates when there were no state or federal elections. Political scientists have apparently not systematically studied the effect of form of tenure on participation in city politics.¹²⁶ I have anecdotal evidence that tenants do tend to be relatively less active than homeowners in local affairs.¹²⁷ Lack of involvement by tenants might of course stem from factors other than their form of tenure—for example, from their relatively higher mobility, or relatively lower socioeconomic status.

Designers of community voting systems often seem to have intuitively understood the possibility that tenants have less at stake

¹²⁶ Political scientists who have studied the correlates of voter turnout in local elections have not examined the influence of form of tenure. See Alford & Lee, *Voting Turnout in American Cities*, 62 AM. POL. SCI. REV. 796 (1968); Hamilton, *The Municipal Voter: Voting and Nonvoting in City Elections*, 65 AM. POL. SCI. REV. 1135 (1971); King, *Comparing Local and Presidential Elections*, 9 AM. POL. Q. 277 (1981). These investigators have found, however, that the probability of someone voting in a local election is positively correlated with both his length of residence and his income. See also R. DAHL, *WHO GOVERNS?* 276-301 (1961) (discussion of correlates of all forms of participation in local politics). See generally R. WOLFINGER & S. ROSENSTONE, *WHO VOTES?* (1980) (study of 17 possible correlates (not including form of tenure) of voter participation in national elections).

A city's taxation and expenditure programs tend to increase in size as its percentage of tenant-occupied dwelling units goes up. See Lineberry & Fowler, *Reformism and Public Policy in American Cities*, 61 AM. POL. SCI. REV. 701, 712 (1967) (this is the single best predictor of the size of a local public sector). The Tiebout model may conceivably help explain this finding. If pure Tieboutian conditions prevailed, only landowners (not tenants) would be damaged by a city's adoption of an inefficient spending program. Thus a tenant-dominated electorate could be expected to be less inclined to punish local officials who wasted local tax dollars.

¹²⁷ In the California cities of Mountain View, Redwood City, and (prior to 1979) Santa Monica, most city council members have come from homeowner ranks, even though a majority of the adults in all these cities have been renters. This is, of course, not direct evidence that homeowners in those cities have been more likely to vote; although I have some evidence that that has also been the case.

in community decisions than landowners do. Electorates in private associations almost invariably include only unit owners.¹²⁸ Before the Supreme Court's decision in *Kolodziejski*, twelve states had constitutional provisions allowing only resident property owners to vote on general-obligation bond issues.¹²⁹ More often than not, state statutes governing municipal annexation procedures have given some form of special political voice to owners of land situated within the area proposed for annexation.¹³⁰ The drafters of these

¹²⁸ See *supra* text accompanying notes 97-103.

¹²⁹ See *supra* text accompanying notes 88-89.

¹³⁰ Prior to the Court's *Avery* decision in 1968, state annexation procedures were extremely diverse. (They still are, mainly because few have been amended on account of *Avery*.) The various state statutes were reviewed in DEP'T OF URBAN STUDIES, NAT'L LEAGUE OF CITIES, ADJUSTING MUNICIPAL BOUNDARIES: LAW AND PRACTICE (1966). This study indicated that at that time, 36 states provided some form of special voice to persons owning land in the area proposed for annexation.

In 19 of these states, owner-influenced procedures could be circumvented because alternative methods of annexation were available. In Arkansas, for example, either a majority of property owners in the affected area could petition the county court for annexation, or the annexing municipality could call a special election in which its voters would decide whether or not to initiate the annexation process. Compare ARK. STAT. ANN. § 19-301 (1980) with *id.* § 19-307.

In 17 states, owners had some form of veto power over annexation. For example, in California, if the owners of one-half or more of the value of the land to be annexed were to file protests, annexation proceedings were to be halted for a one-year period, and during this period annexation could occur only if 100% of the landowners concurred. CAL. GOV'T CODE § 35121 (West 1968), *repealed by* 1974 CAL. STAT. ch. 478, § 8. Similarly, in Arizona a petition signed by owners of a majority of the value of taxable real and personal property in the area in question was required before annexation could occur. ARIZ. REV. STAT. ANN. § 9-471A (1977).

States that extended electoral power to landowners tended to use one of three different methods to apportion landowner votes. First, some states allocated votes in some proceedings in proportion to property value as indicated on property-tax assessment rolls. A prime example was Delaware, which granted owners voting in annexation elections one vote for each \$100 of assessed property owned. Delaware granted nonowning residents only one vote each in these elections. DEL. CODE ANN. tit. 22, § 101 (1981). In South Dakota, petitions to annex had to be signed by owners of $\frac{1}{4}$ of the value of the area to be annexed. S.D. CODIFIED LAWS ANN. § 9-4-1 (1981).

A second system was to allocate landowner voting power by land area. For example, in Colorado the petition of owners of 50% or more of the area to be annexed (exclusive of streets and alleys) was one method for obtaining a voluntary annexation. COLO. REV. STAT. § 31-12-107(1)(a) (1977). Alabama required that owners of 60% of the land area to be annexed consent to any proposed annexation. ALA. CODE § 11-42-2(10) (1977).

Third, several states had some procedures that allocated one vote per owner regardless of area or value owned. See, e.g., ARK. STAT. ANN. § 19-301 (1980) (majority of real estate owners affected may apply for annexation provided such majority owns more than 50% of the land affected); MONT. CODE ANN. § 7-2-4314(2) (1981) (majority of "resident freeholders" can veto annexation).

These three apportionment schemes all had some adherents in 1966. For example, of the 17 states that granted a form of veto power to landowners in annexation elections, 10 states had some type of voting-by-value procedures; 4

various voting systems may have perceived that landowners can be the persons most inextricably involved in community decisions. A short-term tenant aggrieved by a community decision can exit (albeit at the price of paying relocation costs). By contrast, a landowner's grievance (say, having undeveloped land rezoned as open-space) is immediately capitalized into a lower land value; if the landowner exits by selling the land, the cost of the adverse community decision is realized, not avoided. When incorporation or annexation proceedings enable a city to add "involuntary" members, the unconsenting owners of real property in the affected area would thus often feel more distress than the unconsenting tenants who live there would feel.

Now, four important caveats. First, even if there were fierce competition among communities, tenants would likely have at least a modest stake in decisions made by cities and homeowners associations. To the extent that a tenant has idiosyncratic tastes, a community policy may reduce (or increase) his surplus value in his unit. For example, suppose a community closed a putting green of great sentimental value to Lee Trevino, and of no value to anyone else. If Trevino were a tenant in that community, he would suffer a loss. Because Trevino's contract rent is basically set by the general run of consumer tastes, however, it is unlikely that market forces would bring about a subsequent, compensatory reduction in Trevino's contract rent.¹³¹ More generally, a settled

had voting-by-area procedures; and 8, one-owner/one-vote procedures. (Several states had procedures involving more than one of these methods.)

A few more examples will further document the extent to which state legislatures experimented with annexation procedures prior to *Avery*. New Mexico had an annexation procedure that involved the creation of an arbitration board. The board consisted of seven members: three chosen by the municipal government that wished to annex; three *resident landowners*, chosen in a one-resident/one-vote election held in the territory to be annexed; and a seventh member, a county resident and landowner living outside the affected areas, selected by the first six members. This board could, by majority vote, approve an annexation proposal. N.M. STAT. ANN. 3-7-7 to -10 (1981). Oregon developed a procedure known as the "triple two-thirds" consent rule, under which an election in the area proposed for annexation need not be held if at least two-thirds of the owners owning at least two-thirds of the land area *and* at least two-thirds of the land value consented to the annexation. Act of May 23, 1961, ch. 511, § 2, 1961 Or. Laws 938, 939-40 (current version at OR. REV. STAT. § 222.170 (1981)). One Illinois procedure entitled an owner holding 10 or more unsubdivided acres to exclude his land from an annexation. ILL. ANN. STAT. ch. 24, § 7-1-2 (Smith-Hurd 1962).

On the current constitutionality of these procedures, see *Levinsohn v. City of San Rafael*, 40 Cal. App. 3d 656, 115 Cal. Rptr. 309 (1974) (statutory provision granting veto power to owners of majority of assessed value of land in area to be annexed held to violate equal protection clause); Note, *supra* note 80, at 1594-98.

¹³¹ See generally *Alternatives to Zoning*, *supra* note 76, at 735-37 (discussing a resident's nonfungible surplus).

tenant is likely to have sentimental ties with neighborhood people and places. These ties may lead him to value his leasehold at a figure above the contract rent. As with Lee Trevino, this nontransferable surplus value gives the tenant a stake in community affairs.¹³²

A second and related qualification is that, contrary to one of Tiebout's simplifying assumptions, the out-of-pocket and aggravation costs of moving are not trivial. Thus even a short-term tenant who values his living space at its contract rent has a stake in community decisions on issues, such as urban renewal or school closures, whose adverse resolution might force (or induce) him to move.¹³³

Third, a tenant has a property interest—the leasehold itself—whose market value can be affected by community policy.¹³⁴ If a tenant's rent is fixed during the term of his lease, the magnitude of his stake increases with the length of his remaining term. For example, if his landlord is contractually bound not to raise his rent, a tenant can reap benefits from a community service newly available in his neighborhood. When the tenant's term ends, however, his landlord can raise his rent and thereby capture the market value of the new service. Rent control may prevent a landlord from responding in this way.¹³⁵ In a jurisdiction where landlord-tenant law limits landlords' rights to terminate leases and raise rents, that legal policy in effect gives short-term tenants the option of becoming long-term tenants and thereby increases tenants' stakes in community policies. All short-term tenants consequently have a stake in rent-control issues, and tenants in cities that have rent control have a greater stake in the entire range of city policies than short-term tenants in other cities do. This analysis thus predicts that tenant turnout at local elections would be higher in cities

¹³² Dunn, *Measuring the Value of Community*, 6 J. URB. ECON. 371 (1979), estimates that persons who move away from small towns in rural areas suffer significant subjective losses of this sort.

¹³³ Statutory provisions, however, may entitle a tenant to recover tangible moving costs plus a lump-sum dislocation allowance. See, e.g., 42 U.S.C. §§ 4622, 4624 (1976); see also *Devines v. Maier*, 665 F.2d 138 (7th Cir. 1981) (residential tenants ousted by city's housing-code enforcement program were constitutionally entitled to just compensation).

¹³⁴ Cf. *Alamo Land & Cattle Co. v. Arizona*, 424 U.S. 295 (1976) (valuation of long-term lease in eminent domain proceeding).

¹³⁵ Rent control ordinances are essentially municipal attempts to redistribute wealth on a short-run basis from landlords to tenants already in residence. Current evidence indicates that rent control ordinances do not meet the Kaldor-Hicks criterion for efficiency because landlords lose more than tenants gain. See C. RYDELL, C. BARNETT, C. HILLESTAD, M. MURRAY, J. NEELS & R. SIMS, *THE IMPACT OF RENT CONTROL ON THE LOS ANGELES HOUSING MARKET* 87-89 (a RAND Note prepared for the City of Los Angeles, 1981). The debate over rent control is partly a debate over whether cities are appropriate instruments for formulating redistributive policies, a topic discussed *infra* text accompanying notes 139-51.

that either have rent control, or that might realistically adopt rent control.¹³⁶

The fourth, and probably most important, qualification is that markets for communities are not as competitive as the Tiebout model assumes. For example, a community with unique attributes or considerable territorial size usually has a degree of monopoly power.¹³⁷ As another example, if too few households are knowledgeable about community characteristics, rents and sale prices will not fully reflect community quality. Nevertheless, despite the highly fanciful nature of Tiebout's assumptions, a large number of empirical studies indicate that rents and sale prices *tend* to reflect public-sector characteristics in the way that urban economists have predicted.¹³⁸ The empiricists' findings are not tidy, however, and thus also serve as reminders that Tiebout's model drastically oversimplifies the elusive reality of metropolitan organization.

Taken together, these four qualifications suggest that most tenants are in fact likely to have at least some stake in community decisions. The qualifications do not, however, render the Tiebout-inspired literature utterly irrelevant to the issue of voting rights in local communities. The empirical studies on capitalization of local fiscal decisions indicate that landowners, *qua* landowners, do tend to have a major stake in community decisions. If members of a residential community wished to distribute political voice only to persons with a significant economic stake in local political outcomes, this literature thus suggests that they could *plausibly* establish ownership of local land as a qualification for voting. Alternatively, the empiricists' finding of imperfect competition among cities sug-

¹³⁶ The recent history of Santa Monica, California, supports this hypothesis. After successfully pushing through a rent-control initiative in 1979, a renter-dominated coalition captured control of the Santa Monica city council, displacing homeowner representatives.

¹³⁷ Little is known about the elasticity of demand for residence in particular cities. Early probes include Fischel, *Zoning and the Exercise of Monopoly Power: A Reevaluation*, 8 J. URB. ECON. 283 (1980); Hamilton, *Zoning and the Exercise of Monopoly Power*, 5 J. URB. ECON. 116 (1978).

¹³⁸ See sources cited *supra* notes 121-22, and sources cited therein. There is fierce debate over the proper methodology for these studies. See, e.g., Hamilton, *The Effects of Property Taxes and Local Public Spending on Property Values: A Theoretical Comment*, 84 J. POL. ECON. 647 (1976); Reinhard, *Estimating Property Tax Capitalization: A Further Comment*, 89 J. POL. ECON. 1251 (1981).

A less formal study is G. MILLER, *CITIES BY CONTRACT: THE POLITICS OF MUNICIPAL INCORPORATION* 8 (1981), which presents anecdotal evidence that middle-class families voted with their feet in the 1954-78 period among cities in Los Angeles County. See also Gramlich & Rubinfeld, *Micro Estimates of Public Spending Demand Functions and Tests of the Tiebout and Median-Voter Hypothesis*, 90 J. POL. ECON. 536 (1982) (reporting interview data that lend support to Tiebout Hypotheses).

gests that the members could also plausibly regard residency as a desirable qualification for voting. At bottom, while the Tiebout literature certainly does not provide support for a national rule that would require local governments to confer voting rights only on landowners, it also casts doubt on the wisdom of the current national rule that essentially forces all local governments to treat residency as a necessary and sufficient qualification for voting.

3. The Role of Local Government in Redistribution

As noted earlier, its perfectly voluntary nature makes a private association an inappropriate instrument for accomplishing coercive redistributions of wealth.¹³⁹ A city, however, has involuntary members and therefore can better implement coercive redistributive policies. That a city could effect redistribution, however, does not establish that it *should*. This section describes the redistributive role that public-finance theorists would currently assign to cities.

The mainstream position, certain to dismay Professor Laurence Tribe and other *Avery* supporters,¹⁴⁰ is that local governments should essentially have no role in income redistribution. In their leading textbook on public finance, Professors Richard and Peggy Musgrave say flatly, "Policies to adjust the distribution of income among individuals must be conducted on a nationwide basis."¹⁴¹ The Advisory Commission on Intergovernmental Relations also would assign redistributive activity to supralocal levels; it has recommended that the states assume all responsibility for financing public schools and that the federal government bear the entire cost of public assistance.¹⁴²

These centralists offer several justifications for their conclusions. First, they assert that a city's redistributive programs typically generate benefit spillovers that help outsiders. For example, if Miami fed and clothed a flood of refugees, it would be relieving a problem also of concern to non-Miamians. Whenever such benefit spillovers occur from a city activity, public-finance scholars suggest, a city is likely to carry out too little of that activity. The scholars'

¹³⁹ See *supra* text accompanying notes 22-26.

¹⁴⁰ See L. TRIBE, *supra* note 96, § 13-11, at 765; § 16-56, at 1132-34 (criticizing Supreme Court's tolerance of local voting rules that are unlikely to "upset existing wealth distributions").

¹⁴¹ R. MUSGRAVE & P. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 623 (2d ed. 1976); see also R. BISH, *THE PUBLIC ECONOMY OF METROPOLITAN AREAS* 141, 147 (1971); W. OATES, *FISCAL FEDERALISM* 7-8, 14 (1972).

¹⁴² See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *STATE AID TO LOCAL GOVERNMENT* vi (1969).

solution is to assign the activity to a government whose boundaries are sufficiently inclusive to internalize all benefits.¹⁴³

Second, public-finance theorists assert that, when the benefits and burdens of redistributive programs vary by location, both the rich and the poor may move to exploit these locational differences. If New York City's welfare benefits were to be better than Miami's, for example, more of Miami's poor families might move to New York than otherwise.¹⁴⁴ The centralists assert that these moves would result in locational inefficiencies that would not be present if uniform welfare benefits were administered nationally.¹⁴⁵

Pauly and other revisionists assert that they have detected a shortcoming in the mainstream position.¹⁴⁶ Pauly points out that the utility-interdependence of the rich and poor may have a spatial dimension. In less technical terms, a rich person may have more interest in redistributing wealth to poor persons who live close by than to those who live farther away. Charity drives, for example, often focus on local causes. In his turn, a poor person may get more satisfaction from receiving aid from a rich neighbor than from someone more remote. However, because the revisionists agree with the centralists that local redistributive programs may artificially stimulate households to move, the revisionists would not necessarily regard all redistributive activity at the local level as being efficiency-enhancing. Rather, the revisionists argue that the

¹⁴³ See, e.g., G. BREAK, *INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES passim* (1967); R. NETZER, *STATE-LOCAL FINANCE AND INTERGOVERNMENTAL FISCAL RELATIONS passim* (1969).

¹⁴⁴ This problem is hardly fanciful. Between March 1975 and March 1980, 45.1% of Americans age five and older moved to a new residence. San Francisco Chron., Jan. 14, 1982, § 1, at 12, col. 1 (citing census bureau report). Between 1947 and 1975, each year an average of 12.8% of the population moved intra-county, and another 6.5%, intercounty. See Rossi, *Residential Mobility*, in *DO HOUSING ALLOWANCES WORK?* 147, 153 (1981).

Tenants move more often than owner-occupants do. *Id.* 154. In a typical metropolitan housing market, each year the number of tenant turnovers is almost half the number of rental housing units. See RAND, *THIRD ANNUAL REPORT OF THE HOUSING ASSISTANCE SUPPLY EXPERIMENT 64-65* (1977) (reporting turnover rates of 43 per hundred in Brown County, Wisconsin, and 50 per hundred in St. Joseph County, Indiana).

See generally A. DOWNS, *NEIGHBORHOODS AND URBAN DEVELOPMENT* 24-36 (1981).

¹⁴⁵ See, e.g., R. MUSGRAVE & P. MUSGRAVE, *supra* note 141, at 623.

¹⁴⁶ See Pauly, *Income Redistribution as a Local Public Good*, 2 J. PUB. ECON. 35 (1973); see also A. BRETON & A. SCOTT, *THE ECONOMIC CONSTITUTION OF FEDERAL STATES* 111-130 (1978); Buchanan, *Who Should Distribute What in a Federal System?*, in *REDISTRIBUTION THROUGH PUBLIC CHOICE* 22 (1974). But see Ladd & Doolittle, *Which Level of Government Should Assist the Poor?*, 35 NAT'L TAX J. 323, 330-32 (1982) (empirically based critique of the revisionist position).

question of optimal governmental responsibility for redistribution is less clearcut than the mainstream theorists assert it to be.¹⁴⁷

In designing voting systems for local governments, one must of course consider not only the theory of redistribution, but also current redistributive practice. There are few data on the magnitude of public assistance programs of subcounty governments, apparently because these programs are rare.¹⁴⁸ Local governments nevertheless certainly do accomplish a considerable amount of redistribution. For example, a school district that spends equal dollars per pupil ostensibly transfers wealth from richer to poorer families. But this equal-expenditure policy is essentially a product of state and federal law,¹⁴⁹ and as such could be enforced regardless of how a local school board happened to be elected. Local governments that *voluntarily* redistribute wealth in a significant way mostly do so through their land-use regulations.¹⁵⁰ For example, by imposing exactions on developers, a city can transfer wealth from owners of undeveloped land (and perhaps from housing consumers) to current homeowners and others who own already developed land.¹⁵¹ These ad hoc redistributive efforts of course hardly accomplish the broad progressive redistributions that public-finance theorists have traditionally favored.

C. Toward Greater Community Choice Among Voting Rules

Several commentators have noted the incongruity between voting by economic stake in homeowners associations and voting by residency in cities.¹⁵² Some of them would eliminate this incongruity by extending the one-resident/one-vote rule to private

¹⁴⁷ Noneconomists have sometimes advocated local redistributive programs. See, e.g., Krumholz, *The Cleveland Policy Planning Report*, 41 J. AM. INST. PLANNERS 298 (1975) (Cleveland's top priority should be "promoting a wider range of choices for those Cleveland residents who have few, if any, choices").

¹⁴⁸ In fiscal year 1980, local governments (including counties) financed 4.3% of total public welfare expenditures. Ladd & Doolittle, *supra* note 146, at 324.

¹⁴⁹ See, e.g., *Hobson v. Hansen*, 269 F. Supp. 401 (D.D.C. 1967), *aff'd in part and appeal dismissed in part sub nom. Smuck v. Hobson*, 408 F.2d 175 (D.C. Cir. 1969); *Robinson v. Cahill*, 62 N.J. 473, 303 A.2d 273, *cert. denied*, 414 U.S. 976 (1973). See generally Levin, *Current Trends in School Finance Reform Litigation: A Commentary 1977* DUKE L.J. 1099.

¹⁵⁰ Rent control is another local program that may have major redistributive consequences. See *supra* note 135.

¹⁵¹ See Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385, 435-440, 450-54 (1977) [hereinafter cited as *Suburban Growth Controls*].

¹⁵² See, e.g., Note, *supra* note 40, at 656-58; Note, *supra* note 100, at 402-12 (1969).

governments as a matter of constitutional law.¹⁵³ They advocate that courts hold that the actions of homeowners associations constitute state action for equal protection purposes, on the ground either that associations perform "public functions" or that states cannot delegate community governance to "private" organizations. A few state courts have even begun to tilt in that direction.¹⁵⁴ I also favor substantial equalization of the legal constraints on cities and associations when they choose among electoral systems. Unlike these other commentators, however, I urge that this equalization be accomplished by providing greater choice among voting systems to the founders of both cities and homeowners associations.

1. More Choices for Homeowners Associations

Many states have enacted condominium and planned-community statutes that narrowly limit how developers can allocate voting power in the associations they create.¹⁵⁵ Often these statutes specify that votes must be allocated to owners according to a particular formula that attempts to measure the owners' original economic stakes. The drafters of these statutes must assume that consumers lack the capacity to evaluate alternative electoral systems when shopping for units. This is an odd assumption in a society that relies on private markets to allocate housing. If housing consumers are incapable of assessing alternatives, shouldn't the state also precisely dictate the floor plans of buildings and the substance of private architectural controls?

Even someone who believes that merchants regularly exploit consumers would probably be critical of these statutory straitjackets. The recent developments in economic theory reviewed in the prior section suggest both that there is unlikely to be any single optimal voting system for communities and, more importantly, that if there is such a system, no one yet knows what it is. I therefore recommend that state legislatures remove all statutory constraints on the selection of homeowners-association voting systems. A legislature not willing to try total deregulation could adopt intermediate reforms. It could authorize developers to choose a voting system

¹⁵³ See Walter, *Condominium Government: How Should the Laws Be Changed?*, 4 REAL EST. L.J. 141 (1975). But see Reichman, *supra* note 7, at 304-06.

¹⁵⁴ See, e.g., *Franklin v. White Egret Condominium*, 358 So. 2d 1084 (Fla. Dist. Ct. App. 1977), *aff'd on other grounds*, 379 So. 2d 346 (Fla. 1979). But cf. *Laguna Royale Owners Ass'n v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981) (there is "considerable doubt" that an association's actions constitute state action). See generally sources cited in Note, *supra* note 40, at 656-57 nn. 47-54.

¹⁵⁵ See *supra* text accompanying notes 97-99.

from a state-prepared list of alternative voting systems. Alternatively, for a somewhat greater measure of freedom of contract, it could also authorize a developer to choose an unlisted voting system provided that a state administrative agency certified that the system met a statutory standard of "reasonableness."

If legislatures permitted the market for private voting systems to flower, developers might experiment with now forbidden techniques. For example, a developer might specify that an owner's relative voting power would not be fixed in proportion to the original market values set out in the declaration, but would be periodically recalculated according to reassessed market values. More ambitiously, an association's rules could call for use of the Groves-Ledyard mechanism¹⁵⁶ or other innovations to decide certain issues. As a last example, most states currently forbid tenants from voting on association matters. A developer could conceivably believe that enfranchising tenants would raise the rental value (and hence the sale price) of his units.¹⁵⁷ Thus, if allowed more choice among private voting systems, some creators of private associations might experiment with one-resident/one-vote or other rules involving tenant voting.¹⁵⁸

2. More Choices for Cities

The recent developments in economic theory also support a more controversial recommendation: *that the Supreme Court overrule Avery (and related decisions) to eliminate the current federal constitutional requirement that local elections be conducted on a one-resident/one-vote basis.*¹⁵⁹ (I should immediately add that I endorse the federal constitutional rule of one-resident/one-vote in *state* and *federal* elections, partly because those higher-level governments are necessarily more involved than local ones in progressive redistributive activity.)

Although *Avery* is often viewed as bedrock constitutional law, some Justices have never accepted the extension of the one-resident/

¹⁵⁶ See *supra* text accompanying note 114.

¹⁵⁷ See *supra* text accompanying notes 131-38.

¹⁵⁸ The presence of both a taking clause, see *supra* text accompanying notes 62-77, and a unanimity requirement for a change in assessment shares, see *supra* text accompanying notes 51-53, would somewhat allay purchasers' fears that a one-resident/one-vote system would cause an association to pursue coerced redistributions of wealth.

¹⁵⁹ For other academic commentary critical of the *Avery* line of decisions, see Lee, *Mr. Herbert Spencer and the Bachelor Stockbroker: Kramer v. Union Free School District No. 15*, 15 ARIZ. L. REV. 457 (1973); see also A. BICKEL, *THE SUPREME COURT AND THE IDEA OF PROGRESS* 163-66 (1978); Casper, *Apportionment and the Right to Vote: Standards of Judicial Scrutiny*, 1973 SUP. CT. REV. 1.

one-vote rule to local elections. Justice Harlan couched the opening words of his dissent in *Avery* in the strongest possible terms: "I could not disagree more with this decision . . ." ¹⁶⁰ Thirteen years later, Justice Powell hinted that he stood ready to reconsider the *Avery* line of decisions.¹⁶¹ If the Court observed its usual cautions, it would probably chip away at *Avery* before overruling it. If an appropriate case came before it, the Court could start by overruling *Kolodziejewski*, thereby resurrecting a state's option to limit eligibility to vote in local general-obligation bond elections to persons the state plausibly perceived as having an interest in the long-term economic condition of the community.¹⁶² As another intermediate step, the Court could exempt from the *Avery* rule not only narrow special districts, but also small general-purpose local governments that have close substitutes. When a small suburb must compete vigorously with many other suburbs for residents, it is unlikely to try much progressive redistribution because the high mobility of the regional population would cause many of the benefits of the redistribution to spill out to others in the region.¹⁶³ (New York City tried a tuition-free city university; Scarsdale never did.) To the extent that the Justices who supported *Avery* did so to foster progressive redistributive activity, they could rather painlessly exempt from the rule small local governments in areas of high population mobility.¹⁶⁴

My reasons for doubting the soundness of *Avery* should by now be apparent. Different voting systems accord different weight to the competing interests of allocative efficiency, administrative efficiency, progressive redistribution, and participation.¹⁶⁵ *Avery* dictates that cities use a particular voting system as a matter of national law. It thus prevents subnational governments whose members weigh these competing interests differently than the Court

¹⁶⁰ *Avery v. Midland County*, 390 U.S. 474, 486 (1968) (Harlan, J., dissenting).

¹⁶¹ See *Ball v. James*, 451 U.S. 355, 373 (1981) (Powell, J., concurring) (Court should allow experimentation with local political structures and rely on state legislatures elected in compliance with one-person/one-vote rule to police this experimentation).

¹⁶² See *supra* text accompanying notes 88-90.

¹⁶³ See *supra* text accompanying note 143.

¹⁶⁴ Although the best test of a political unit's "smallness" is the presence of good substitutes, this test is not readily applied. Rather than use this performance standard, the Court might therefore choose to employ population or land area, or a combination of the two, see *infra* note 178, as a yardstick for measuring the size of a local government.

¹⁶⁵ See *supra* text accompanying notes 78-84.

weighs them from experimenting with other mechanisms for community decisionmaking.

Avery limits the choices of both states and cities.¹⁶⁶ State legislatures specify the procedures, including the voting rules, that local citizens are to follow when forming a new local government. If state legislators were mainly concerned about administrative efficiency and maximizing progressive redistribution at the local level, they might indeed choose the one-resident/one-vote rule for incorporation proceedings. On the other hand, particularly if the state itself did a lot of redistributing, the state legislators might give more weight to other interests. They might conclude, for example, that voting by economic stake would better reflect intensities of preference, and thus be more likely to promote allocative efficiency.¹⁶⁷ They might also conclude (ironically for the critical legal scholars) that voting by economic stake better identifies the persons whose lives would be most affected by incorporation, and who would thus gain the most from the experience of participating in an incorporation election.

Avery constrains not only how states allocate votes in city incorporation proceedings, but also how cities run post-incorporation elections. The limitation on city choices is a major inroad on local autonomy. For example, it is conceivable that even community members who employed a one-resident/one-vote rule when deciding to incorporate would also decide by the same procedure to adopt a charter that allocated votes in post-incorporation elections according to some other system. Like the state legislators who rather consistently disenfranchise tenants in condominium elections, local citizens could plausibly read the capitalization literature¹⁶⁸ as indicating that short-term tenants as a class have less stake in community decisions than owners of local land do. They might therefore reject the one-resident/one-vote rule in favor of a property-ownership qualification for voting,¹⁶⁹ or even in favor of some

¹⁶⁶ Several Court majority opinions have emphasized the desirability of flexibility in local political arrangements. See *Town of Lockport v. Citizens for Community Action at the Local Level, Inc.*, 430 U.S. 259, 269-70 (1977); *Abate v. Mundt*, 403 U.S. 182, 185 (1971); *Sailors v. Board of Education*, 387 U.S. 105, 109 (1967).

¹⁶⁷ A California statute once authorized owners of a majority of the assessed valuation of land in the relevant area to veto an incorporation proceeding. Citing the *Avery* line of decisions, the California Supreme Court unanimously held that the statute violated the equal protection clause. See *Curtis v. Board of Supervisors*, 7 Cal. 3d 942, 501 P.2d 537, 104 Cal. Rptr. 297 (1972).

¹⁶⁸ See *supra* text accompanying notes 119-38.

¹⁶⁹ See *Harper v. Virginia Bd. of Elections*, 383 U.S. 663, 684-86 (1966) (Harlan, J., dissenting) (historical review of property qualifications for voting).

system that weighted votes by acreage or property value.¹⁷⁰ Alternatively, local incorporators might emphasize the goal of progressive income redistribution. They could then point to the findings of incomplete capitalization in the same literature as a plausible justification for giving more per capita voting power to tenants than to homeowners. Their reasons would be that tenants do have some stake in local outcomes, and are apt to be poorer than persons who own real property. *Avery* denies local incorporators the option of employing any of these unorthodox voting systems.

The Supreme Court may have believed that *Avery* and its progeny would more progressively distribute voting power in local elections, and therefore increase progressive redistribution by cities. Especially in light of the current controversy about whether local governments should have *any* role in income redistribution,¹⁷¹ the Court should abandon its implicit emphasis on redistribution, which is, after all, only one of the interests at stake when a community chooses a voting system. So long as the Court has assured that voting power is properly distributed at the state level, the Court should let state legislators and state courts decide whether local electoral systems must be structured to maximize progressive redistribution.¹⁷²

In addition, the Court may not have recognized that in some situations the one-resident/one-vote rule may lead to more regressive results than voting by economic stake would. I invoke the example of exclusionary zoning. The main discretionary business of a suburban government is land-use control. *Avery* entitles a suburb's current homeowners and other residents to vote, but seems to forbid voting by both nonresidents who might want to move to the suburb and nonresidents who own land in the suburb. Partly as a consequence of this allocation of political power, suburbs tend to employ their land-use controls to maximize the wealth of current homeowners.¹⁷³ Suburbs not only impose exactions on developers to capture part of the value of undeveloped land, but also (where possible) limit housing production to drive housing prices above competitive levels. These policies transfer wealth from future housing consumers to owners of existing housing units and are pre-

¹⁷⁰ Some states have used these apportionment systems in annexation proceedings, for example. See *supra* note 130.

¹⁷¹ See *supra* text accompanying notes 139-51.

¹⁷² See *Ball v. James*, 451 U.S. 355, 372 (1981) (Powell, J., concurring); *Kramer v. Union Free School Dist. No. 15*, 395 U.S. 621, 639 (1969) (Stewart, J., dissenting). But see *id.* 628-30; *Avery v. Midland County*, 390 U.S. 474, 481 (1968); L. TRIBE, *supra* note 96, § 13-11, at 765; § 16-56, at 1132-34.

¹⁷³ See generally *Suburban Growth Controls*, *supra* note 151.

sumptively inefficient in Kaldor-Hicks terms—that is, current housing owners gain less than consumers, and owners of undeveloped land, lose.¹⁷⁴ If there were no constitutional barrier to enfranchising affected nonresident consumers¹⁷⁵ and landowners, states and local incorporators could perhaps structure local electoral systems to give these nonresidents more political influence, thereby reducing the frequency of regressive exclusionary practices.

To underscore this point, suppose that voting power in a suburb were to be reallocated from one-vote-per-resident to one-vote-per-acre. That reallocation would strengthen prodevelopment forces relative to antidevelopment forces because owners of undeveloped land would gain in political power. Assume more housing would be built. If exclusionary practices had previously pushed housing prices above competitive levels, housing prices would fall. It is possible that the gains low-income families would obtain from the drop in housing prices would outweigh other losses they would sustain from residing in a suburb that conferred voting power according to a formula that was facially disadvantageous to them.¹⁷⁶ In other words, an apparently regressive voting system may have progressive distributional consequences.

How best to organize a municipal political system is currently far from clear. The Supreme Court should therefore refrain from rendering decisions that prohibit virtually all state and local experimentation in local voting mechanisms. The Supreme Court itself presaged the public-choice literature when it noted in *Anderson v. Dunn* over a century ago: "The science of government is . . . the science of experiment."¹⁷⁷

¹⁷⁴ See *id.* 435-36.

¹⁷⁵ There are enormous practical difficulties in identifying affected nonresident consumers. Commentators who have concluded that nonresident consumers are constitutionally entitled to a voice in shaping suburban land-use policy have therefore suggested that courts simply declare that the present zoning system violates the equal protection clause, on the assumption that state legislatures would then replace or supplement local zoning with a system of state or regional land-use controls. Note, *The Constitutionality of Local Zoning*, 79 *YALE L.J.* 896, 924 (1970). For a description of recent efforts to assure a consumer voice in administrative decisionmaking, see Morone & Marmor, *Representing Consumer Interests: The Case of American Health Planning*, 91 *ETHICS* 431 (1981).

¹⁷⁶ How a city allocates voting power should arguably vary according to the stage of municipal development. During the early life of a homeowners association, the developer is typically granted three votes per unit to protect against the possibility that the first residents might raise the ante for entry. See *supra* note 101 and accompanying text. The original incorporators of a city might similarly (1) choose for the city's developing stage a voting system (such as one-acre/one-vote) that protects late developers, but also (2) schedule an eventual switch to another voting system (such as one-resident/one-vote).

¹⁷⁷ 19 U.S. (6 Wheat.) 204, 226 (1821).

My recommendation that the Supreme Court overrule *Avery* implies neither that the Court has no role in supervising how states structure local political arrangements nor that state courts and legislatures should place no bounds on the structuring of municipal voting systems.¹⁷⁸ The Court can properly insist that the allocation and weighting of votes at the local level accord with some plausible theory of popular government. Moreover, the Supreme Court retains its role in assuring that incumbents do not manipulate districting and other decisions to malapportion voting power away from the pattern originally intended.¹⁷⁹ Yet these caveats do not weaken the central thesis: that the Supreme Court should allow the states some freedom in deciding how votes are allocated in local elections.

IV. DOES LEGAL DOCTRINE DISFAVOR CITIES?: A CRITIQUE OF *The City as a Legal Concept*

In his recent article, Professor Frug asserted that legal rules currently prevent cities from engaging in the normal range of business activities and deny cities any inherent right to resist intervention by the state. These rules have made cities "powerless."¹⁸⁰ Frug is distressed that current law "prefer[s] corporations to cities as vehicles for decentralized power."¹⁸¹ As Frug perceives the situation, private corporations tend to be hierarchical, rather than democratic, in structure. This characteristic usually disables a private organization from serving as a vehicle for group fulfillment and as an intermediary between the individual and the state. Although Frug himself sees much value in intermediaries (quite rightly, in my view), he perceives "liberalism"—that is, the world

¹⁷⁸ Before *Avery* occupied the field in 1968, some state supreme courts were beginning to restructure local political systems on constitutional grounds. See, e.g., *Miller v. Board of Supervisors*, 63 Cal. 2d 343, 405 P.2d 857, 46 Cal. Rptr. 617 (1965) (ordering reapportionment of districts used to elect county supervisors, apparently on the authority of the federal equal protection clause).

As a state legislator, I myself would favor a state statute or state constitutional provision that required all local governments above a certain size in either area (36 square miles?) or population (20,000?) to entitle all residents to vote in elections for local offices.

¹⁷⁹ In *Avery* itself, the Midland County electoral districts were grossly malapportioned. See *Avery*, 390 U.S. at 476. I agree with *Avery's* narrow holding that, because the county had adopted a one-resident/one-vote rule, this apportionment violated the equal protection clause. I of course strongly disagree with the Court's implicit broader holding in *Avery* that all elections conducted by general-purpose local governments must be conducted on a one-resident/one-vote basis.

¹⁸⁰ Frug, *supra* note 1, at 1059, 1074, 1119.

¹⁸¹ *Id.* 1061.

view of most Western thinkers—as being hostile to the creation of buffers between citizen and state.

For Frug, the Western world is out of joint. He concludes his ambitious article with these words: “[W]e need a basic rethinking of liberalism and then a restructuring of our society itself.”¹⁸² Like most critical legal thinkers, Frug describes what he does not like about the current scene more concretely than he describes what a “restructured” American society would look like after the proper “rethinking.” However, he does identify some initial reforms that would promote true decentralization and “public freedom,”¹⁸³ namely, city establishment of public banks, insurance companies, and retail food outlets.¹⁸⁴ Frug believes cities have rarely undertaken these sorts of enterprises because current legal doctrine prevents cities from engaging in business activities.

In this Part, I discuss my three major disagreements with Frug’s analysis. They deal in turn with his perceptions (1) of how best to identify legal phenomena, (2) of the relative merits of public and private intermediaries, and (3) of the reality of current legal doctrine.

A. *The Hypothesized Liberal Attack on Intermediaries*

As one whom the critical legal scholars would be certain to characterize as a Prisoner of Liberal Thought, I was puzzled to discover that Frug and I fervently agree on one important point: the desirability of nurturing intermediary institutions between the individual and the state. Why, I wondered, should Frug have thought that non-critical scholars would want to “attack”¹⁸⁵ or “undermine”¹⁸⁶ the city, the family, and the private association?

In the style of many of his critical compatriots,¹⁸⁷ Frug relies more on deductive reasoning than on observation to discover the asserted liberal attack on intermediaries. His deductive syllogism starts with his definition of liberalism. Frug views liberals as having two fundamental outlooks: (1) a dedication to reason and (2) a perception that the world poses numerous complex dualities.¹⁸⁸

¹⁸² *Id.* 1154; *see also id.* 1060.

¹⁸³ *See* H. ARENDT, *supra* note 79, at 115-16, 120-29.

¹⁸⁴ Frug, *supra* note 1, at 1128, 1150-52.

¹⁸⁵ *Id.* 1121.

¹⁸⁶ *Id.* 1126.

¹⁸⁷ *See, e.g.*, R. UNGER, KNOWLEDGE AND POLITICS 72-76 (1975).

¹⁸⁸ *See* Frug, *supra* note 1, at 1074-75. The liberal perception of these dualities is taken as a given, not as something to be verified. One thus cannot ask why liberal thought should be characterized by dualities as opposed to, say, eternal triangles.

One of these dualities is that between the individual and the state. Frug deduces that liberal thinkers are conceptually bound to this duality, and thus discomforted by the existence of intermediate institutions that are hard to classify at either pole. This leads to "the liberal undermining of intermediate entities."¹⁸⁹

As an empiricist, I predictably respond that the question of whether anyone is systematically undermining the city, the family, or any other intermediary is better answered by inductive methods than by the stipulation of nonverifiable "dualities" and the deduction of consequences that logically follow.¹⁹⁰ In part of his article, Frug does persuasively and impressively document the decline in city powers between medieval times and the early twentieth century.¹⁹¹ Yet this historical evidence hardly proves the existence of a current liberal attack on intermediaries.

First, as will soon be demonstrated, since the early twentieth century, changes in legal doctrines have considerably expanded the powers of cities.¹⁹² Frug makes almost no mention of these legal developments. Second, the American society that Frug wants to rethink and restructure currently contains within it a broad array of intermediaries: religious groups, business firms, labor unions, social clubs, professional associations, universities, and on and on.¹⁹³ New types of intermediaries—for example, the homeowners association—are continually emerging. To be sure, some voices regularly attack the independence of these entities. At the same time, other (unquestionably "liberal") voices defend them.¹⁹⁴ The situation is sufficiently complex that a sound understanding of the current role of intermediaries is more likely to come from observation than from the armchair application of abstract dualities.

¹⁸⁹ *Id.* 1126.

¹⁹⁰ I might note that empirical methods have dominated American legal thought in this century. See Summers, *Pragmatic Instrumentalism in Twentieth Century American Legal Thought—A Synthesis and Critique of Our Dominant General Theory About Law and Its Uses*, 66 CORNELL L. REV. 861, 880-81 (1981).

¹⁹¹ See Frug, *supra* note 1, at 1080-1120.

¹⁹² See *infra* text accompanying notes 210-31.

¹⁹³ An early commentator on American society was struck by the abundance of intermediary institutions. See 2 A. DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 129-46 (H. Reeve trans. 1898). "Americans of all ages, all conditions, and all dispositions, constantly form associations." *Id.* 129.

¹⁹⁴ See, e.g., P. BERGER & R. NEUHAUS, *TO EMPOWER PEOPLE: THE ROLE OF MEDIATING STRUCTURES IN PUBLIC POLICY* (1980); Novak, *Mediating Institutions: The Communitarian Individual in America*, PUB. INTEREST, Summer 1982, at 3.

B. *The Inexplicable Preference for "Public" Intermediaries*

At the end of his article, Frug compares two possible vehicles for the exercise of decentralized power: the business corporation and the city.¹⁹⁵ Although he claims to be showing only that the two are equally qualified, he clearly prefers the public form. This preference leads naturally to his advocacy of city entry into the banking and insurance industries.¹⁹⁶

Frug's discussion is not persuasive. First, Frug intentionally bypasses the existing social science literature on the relative efficiency of public and private organizations on the ground that these entities currently operate under different legal rules.¹⁹⁷ This assumes social scientists could not control for legal differences (such as the civil service system) and wrongly implies that all legal differences favor the corporation. Second, the business corporation Frug describes resembles a candidate for *Fortune's* 500.¹⁹⁸ Frug refers to "the currently hierarchical, massively centralized corporate structure"¹⁹⁹ and assumes that shareholders are "strangers" lacking "some real relationship."²⁰⁰ Frug assumes a city will usually be small enough to serve as a site for true participatory democracy.²⁰¹ This stacked comparison leads to the unsurprising conclusion that the resident of a *small city* has a better chance of controlling his organization than does a shareholder in a *large corporation*.

Had he compared a *small corporation* and a *large city*, however, Frug might well have shown more enthusiasm for corpora-

¹⁹⁵ See Frug, *supra* note 1, at 1141-49.

¹⁹⁶ This recommendation stems from Frug's interest in the amorphous goal of "public freedom." Frug does not invoke conventional economic theory to defend public enterprise. For others' efforts along those lines, see W. SHEPHERD, *PUBLIC ENTERPRISE: ECONOMIC ANALYSIS OF THEORY AND PRACTICE* (1976) (especially at 185-204, a discussion of public banking); Prichard & Trebilcock, *Crown Corporations: The Calculus of Instrument Choice*, in *CROWN CORPORATIONS IN CANADA* (J. Richard ed. 1983).

¹⁹⁷ See Frug, *supra* note 1, at 1143. Empirical studies support the proposition that private firms tend to be more efficient than government agencies in providing specific services. Some leading studies are reviewed in Spann, *Public versus Private Provision of Governmental Services*, in *BUDGETS AND BUREAUCRATS: THE SOURCES OF GOVERNMENT GROWTH* 71 (T. Borcharding ed. 1977). See also Sonstelie, *The Welfare Cost of Free Public Schools*, 90 J. POL. ECON. 794 (1982) (reporting data that indicate that private schools are more efficient than public schools).

¹⁹⁸ According to one estimate, 90% of U.S. corporations have ten or fewer shareholders, and over 99%, one hundred or fewer. In 1971, only 71 corporations had over 100,000 shareholders. A. CONARD, *CORPORATIONS IN PERSPECTIVE* 116-17 n.36 (1976).

¹⁹⁹ Frug, *supra* note 1, at 1142.

²⁰⁰ *Id.* 1147.

²⁰¹ See *id.* 1148-49.

tions as intermediaries between citizen and state. Homeowners associations are territorially circumscribed organizations that tend to be much smaller than cities. Because they are smaller, they are less hierarchically organized. Compared to city residents, association members are more likely to share "real relationships" and to have genuine opportunities to participate in the decisions that affect their lives. At bottom Frug's analysis points only to the desirability of decentralizing power to small organizations.²⁰² He therefore should regard the homeowners association as generally superior to the city as an intermediary between state and individual. Despite his herculean research, Frug's article never mentions the homeowners association.

City establishment of banks and insurance companies would also be a highly inexact way to achieve Frug's own goals. The agglomeration of multiple functions under the umbrella of a single organization is often a move toward centralization, not away from it. For example, some social critics oppose conglomerate mergers between business corporations simply because of the alleged social disadvantages of bigness.²⁰³ There are almost as many different banking companies in the United States as there are municipalities.²⁰⁴ Allowing a person to patronize a *small bank* in a *large city* enables him to *decentralize* the power of the institutions that affect his life.

The recent history of the public school system should give Frug pause. Proponents of education vouchers believe that a greater role for private providers of educational services would *increase*, not decrease, parental freedom.²⁰⁵ The anecdotal evidence I have indicates that parents are less frustrated by, and participate more actively in, the governance of private schools than in the

²⁰² Frug asserts that his preference is for democratic, rather than hierarchical, organizations. *Id.* As the text suggests, I perceive that the nature of an organization depends more on its size than on whether it is a "city" or a "corporation." See also D. MUELLER, *supra* note 49, at 15-17; M. OLSON, *supra* note 6, at 16-52 (discussing advantages of small organizations).

²⁰³ See, e.g., Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051 (1979).

²⁰⁴ In 1977, there were 3,042 counties, 18,862 municipalities, and 16,822 townships in the U.S. In the same year, there were 14,671 commercial banks (with 34,578 different branches), 4,761 savings and loan associations, 467 mutual savings banks, and 12,750 state or federally chartered credit unions. BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 309, 532, 536-37 (1980).

²⁰⁵ See CENTER FOR THE STUDY OF PUBLIC POLICY, EDUCATION VOUCHERS: A REPORT ON FINANCING ELEMENTARY EDUCATION BY GRANTS TO PARENTS (1970); J. COONS & S. SUGARMAN, FAMILY CHOICE IN EDUCATION: A MODEL STATE SYSTEM FOR VOUCHERS (1971).

governance of public schools.²⁰⁶ I would guess their greater satisfaction stems from both the smaller size of private schools and the incentive structure (market competition) that disciplines managers of private institutions.²⁰⁷

C. *Are Cities Really So Powerless?*

Frug's central factual premise is that American cities are powerless, at least in comparison to private corporations. His historical research does show cities losing power up to the early part of this century. Yet history for Frug inexplicably stops in about 1910—near the high-water mark of legal restrictions on the powers of all levels of American government. Yet since 1910, legal restrictions on city powers have been considerably relaxed, and new legal distinctions—especially some in the Internal Revenue Code—now give cities major countervailing advantages in competing with homeowners associations and other private entities.

1. The Power of Cities to Engage in Business Enterprises

Does current legal doctrine in fact bar cities from opening banks and insurance companies, Frug's proposed initial experiments in "public freedom"? Frug writes that "municipalities may not engage in any 'business' activity unless it falls under the heading of a 'public utility,' and is not for profit."²⁰⁸ His sole source for this proposition is Michelman and Sandalow's influential casebook on local government law. However, on the page Frug cites, Michelman and Sandalow refer to the rule against city business activities as a "venerable maxim" that one finds in "e.g., 3 Dillon, *Municipal Corporations* §§ 977, 1291 (5th ed. 1911)."²⁰⁹ Post-1911 legal developments show Frug's assertions of city "powerlessness" to be greatly exaggerated.

²⁰⁶ An evaluator of the Alum Rock, Cal., voucher experiment concluded that "the Alum Rock experience seems to support strongly the voucher model premise that parents want to influence school decisions, and that the introduction of vouchers will increase parental interest in school decision making." Bridges, *Parental Decision Making in an Education Voucher System* (paper presented at Am. Educational Research Ass'n annual meeting, Chicago, April 1974), quoted in J. LINDELOW, *EDUCATIONAL VOUCHERS* 48 (1980).

²⁰⁷ The 1981 California Opinion Index poll found that California adults ranked "the public school system" 32nd out of 34 public and private institutions studied in terms of "degree of confidence." "Banks" were ranked 14th; "local government," 15th; and "insurance companies," 27th. San Francisco Chron., Nov. 18, 1981, § 1, at 4, col. 3.

²⁰⁸ Frug, *supra* note 1, at 1065.

²⁰⁹ F. MICHELMAN & T. SANDALOW, *supra* note 19, at 103.

First, during the twentieth century, state grants of power to cities have become more and more generous. Dillon's Rule, which required courts to construe strictly all state statutory delegations of power to cities, was widely accepted in 1910. Today it is a dead letter in many states.²¹⁰ More significantly, over the past few decades more and more states have conferred broad home-rule powers on certain of their cities. The home-rule movement has not only given cities new powers, but has also created in them an (admittedly limited) right to resist state interference in their "local" or "municipal" affairs.²¹¹

Second, state courts have considerably altered their interpretation of the constitutional and statutory texts that they once invoked to limit city business activities. In most states the key limitations have been state constitutional provisions that forbid cities from spending tax and bond revenues for other than "public purposes."²¹² These constitutional doctrines continue to have some bite in most states, but less and less bite as the years pass.²¹³ Cities now rarely lose lawsuits that challenge their power to engage in business

²¹⁰ See, e.g., *State v. Hutchinson*, 624 P.2d 1116, 1118-27 (Utah 1980) (disapproving Dillon's Rule by name, and citing Frug, *supra* note 1, as authority); IOWA CONST. art. 3, § 38A; N.J. CONST. art. IV, § 7, ¶ 11 (a city's statutory powers are to be liberally construed). But see, e.g., *City of Osceola v. Whistle*, 241 Ark. 604, 410 S.W.2d 393 (1966); *Tabler v. Board of Supervisors*, 221 Va. 200, 269 S.E.2d 358 (1980). See generally D. MANDELKER & D. NETSCH, *STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM* 148-78 (1977).

²¹¹ Forty states now have constitutional provisions that delegate power to local governments in general terms. (This is twice the number of states that had constitutional home-rule in 1953. See D. MANDELKER & D. NETSCH, *supra* note 210, at 179, 185.) Additional states confer home-rule powers by statute. Courts have tended to construe generously the home-rule powers of cities. See, e.g., *Marshall Field & Co. v. Village of South Barrington*, 92 Ill. App. 3d 360, 362-63, 415 N.E.2d 1277, 1279-80 (1981) ("Prior to the adoption of the 1970 Constitution, the power and authority of municipal entities were governed by what is commonly referred to as Dillon's Rule. . . . The 1970 Constitution radically altered this relationship of municipalities to the state by introducing the concept of home rule."); Sandalow, *The Limits of Municipal Power Under Home Rule: A Role for the Courts*, 48 MINN. L. REV. 643, 663 (1964). See generally D. MANDELKER & D. NETSCH, *supra* note 210, at 179-216.

Frug makes but passing mention of the home-rule movement. See Frug, *supra* note 1, at 1062-63.

²¹² See generally F. MICHELMAN & T. SANDALOW, *supra* note 19, at 36-39.

²¹³ See 2 E. MCQUILLEN, *THE LAW OF MUNICIPAL CORPORATIONS* § 10.31 (3rd ed. 1979) ("The modern trend of the decisions is to extend the class of public uses or purposes in considering the municipal activities sought to be included therein."); 56 AM. JUR. 2D *Municipal Corporations* § 210, at 269 (1971) ("More recent cases, although reasserting the rule, indicate a tendency to broaden the scope of those activities which may be classed as involving a public purpose in which a municipal corporation may lawfully engage."); Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 293-96 (1963).

activities that deviate from the public-utility paradigm.²¹⁴ Frug's "powerless" local governments currently develop housing complexes,²¹⁵ retail stores,²¹⁶ office buildings,²¹⁷ sports stadiums,²¹⁸ and redevelopment projects.²¹⁹ They rent tools;²²⁰ own and operate distant vacation resorts;²²¹ sell at retail products such as gasoline,²²²

²¹⁴ Some quotations will illustrate the standard of review applied by the more deferential courts:

R. E. Short Co. v. City of Minneapolis, 269 N.W.2d 331, 338 (Minn. 1978): [T]he city, in implementing the powers delegated to it by the legislature, is also vested with broad discretion in determining whether particular projects will serve a public purpose. While such decisions are reviewable, they can only be set aside if it is established that the city's action is manifestly arbitrary and capricious because the projects primarily serve a private interest.

State *ex rel.* Taft v. Campanella, 50 Ohio St. 2d 242, 244, 364 N.E.2d 21, 23, 24 (1977) (per curiam) (legitimizing county bonds issued to purchase a privately owned hospital):

The modern trend is to expand and liberally construe the term 'public use' in considering state and municipal activities sought to be brought within its meaning. . . .

. . . .

The determination of whether a use of bonds constitutes a public purpose is primarily the function of the bond issuing authority, and will be overruled by the courts only if manifestly arbitrary or unreasonable.

²¹⁵ Under the traditional public housing program, local housing authorities design, build, and manage low-rent housing units. See 42 U.S.C.A. § 1437-1437j (1978). There were 822,000 public housing units in 1969. See R. MUTH, PUBLIC HOUSING: AN ECONOMIC EVALUATION 1 (1973).

²¹⁶ See, e.g., Marshall Field & Co. v. Village of South Barrington, 92 Ill. App. 3d 360, 415 N.E.2d 1277 (1981) (department store located beyond city boundaries); Mayor & Members of the City Council v. Industrial Dev. Auth., 221 Va. 865, 275 S.E.2d 888 (1981) (K-Mart). In the usual instance, the city has a prior commitment to lease or sell the facility to a private operator.

²¹⁷ See State v. City of Tallahassee, 142 Fla. 476, 195 So. 402 (1940); see also Courtesy Sandwich Shop, Inc. v. Port of N.Y. Auth., 12 N.Y.2d 379, 190 N.E.2d 402, 240 N.Y.S.2d 1 (1963).

²¹⁸ See, e.g., Alan v. County of Wayne, 388 Mich. 210, 317-23, 356-57, 200 N.W.2d 628, 680-83, 699, modified, 388 Mich. 626, 202 N.W.2d 277 (1972); Lifteau v. Metropolitan Sports Facilities Comm'n, 270 N.W.2d 749, 753-55 (Minn. 1978) (disapproving Burns v. Essling, 156 Minn. 171, 194 N.W. 404 (1923)).

²¹⁹ The well-known federal urban renewal program for a long time provided funds to local redevelopment agencies. See Title I of the Housing Act of 1949, ch. 338, 63 Stat. 414 (repealed 1971). In many states, these agencies now obtain funds through state systems of tax-increment financing. See, e.g., Richards v. City of Muscatine, 237 N.W.2d 48 (Iowa 1975). See generally R. ELLICKSON & A. TARLOCK, LAND-USE CONTROLS 1002-13 (1981).

²²⁰ The city of Berkeley, Cal., has a program of this sort.

²²¹ Since 1921, the city of Berkeley, Cal., has operated a summer recreation camp just west of Yosemite National Park. The city of San Jose, Cal., operates another camp nearby. San Francisco Chron., Oct. 29, 1981, § 1, at 2, col. 5; see also Sabaugh v. City of Dearborn, 384 Mich. 510, 185 N.W.2d 363 (1971) (upholding Dearborn's purchase of apartment buildings in Florida for rental to city's senior citizens).

²²² See, e.g., Standard Oil Co. v. City of Lincoln, 114 Neb. 243, 207 N.W. 172 (1926) (per curiam), *aff'd mem.*, 275 U.S. 504 (1927) (city sales of gasoline and oil do not violate due process rights of private sellers).

liquor,²²³ light bulbs,²²⁴ and sportswear;²²⁵ and lend money to homebuyers²²⁶ and business enterprises.²²⁷ In Arizona, a state more rugged in its individualism than most, a constitutional provision explicitly authorizes all cities "to engage in industrial pursuits."²²⁸ Current mainstream economic theory, which would limit the role of government to instances of market failure, seems today to have little more constitutional relevance in most states than Herbert Spencer's social statics.

Frug mentions the due process clause of the fourteenth amendment as a source of city powerlessness. He cites as authority *Moore v. City of East Cleveland*.²²⁹ In *Moore*, the due process clause was construed to prohibit a city from preventing a grandmother from living with two grandchildren who were not siblings. Other Supreme Court decisions are more relevant to the power of cities to engage in business. Even during the *Lochner* era, the Supreme Court repeatedly held that the due process clause did not prevent states and cities from entering into businesses commonly carried out by private enterprise. Perhaps the broadest holding came in 1920, when the Court in *Green v. Frazier*²³⁰ unanimously sustained the constitutionality of a North Dakota statute that authorized the

²²³ See, e.g., *Shaffer v. Allt*, 25 Ariz. App. 565, 569, 545 P.2d 76, 80 (1976) ("[T]he fact that a municipal corporation may make a profit from engaging in a proprietary activity does not negate the underlying public purpose of the enterprise").

²²⁴ The city of Huntington Woods, Mich., sells not only light bulbs, but fire extinguishers, smoke detectors, and plastic garbage bags. Letter-to-the-editor from Mark Wollenweber, City Manager, Huntington Woods, Michigan, PUB. MGMT., June 1981, at 12.

²²⁵ City pro shops at Mt. Lebanon, Pa., recreational facilities sell both sports equipment and sports clothing. Wesemann, *Innovative Revenue Sources: The Entrepreneurial Municipality*, PUB. MGMT., Jan.-Feb. 1981, at 21, 22.

²²⁶ In 1978, cities first began floating tax-exempt bonds to fund below market-rate home mortgages. By 1980, these local bond issues had soared to an annual total of \$5.5 billion. To stanch the drain on the federal treasury, Congress passed the Mortgage Subsidy Bond Tax Act of 1980, Pub. L. No. 96-499, 94 Stat. 2660. The Act reduced the 1981 total to \$1.8 billion. See PRESIDENT'S COMM'N ON HOUS., REPORT 169-71 (1982).

²²⁷ When a city issues tax-exempt industrial-revenue bonds, uses the proceeds to build industrial facilities, and leases those facilities "at cost" to a private firm, the city is essentially making a below-market-rate loan to the firm. See generally Pinsky, *supra* note 213. According to one count, 42 states had affirmed the state constitutionality of this practice by 1968. *Mitchell v. North Carolina Indus. Dev. Fin. Auth.*, 273 N.C. 137, 159 S.E.2d 745 (1968) (program would serve no "public purpose" in North Carolina).

²²⁸ ARIZ. CONST. art. 2, § 34.

²²⁹ 431 U.S. 494 (1977) (plurality opinion), cited in Frug, *supra* note 1, at 1063 n.13.

²³⁰ 253 U.S. 233 (1920).

establishment of state banks, state mills and grain elevators, state homebuilding agencies, and other state enterprises.²³¹

Although the constitutional decisions are not what Frug's dialectics predicted they would be, Frug correctly points out that higher-level legislatures have recently been abusing city autonomy. State and federal statutory directives, not to mention strings on grants-in-aid, tightly restrict municipal choice in numerous instances. Frug's factual premise, however, is that cities are powerless compared to private corporations. This he does not prove. State and federal regulation of business activity has also proceeded apace. Although neither the city nor the corporation has much federal constitutional protection against governmental intrusions, *National League of Cities v. Usery*²³² suggests that of the two, cities can expect more sympathy from the Supreme Court. Corporations unambiguously lack the powers of taxation, regulation, and eminent domain that cities have. Cities have steadily expanded their activities in recent years. From 1949 to 1977, while employment in private industry increased by sixty-two percent, the number of municipal employees increased by ninety-four percent.²³³ Land developers and builders would be startled by Frug's characterization that cities are "powerless." American law simply does not prefer corporations to cities as vehicles for decentralized power.

As luck would have it, at about the time Professor Frug's article was published, prairie socialists in the city of Minot, North Dakota, gathered enough signatures to place on the city ballot an initiative measure calling for establishment of a city-owned bank. (Because Minot already had four local banks as well as a variety of other financial institutions,²³⁴ one might wonder whether this was truly a campaign that would decentralize power.) Unlike Frug, both Minot city officials and the bank's proponents saw no serious legal obstacles to this venture.²³⁵ Minot's city charter explicitly

²³¹ See also *Puget Sound Power & Light Co. v. Seattle*, 291 U.S. 619, 621 (1934); *Jones v. City of Portland*, 245 U.S. 217 (1917) (Maine statute authorizing cities to sell heating fuels did not deprive taxpayers of due process).

²³² 426 U.S. 833 (1976) (commerce clause gives federal government broader power to regulate labor practices of private businesses than labor practices of state and local governments).

²³³ TAX FOUND., INC., *FACTS AND FIGURES ON GOVERNMENT FINANCE* 24-25 (1979). The number of employees of local school districts increased by 276% during the same period. *Id.* 25.

²³⁴ Ferris, *City Owned Bank Derailed in ND*, AM. BANKER, June 5, 1981, at 2.

²³⁵ Wall St. J., Mar. 25, 1981, at 31, col. 3 (quoting Professor Carl Kalvelage, a major proponent of the initiative); telephone interview with Robert Schempp, City Manager, City of Minot (Nov. 5, 1981).

authorizes the city to engage in "any enterprise."²³⁶ Partly because North Dakota has long operated a state bank (the only presently viable one of its kind),²³⁷ no clause in either the North Dakota or the federal constitution was seen as posing a serious legal barrier to forming a city bank. Federal banking officials said they had no objection so long as Minot's bank would be financially sound.²³⁸ State banking officials did observe that North Dakota's banking statutes specify that only "natural persons" can apply for a certificate of authority to open a bank, and that a city would not qualify as a natural person.²³⁹ Yet in the end, this technical barrier was seen as readily circumvented; the city could use specific individuals as agents to obtain the certificate, and those agents could then transfer the certificate to whomever the city chose.²⁴⁰

In sum, although there was some public debate over Minot's power to engage in banking, the campaign centered on the merits of the bank proposal. On April 21, 1981, the Minot electorate voted down the initiative measure by a margin of five-to-one.²⁴¹ This result suggests that voter preferences, not legal barriers, better explain the current absence of city banking in the United States.

2. Pro-City Biases in the Tax Structure

Frug did not compare the legal status of the city with that of the homeowners association—the real alternative candidate for decentralized control of a residential community. Associations now certainly enjoy some legal preferences. For example, associations are exempt from civil service and public bidding requirements, and from federal constitutional rules (such as *Avery's*) that apply only when state action is present. On the other hand, many legal distinctions favor cities. To give some examples, a city may be immune from tort and antitrust liability in situations where a corporation would not be.²⁴² As administrators of private schools would

²³⁶ Minot, N.D., Home Rule Charter, art. 3, §j (1972); see also Flagstad, *Home-Rule Allows Bank; But How to Fund?*, Minot (N.D.) Daily News, Jan. 12, 1981, at 1, col. 2.

²³⁷ See Flagstad, *Expert Says Nothing to Prevent City Bank*, Minot (N.D.) Daily News, Dec. 23, 1980, at 7, col. 1; N.D. CENT. CODE §§ 6-09-01 to 6-09.2-11 (1975).

²³⁸ Minot (N.D.) Daily News, Feb. 4, 1981, at 1, col. 3 (discussing public remarks of Vince Ryszewski, a bank examiner for the Federal Deposit Insurance Corporation).

²³⁹ Telephone interview with Robert Keim, Assistant Comm'r of the Dep't of Banking and Fin. Insts., State of North Dakota (Nov. 5, 1981) [hereinafter cited as Keim interview]; see N.D. CENT. CODE § 6-02-02 (1975).

²⁴⁰ Keim interview, *supra* note 239.

²⁴¹ L.A. Times, Apr. 23, 1981, § 4, at 1, col. 1.

²⁴² Although most state courts have recently attempted to narrow or abolish municipal tort immunities, these immunities retain some life in many states, often by

quickly point out, state and federal grant-in-aid programs generally prefer public to private applicants for aid.²⁴³ A city is exempt from OSHA regulations, but a homeowners association whose activities affect interstate commerce is not.²⁴⁴ Perhaps most significantly, the tax status of a city is vastly superior to the tax status of an association. A city's tax advantages alone probably outweigh any legal disadvantages a city suffers. When the choice is available to them, residents of an association often "go public" to exploit the tax advantages of the municipal form.²⁴⁵

The pro-city tax bias mainly arises from three statutory policies: (1) the exemption from federal income taxation of interest paid to municipal bondholders; (2) the deductibility of municipal taxes (but not homeowners-association assessments) from the income that is subject to federal tax; and (3) the exemption of most municipally owned land from the property taxes imposed by other governments. Each of these warrants brief discussion.

Section 103 of the Internal Revenue Code exempts interest paid on municipal bonds from federal income taxation.²⁴⁶ This exemption usually enables cities to borrow money at annual interest rates several percentage points below the rates that corporate borrowers pay. Because taxpayers nationwide bear the revenue losses resulting from this exemption, city officials often attempt to arrange for municipal-bond financing of a wide variety of local capital improvements that they might otherwise leave to the private sector. This tax provision is a principal reason that cities now build housing,²⁴⁷ make home loans,²⁴⁸ run convention centers and stadiums,²⁴⁹

grace of a partial legislative reprieve. See, e.g., CAL. GOV'T CODE §§ 810-965.9 (West 1980). See generally K. DAVIS, ADMINISTRATIVE LAW TREATISE § 25.00 (1970, 1976 & 1980 Supps.). Municipalities are still typically immune from liability for punitive damages. See Annot., 19 A.L.R.2d 903 (1951).

Municipalities are free from antitrust liability when they pursue express state policies. See *Community Communications Co. v. City of Boulder*, 102 S. Ct. 835 (1982).

²⁴³ See, e.g., *Aid to Nonpublic Education, 1971-72: Hearings Before the Subcomm. on Education of the Senate Comm. on Labor and Public Welfare*, 92d Cong., 1st & 2d Sess. 138 (1971-72) (statement of Gary Potter, et al.).

²⁴⁴ See 29 U.S.C. § 652(5) (1976).

²⁴⁵ See *infra* text accompanying notes 254-55.

²⁴⁶ See I.R.C. § 103(a) (1976). There are two major exceptions to this general rule. First, I.R.C. § 103(b) denies the exemption of interest on certain industrial development bonds issued after April 30, 1968. Second, I.R.C. § 103(c) denies the exemption of interest on arbitrage bonds.

²⁴⁷ See *supra* note 215.

²⁴⁸ See *supra* note 226.

²⁴⁹ See, e.g., sources cited *supra* note 218; *State v. City of Tampa*, 146 So. 2d 100 (Fla. 1962) (affirming city's power to build convention center financed with special obligation bonds).

operate parking structures,²⁵⁰ and finance the construction of industrial plants²⁵¹ and antipollution equipment.²⁵² In effect, section 103 constitutes a multibillion-dollar-per-year *inducement* for city enterprise.²⁵³

Internal Revenue Code section 164 entitles nonbusiness taxpayers to deduct, as an itemized deduction, amounts paid for most types of municipal taxes.²⁵⁴ The compulsory assessments levied by homeowners associations, by contrast, are generally not deductible.²⁵⁵ Everything else being equal, this disparity in tax treatment leads a community resident to prefer that recreation programs, public security operations, and other community services be financed by cities, not private associations. The quest for deductibility helps explain why wealthy residents in such private residential associations as Hidden Hills, Palos Verdes Estates, and Rolling Hills, California, eventually decided also to incorporate themselves as municipalities. "Going public" enabled them to shift to federal taxpayers part of the costs of financing local services.

²⁵⁰ See, e.g., Opinion of the Justices, 109 N.H. 396, 254 A.2d 273 (1969); *Goldberg v. City Council*, 273 S.C. 140, 254 S.E.2d 803 (1979) (upholding city use of eminent domain powers and bonding authority to build parking facilities).

²⁵¹ Nearly all states permit municipalities to issue industrial revenue bonds (IRB's) to acquire or build factories for sale or lease to private concerns. See, e.g., *State v. City of Riviera Beach*, 397 So. 2d 685 (Fla. 1981) (building and leasing of electronics plant located beyond city boundaries); *Carruthers v. Port of Astoria*, 249 Or. 329, 438 P.2d 725 (1968) (building and leasing of aluminum processing plant). However, after listing authorities in dozens of states that permit IRB's, the Supreme Court of North Carolina held that these bonds fail to meet the public purpose clause of the North Carolina constitution. *Mitchell v. North Carolina Indus. Dev. Fin. Auth.*, 273 N.C. 137, 159 S.E.2d 745 (1968). North Carolina voters then approved a constitutional amendment authorizing counties to issue IRB's. N.C. CONST. art. 5, § 9 (1976).

²⁵² See, e.g., *Fickes v. Missoula County*, 155 Mont. 258, 470 P.2d 287 (1970) (county bonds); *Kennecott Copper Corp. v. Town of Hurley*, 84 N.M. 743, 507 P.2d 1074 (1973). But see *Port of Longview v. Taxpayers of Longview*, 84 Wash. 2d 475, 527 P.2d 263 (1974) (pollution-control bond issue would violate constitutional clause prohibiting municipal loans to private corporations).

²⁵³ See I. B. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* 15-2 to 15-3 n.2 (1981), which cites a Joint Economic Committee estimate that in fiscal 1976 state and local borrowers saved \$3.5 billion in interest expense because of the exemption.

²⁵⁴ See I.R.C. § 164 (1976).

²⁵⁵ Rev. Rul. 76-495, 1976-2 C.B. 43, states the general rule that "assessments paid to a homeowner's association by its members for the exclusive purpose of promoting the recreation, health, safety, and welfare of the residents and for maintaining common areas of a residential housing project are not deductible as real property taxes." Note the similarity between the described functions and the normal functions of a local government. The IRS does allow a pass-through to the condominium owner of deductions for "taxes assessed on his interest in property." Rev. Rul. 64-31, 1964-1 C.B. 300. Similar treatment is rendered shareholders in cooperative housing corporations, who may deduct their share of interest and taxes paid by the cooperative. See I.R.C. § 216 (1976).

In several states, all municipally owned land, regardless of use, is categorically exempt from property taxation by the state and other local governments. Thus, if Houston, Texas, were to open a city bank, the bank's offices would be exempt from Harris County property taxes.²⁵⁶ In perhaps a greater number of states, however, municipal land enjoys a property-tax exemption only when it is devoted to either a "public use" or a "public purpose." A city's bank building might possibly fail this test in Illinois and Wyoming, but would probably meet it in New Jersey and New York.²⁵⁷ Like the Internal Revenue Code, a good number of state tax codes thus implicitly subsidize public enterprise.²⁵⁸

3. Redressing the Legal Inequalities

I hereby *conditionally* agree to support Frug's call for the removal of any remaining legal restrictions that prevent cities from engaging in business activities. As one who favors decentralized

²⁵⁶ *City of Beaumont v. Fertitta*, 415 S.W.2d 902, 911 (Tex. 1967); *accord* *Platte Valley Pub. Power & Irrigation Dist. v. Lincoln County*, 144 Neb. 584, 14 N.W.2d 202 (1944).

²⁵⁷ The Illinois Supreme Court's rather strict interpretation of "public purpose" is exemplified by *City of Lawrenceville v. Maxwell*, 6 Ill. 2d 42, 126 N.E.2d 671 (1955). The court placed the burden of proof on the municipality to show that it was pursuing an exclusively public purpose. In that case, the municipality leased part of its airport property to private farmers and used the rental income to defray airport expenses. The court held that this was not a public purpose and subjected the rented airport property to state property taxes.

Wyoming also rather strictly defines "public purpose" in demarcating property tax exemptions. In *City of Cheyenne v. Board of County Comm'rs*, 484 P.2d 706 (Wyo. 1971), the court held that a city airport building leased to a city-and-county subsidized private ambulance service was not devoted to a public use and was taxable.

In New Jersey, "the phrase 'used for public purposes' should be liberally construed; it probably includes any municipal enterprise which the legislature has authorized." *Hanover Township v. Town of Morristown*, 4 N.J. Super. 22, 24, 66 A.2d 187, 188 (App. Div. 1949). The *Hanover* court upheld a property tax exemption for a municipal airport located in another municipality.

The New York approach is examined in Note, *Municipal Property Tax Exemption: Application of New York's 'Held for Public Use' Standard*, 45 ALB. L. REV. 740 (1981), which states that New York courts have primarily used a standard of "public access" in deciding "public use." For example, hangars at a municipal airport are not exempt from taxation. *Town of Harrison v. County of Westchester*, 13 N.Y.2d 258, 196 N.E.2d 240, 246 N.Y.S.2d 593 (1963). But locally owned stadiums are exempt. *Dubbs v. Board of Assessment Review*, 81 Misc. 2d 591, 367 N.Y.S.2d 898 (Sup. Ct. 1975).

²⁵⁸ Cities enjoy other tax advantages as well. I.R.C. § 115(1) (1976) exempts from taxation city income derived from the performance of "any essential governmental function." This provision would possibly shelter the profits of a city bank from federal income taxation. If it did not, the organizers of the city bank might try to qualify the bank as an exempt nonprofit organization under I.R.C. § 501(c). Owners of private banks could try neither of these moves. Homeowners associations, it should be noted, are now often able to avoid paying federal taxes on income. See *id.* § 528 (added in 1976).

public decisionmaking, I am willing to entitle a city to socialize formerly private sectors of its economy. However, because I adhere to the prevailing economic view that public-sector activity is justified only in cases of market failure, I would of course oppose any campaigns in my city to establish a city bank, insurance company, or food-retailing cooperative.²⁵⁹ Nevertheless, if some cities choose to experiment with public enterprise, perhaps we will all learn something more about the robustness of current economic theory.

My condition for agreeing with Frug is that he agree that municipal businesses be placed on the same legal footing as private businesses. This means, for example, that city businesses could not enjoy special tort and antitrust immunities, or any preferred access to financial support from higher-level governments. More importantly, it would mean that city businesses would lose their significant tax preferences. In some states, one of Frug's proposed city banks might now conceivably be able to

- raise its equity capital through property taxes, thereby entitling equity contributors to federal income tax deductions;
- borrow debt capital at below-market interest rates because of the tax-exempt status of municipal-bond interest;
- own real estate that would be exempt from property taxation; and
- avoid federal taxation of its "corporate" income.

As long as cities have advantages like these, any legal rules limiting their power to engage in business can be justified on grounds similar to the grounds that underlie the economic theory of second best. In other words, the "wrong" rules on city powers are in fact appropriate because those rules offset other legal advantages that cities wrongly possess. My own guess is that if the legal treatment of cities and private organizations were substantially equalized, political forces would on balance lead to some shrinkage in the size of the local public sector.

Because I stand conditionally ready to join Frug in supporting the expansion of city business powers, I hope he will join me in

²⁵⁹ As it happens, the city council of Palo Alto, Cal. (the city where I live), recently considered marketing homeowners' insurance. The council eventually dropped the idea, in part because of opposition from private insurance agents. *Peninsula Times-Tribune*, Mar. 9, 1982, § A, at 1, col. 1. Newspaper reports of the debate over this proposal do not indicate that the opponents questioned the city's power to sell insurance.

endorsing two specific tax reforms. First, because there is no persuasive reason for the federal government generally to subsidize borrowing by subfederal governments, Congress should amend the Internal Revenue Code to subject to federal income taxation all interest paid on future state²⁶⁰ and local bond issues. The current exemption of interest paid on municipal bonds encourages cities to borrow capital that would earn a higher social return if invested privately.²⁶¹ Despite what the mayors and the municipal-bond lobby would have us believe, there are probably no serious constitutional barriers to this reform.²⁶²

Second, Congress should amend section 164 of the Internal Revenue Code to limit the extent to which a nonbusiness, itemizing taxpayer can deduct his payments for state and local taxes from income. Homeowners-association members are currently not entitled to deduct their monthly assessments because it is assumed that the value of the association services they receive equals the value of the assessments they pay. This assumption is largely valid because both market forces and legal rules make it difficult for an association to redistribute much wealth. To exclude members' assessment payments from their income would therefore be to underestimate their affluence.²⁶³

However, households that pay taxes to cities and states also receive valuable public services in return for those payments. Professor Bittker and other tax scholars have nevertheless half-heartedly

²⁶⁰ The abolition of the tax-exempt status of *state* bonds will curb tendencies toward excessive state enterprise. Moreover, if municipalities lost their exemption but states did not, states would be tempted to become wholesale borrowers on behalf of their cities.

²⁶¹ As the real borrowing costs of municipal governments fall lower and lower relative to the real borrowing costs of private firms, more and more dollars are diverted from private investments with high social return to public investments with lower social return. The result is a loss of economic efficiency: a reduction in the society's total output of goods and services. Unquestionably, some such loss of economic efficiency results from the [municipal bond] exemption.

M. MUSSA & R. KORMENDI, *TAXATION OF MUNICIPAL BONDS* 213-14 (1979).

²⁶² See Martori & Bliss, *Taxation of Municipal Bond Interest—"Interesting Speculation" and One Step Forward*, 44 NOTRE DAME LAW. 191 (1968); Surrey, *Federal Income Taxation of State and Local Government Obligations*, TAX POL'Y, May-June 1969, at 3, 13. *Contra* Goldberg, *A Call to Action: State Sovereignty, Deregulation, and the World of Municipal Bonds*, 13 URB. LAW. 253 (1981); Healy, *The Assault on Tax-Exempt Bonds*, TAX POL'Y, July-Aug. 1969, at 2. See generally Gabinet, *The Municipal Bond Interest Exemption: Comments on a Running Battle*, 24 CASE W. RES. L. REV. 64 (1972); Note, *Reform of the Municipal Bond Market: Alternatives to Tax-Exempt Financing*, 15 COLUM. J.L. & SOC. PROBS. 233 (1979).

²⁶³ This approach assumes the administrative impossibility of counting as income the value of services received.

defended the deductibility of state and local taxes on the ground that there is only a loose fit between what the taxpayer pays and what he receives in public services.²⁶⁴ This looseness of fit arises because local and state governments do redistribute a fair amount of wealth by, for example, financing public schools and universities that are likely to be of different benefit to taxpayers who pay the same amount of tax.

A "loose fit" is not "no fit," however. Virtually all taxpayers receive some significant benefits from state and local services. Nevertheless the Internal Revenue Code not only fails to count the value of these services as income, but also authorizes the 100% deduction of state and local taxes. These tax policies, combined with the Code's disallowance of the deduction of payments to homeowners associations (and most other private entities), produce a federal-tax bias in favor of the public provision of services. Put another way, the Code exaggerates the affluence of association members relative to the affluence of city residents, and subjects the former to higher taxes.

How might Congress neutralize the Code's influence on community choice between the public and private provision of services? As an initial proposal, I suggest that Congress amend section 164 to authorize itemizing taxpayers to deduct from income only one-third, instead of 100%, of amounts paid to state²⁶⁵ and local tax collectors. Allowing the one-third deduction would serve two purposes. First, it would compensate all taxpayers for the probable inefficiency of state and local governments, which, *pace* Galbraith and Frug, currently appear unable to give out as much as they take in.²⁶⁶ Second, the one-third deduction provides a modest cushion to protect taxpayers who end up on the losing end of state and local redistributive programs. I have no great confidence that one-third is the best fraction to use. But would my amended section 164 be worse than the current section 164, which implicitly assumes that state and local taxpayers receive *no* benefits from state and local programs?²⁶⁷

²⁶⁴ See Bittker, *Income Tax Deductions, Credits, and Subsidies for Personal Expenditures*, 16 J.L. & ECON. 193, 201 (1973); see also U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 92 (1977):

²⁶⁵ Disallowing any greater deductibility of state taxes avoids creating an incentive for states to do revenue-raising on behalf of their local governments. Cf. *supra* note 260.

²⁶⁶ See *supra* note 197.

²⁶⁷ Cf. Bittker, *supra* note 264, at 201 (the deductibility of state and local taxes is perhaps only justified to the extent of the redistributive component of state and local spending).

V. CONCLUSION

Professor Frug and I agree that current legal doctrine distinguishes too sharply between cities and private associations. The imperfectly voluntary nature of membership in a city is the only salient difference between the two forms of organization. This difference does justify some variations in legal treatment—for example, stricter judicial scrutiny of association rulemaking. Many other legal distinctions between cities and homeowners associations, however, should be softened or eliminated so that

- a taking clause would constrain the actions of associations;
- associations would be free to choose among a wide variety of voting rules;
- cities would be free from the Supreme Court's current mandate that they allocate votes according to a one-resident/one-vote rule;
- cities would be free of any remaining federal and state restrictions on their power to engage in business enterprises; and
- cities would be stripped of the tax preferences and other legal advantages they currently enjoy.

Critical legal scholars admit that they have too rarely focused their analytic apparatus on specific policy proposals.²⁶⁸ I have intentionally served up some middle-level proposals for them to react to. I hope to receive focused comments on the substance of these proposals, not just Olympian evaluations of the "coherence" of my "discourse."

Professor Duncan Kennedy, the spiritual leader of the critical legal scholars, wrote recently: "[W]e need utopian speculation. We need to spend time not on scientism but on dreaming up the ways we think things might be better than they are. Utopian speculation is in some ways the hardest to come by. What would we do with power, anyway?"²⁶⁹

Is it possible that the people of Minot, North Dakota, know better than the critical legal scholars the inauspicious track record of utopian speculators?²⁷⁰

Adoption of my proposed reform would make itemizing taxpayers interested in expanding the role of charitable organizations. The Code may be due for tightening in that area as well.

²⁶⁸ Gordon, *Historicism in Legal Scholarship*, 90 YALE L.J. 1017, 1056 (1981).

²⁶⁹ Kennedy, *Cost-Reduction Theory as Legitimation*, 90 YALE L.J. 1275, 1283 (1981).

²⁷⁰ See *supra* text accompanying notes 234-41.