In his recent article, *The City as a Legal Concept*, 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. 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. 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," a form of human fulfillment that the critical legal scholars think an impersonal market economy suppresses.

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-
tially coercive central authority. 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.

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. 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."

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-

---


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? Do they support my call for repeal of the current exemption of municipal-bond interest from federal income taxation? 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.\footnote{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).}

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."\footnote{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).} 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,\footnote{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).} prohibit certain kinds of conduct (not only in common areas but also within the confines of individual homes),\footnote{See Dulaney Towers Maintenance Corp. v. O'Breay, 46 Md. App. 464, 418 A.2d 1233 (1980) (sustaining house rule barring second pets).} and tightly control the physical alteration of a member's unit.\footnote{See Note, Promulgation and Enforcement of House Rules, 48 St. John's L. Rev. 1132, 1136-39 (1974).} An association's "taxation" takes the form of monthly assessments on members. Assessments can be raised without the unanimous consent of the membership.
Payment of an assessment is secured by a lien on a member's unit, making the assessment is 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. 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.

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. By contrast, membership in a private organization is wholly voluntary.

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.
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. 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. 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, 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.

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


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. 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).

in the association's original governing documents. In the language of Buchanan and Tullock, this unanimous ratification elevates those documents to the legal status of a private "constitution." The original documents—which today typically include a declaration of covenants, articles of association (or incorporation), and by-laws—are a true social contract. 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. 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.

---

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 Homeowners 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, 1402-03 (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. 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, lower courts perceive municipal zoning by age as posing serious constitutional questions. By contrast, homeowners-association regulations that limit the age of dwelling occupants have tended to survive legal challenge. 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.

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).
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 documents\(^{39}\) or a state statute\(^{40}\) 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"

---


\(^{39}\) 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").


that an association adopts by procedures less cumbersome than the association's procedures for a constitutional amendment.\footnote{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).} "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 review\footnote{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).} 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.\footnote{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.} To illustrate, the reasonableness of a board rule banning alcoholic beverages from the swimming pool area\footnote{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).} 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
CITIES AND HOMEOWNERS ASSOCIATIONS

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. 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 Pareto criteria (or, less ambitiously, the Kaldor-Hicks criterion) 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-


48 For a description of the Kaldor-Hicks criterion, see supra note 47.
istrative costs of the amendment procedure.\textsuperscript{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.\textsuperscript{50} This \textit{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.\textsuperscript{51} Current law recognizes an entrant's \textit{ex ante} distaste for \textit{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.\textsuperscript{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.\textsuperscript{53}

\textsuperscript{49} Cf. J. Buchanan & G. Tullock, \textit{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, \textit{Politics and Values or What's Really Wrong with Rationality Review}, 13 CREIGHTON L. REV. 487, 494-95 (1979) (economies-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, \textit{Foundations of Political Analysis: An Introduction to the Theory of Collective Choice} 13-26 (1980); D. MUeller, \textit{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. \textit{See infra} text accompanying notes 78-80.

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

\textsuperscript{51} See \textit{supra} text accompanying notes 22-26.

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

\textsuperscript{53} See \textit{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.\(^\text{54}\)

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.\(^\text{55}\) Moreover, the Act states that the declaration can itself call for an even larger majority.\(^\text{56}\) 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.\(^\text{57}\) 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,\(^\text{58}\) an entrant in his \textit{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.\(^\text{59}\) However, a member who loved dogs might nevertheless suffer a deep subjective loss and be skeptical of the adequacy of damage remedies.\(^\text{60}\) In his \textit{ex ante} calculation, this member might therefore favor supplementing the taking clause with an extraordinary-majority rule for constitutional amendments.\(^\text{61}\)

\(^{58}\) 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, \textit{Corporate Control Transactions}, 91 \textit{Yale L.J.} 698 (1982) (criticizing Carney, \textit{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 \textit{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

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.

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-rule 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 disgruntle 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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.

\textsuperscript{65} See Michelman, \textit{supra} note 62, at 1218-1224.


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*, 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. 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." A Florida decision, *Thiess v. Island House Association*, 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 multifamily uses permitted by original covenants).

69 See generally *Public Prices for Public Products* (S. Mushkin ed. 1972).


fertile young couples who had joined the association in reliance on an express policy allowing children.\textsuperscript{72} An analogous situation arose in \textit{Warren v. Del Pizzo},\textsuperscript{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.\textsuperscript{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 \textit{Bay Island} where the losers were investors unlikely to have a reservation price much above market price.\textsuperscript{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.\textsuperscript{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


\textsuperscript{74} See also \textit{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).

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

\textsuperscript{76} Cf. \textit{Ellickson, Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Controls}, 40 U. Cm. 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 \textit{Alternatives to Zoning}].
damages, a duty that might occasionally be interpreted as requiring him to move.\textsuperscript{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.\textsuperscript{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,\textsuperscript{79} they would pay attention to the relative “participation benefits” of competing voting systems.\textsuperscript{80} The complex and usually contradictory nature of these goals makes it unlikely that any particular voting system will be best in all situations.

\textsuperscript{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).

\textsuperscript{78} See supra note 47.


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.

\textsuperscript{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, one might be inclined to include in the electorate all affected persons, even though some are less affected than others. 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; community decisions can affect the value of real property, but rarely the value of moveable assets.

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.

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*, 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.

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*, for example, the Court considered an Arizona constitutional provision (similar to those in eleven other states) 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, 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 landowners.

87 See generally Note, supra note 82.
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. 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. 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. 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.

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 492, 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. The Court has yet to identify a persuasive reason for this exception. 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, or in proportion to floor area. Most statutes, however, allocate votes according to the ownership interests set out in the original declaration, a system that gives developers some initial flexibility. 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

---


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, 365-87.

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).

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. 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. 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. 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. 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).


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. 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. 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. 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.
ized journal and several college textbooks and has begun to influence the legal literature.

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, are troubled by voting systems that do not permit voters to register the intensity of their preferences. 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. 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.

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 mechanism—need not be described here. The salient feature of the new mechanisms is that they usually ask affected persons to reveal their preferences by voting with dollars. 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.
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.
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.
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. For their part, the condominium statutes require fixed allocations of voting strength for all voting matters, and thus also forbid voting with dollars.

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

Since the publication of a seminal article by Charles Tiebout in 1956, 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. 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. 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.


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.

landlord's interest should reflect not only the capitalized value of local services, but also the capitalized burden of local property taxes.\textsuperscript{122} Empiricists have marshalled some support for these theoretical propositions.\textsuperscript{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.\textsuperscript{124}

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


\textsuperscript{123}See sources cited supra notes 121-22; infra note 138.

\textsuperscript{124}See Epple & Zelenitz, supra note 123, 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.

\textsuperscript{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.\(^{226}\) 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

---


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 1966 in *Dep't of Urban Studies, Nat'l League of Cities, Adjusting Municipal Boundaries: Law and Practice* (1969). 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 (1950) *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 § 55121 (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 % 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. 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).
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).


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.\textsuperscript{138}

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.\textsuperscript{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.\textsuperscript{138} The empiricists' findings are not tidy, however, and thus also serve as reminders that Tiebout's model drastically over-simplifies 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, \textit{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 \textit{plausibly} establish ownership of local land as a qualification for voting. Alternatively, the empiricists' finding of imperfect competition among cities sug-

\textsuperscript{138} The recent history of Santa Monica, California, supports this hypothesis. After successfully pushing through a rent-control initiative in 1979, a renter-dominant coalition captured control of the Santa Monica city council, displacing homeowner representatives.


A less formal study is G. Miller, \textit{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, \textit{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. 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, 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." 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.

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").
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.\textsuperscript{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.\textsuperscript{144} The centralists assert that these moves would result in locational inefficiencies that would not be present if uniform welfare benefits were administered nationally.\textsuperscript{145}

Pauly and other revisionists assert that they have detected a shortcoming in the mainstream position.\textsuperscript{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


\textsuperscript{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 intracounty, and another 6.5\%, intercounty. See Rossi, \textit{Residential Mobility, in Do Housing Allowances Work?} 147, 153 (1981).

Tenants move more often than owner-occupants do. \textit{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, \textit{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).


\textsuperscript{145} See, e.g., R. Musgrave & P. Musgrave, \textit{supra} note 141, at 623.

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 \textit{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. \textit{See}, e.g., Krumholz, \textit{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. \textit{Ladd & Doolittle, supra} note 146, at 324.


\(^{150}\) Rent control is another local program that may have major redistributive consequences. \textit{See supra} note 135.


\(^{152}\) \textit{See, e.g.}, Note, \textit{supra} note 40, at 656-58; Note, \textit{supra} note 100, at 402-12 (1969).
governments as a matter of constitutional law.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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

\textsuperscript{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.


\textsuperscript{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 mechanism 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. 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.

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. (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/one-vote system would cause an association to pursue coerced redistributions of wealth.

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 *Kolodziejski*, 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


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. 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. 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 literature 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, 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).

system that weighted votes by acreage or property value.\textsuperscript{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. \textit{Avery} denies local incorporators the option of employing any of these unorthodox voting systems.

The Supreme Court may have believed that \textit{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 \textit{any} role in income redistribution,\textsuperscript{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.\textsuperscript{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. \textit{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.\textsuperscript{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-

\textsuperscript{170} Some states have used these apportionment systems in annexation proceedings, for example. \textit{See supra} note 130.

\textsuperscript{171} \textit{See supra} text accompanying notes 139-51.

\textsuperscript{172} \textit{See supra} text accompanying notes 139-51.


\textsuperscript{173} \textit{See generally} Suburban Growth Controls, \textit{supra} note 151.
sumptively inefficient in Kaldor-Hicks terms—that is, current housing owners gain less than consumers, and owners of undeveloped land, lose. If there were no constitutional barrier to enfranchising affected nonresident consumers 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. 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, Representative 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. 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. 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." Frug is distressed that current law "prefer[s] corporations to cities as vehicles for decentralized power." 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." 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," namely, city establishment of public banks, insurance companies, and retail food outlets. 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" or "undermine" the city, the family, and the private association? In the style of many of his critical compatriots, 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.
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 discomfited 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.


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.

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); Frichard & 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. Borcherding 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. 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. There are almost as many different banking companies in the United States as there are municipalities. 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. 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).


\[204\] 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).

governance of public schools. 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.

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." 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)."

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. 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.

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." These constitutional doctrines continue to have some bite in most states, but less and less bite as the years pass. Cities now rarely lose lawsuits that challenge their power to engage in business.

---


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, 362-93, 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.\textsuperscript{214} Frug's "powerless" local governments currently develop housing complexes,\textsuperscript{215} retail stores,\textsuperscript{216} office buildings,\textsuperscript{217} sports stadiums,\textsuperscript{218} and redevelopment projects.\textsuperscript{219} They rent tools;\textsuperscript{220} own and operate distant vacation resorts;\textsuperscript{221} sell at retail products such as gasoline,\textsuperscript{222} Some quotations will illustrate the standard of review applied by the more deferential courts:

\textsuperscript{214} Some quotations will illustrate the standard of review applied by the more deferential courts:

- \textit{R. E. Short Co. v. City of Minneapolis, 269 N.W.2d 331, 338 (Minn. 1978)}: The 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.

- \textit{State ex rel. Taft v. Campanella, 50 Ohio St. 2d 242, 244, 364 N.E.2d 21, 23 (1977) (per curiam)} (legitimating 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.

  \ldots

  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.

\textsuperscript{216} 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, Poruc HoUsING: AN EcoNoMIc EVALUATION 1 (1973).

\textsuperscript{217} See, e.g., \textit{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.}

\textsuperscript{218} See, e.g., \textit{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).}

\textsuperscript{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., \textit{Richards v. City of Muscatine, 237 N.W.2d 48 (Iowa 1975). See generally R. ELICKESEN & A. TARLOCK, LAND-USE CONTROLS 1002-13 (1981).}

\textsuperscript{220} The city of Berkeley, Cal., has a program of this sort.

\textsuperscript{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).

\textsuperscript{222} See, e.g., \textit{Standard Oil Co. v. City of Lincoln, 114 Neb. 243, 207 N.W. 172 (1926) (per curiam), aff'd mem., 275 U.S. 504 (1937) (city sales of gasoline and oil do not violate due process rights of private sellers).}
liquor, light bulbs, and sportswear; and lend money to home-buyers and business enterprises. In Arizona, a state more rugged in its individualism than most, a constitutional provision explicitly authorizes all cities “to engage in industrial pursuits.” 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. 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 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”).


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.


230 253 U.S. 233 (1920).
establishment of state banks, state mills and grain elevators, state homebuilding agencies, and other state enterprises.\footnote{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, \textit{National League of Cities v. Usery} \footnote{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.\footnote{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,\footnote{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.\footnote{235} Minot’s city charter explicitly

\footnote{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).}

\footnote{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).}

\footnote{233 \textit{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. \textit{Id.} 25.}

\footnote{234 \textit{Ferris, City Owned Bank Derailed in ND}, \textit{Am. Banker}, June 5, 1981, at 2.}

\footnote{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." Partly because North Dakota has long operated a state bank (the only presently viable one of its kind), 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. 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. 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.

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. 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. As administrators of private schools would

---

240 Keim interview, supra note 239.
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.\textsuperscript{243} A city is exempt from OSHA regulations, but a homeowners association whose activities affect interstate commerce is not.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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,\textsuperscript{247} make home loans,\textsuperscript{248} run convention centers and stadiums,\textsuperscript{249} grace of a partial legislative reprieve. \textit{See, e.g.}, \textsc{Cal. Gov't Code} §§ 810-965.9 (West 1980). \textit{See generally} K. \textsc{Davis}, \textsc{Administrative Law Treatise} § 25.00 (1970, 1976 & 1980 Supps.). Municipalities are still typically immune from liability for punitive damages. \textit{See Annot.}, 19 A.L.R.2d 903 (1951).

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


\textsuperscript{244} \textit{See} \textsc{29 U.S.C.} § 652(5) (1976).

\textsuperscript{245} \textit{See infra} text accompanying notes 254-55.

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

\textsuperscript{247} \textit{See supra} note 215.

\textsuperscript{248} \textit{See supra} note 226.

\textsuperscript{249} \textit{See}, e.g., \textit{sources cited supra} note 218; \textit{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,\textsuperscript{250} and finance the construction of industrial plants\textsuperscript{251} and antipollution equipment.\textsuperscript{252} In effect, section 103 constitutes a multibillion-dollar-per-year \textit{inducement} for city enterprise.\textsuperscript{253}

Internal Revenue Code section 164 entitles nonbusiness taxpayers to deduct, as an itemized deduction, amounts paid for most types of municipal taxes.\textsuperscript{254} The compulsory assessments levied by homeowners associations, by contrast, are generally not deductible.\textsuperscript{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.


\textsuperscript{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).


\textsuperscript{253} See 1 B. Bittker, \textit{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.

\textsuperscript{254} See I.R.C. § 164 (1976).

\textsuperscript{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. 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. Like the Internal Revenue Code, a good number of state tax codes thus implicitly subsidize public enterprise.

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


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.


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.\textsuperscript{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

\textsuperscript{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 state 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. Despite what the mayors and the municipal-bond lobby would have us believe, there are probably no serious constitutional barriers to this reform.

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.

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.


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.


\(^270\) See supra text accompanying notes 234-41.