Competition Among Municipalities as a Constraint on Land Use Exactions

Stewart E. Sterk

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I. INTRODUCTION

Even before the Supreme Court decided *Nollan v. California Coastal Commission*,[1] courts and scholars debated the wisdom and constitutionality of land use exactions and impact fees—government-imposed charges on the right to develop land.[2] Many municipalities have long required developers to finance infrastructure improvements.[3] Fiscally drained municipalities, particularly big cities, had begun to use, or to consider using, exactions or their close cousins, "linkage" programs, as a means to finance a wider variety of government services.[4]

The controversy these fees have generated reflects more general concerns about financing local government. Municipalities and their defenders justify exactions and impact fees as necessary to assure that new development pays its own way rather than imposing external costs on existing residents.[5] Others, however, express concern that unconstrained municipalities might use exactions to "extort" money from outsiders inadequately represented in municipal political processes—principally landowners and prospective homebuyers.[6]

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1. 483 U.S. 825 (1987).

2. Early commentary on exactions includes Ira Michael Heyman and Thomas K. Gilhool, *The Constitutionality of Imposing Increased Community Costs on New Suburban Residents Through Subdivision Exactions*, 73 Yale L. J. 1119 (1964), and John D. Johnston, Jr., *Constitutionality of Subdivision Control Exactions: The Quest for a Rationale*, 52 Cornell L. Q. 871 (1967). These articles responded to early cases addressing the constitutionality of exactions, including *Pioneer Trust & Savs. Bank v. Village of Mount Prospect*, 22 Ill.2d 375, 176 N.E.2d 799 (1961), and *Gulest Associates v. Town of Newburgh*, 25 Misc. 2d 1004, 209 N.Y.S.2d 729 (Sup. Ct. 1960), aff'd, 15 A.D.2d 815, 225 N.Y.S.2d 538 (1962).

With the expanding use of exactions to fund governmental activities, the subject received increasing attention in the literature. Indeed, just months before the *Nollan* case was decided, Law and Contemporary Problems devoted a symposium issue to the subject. See Richard F. Babcock, spec. ed., *Exactions: A Controversial New Source for Municipal Funds*, Law & Contemp. Probs., Winter 1987, at 1.

3. Municipalities first required developers to build roads and other infrastructure improvements as a condition for subdivision approval, and then required dedication of lands for park and other public purposes. From these requirements grew the practice of making developers pay cash in lieu of land dedications—especially where an outright dedication of land would not be sufficiently useful to the public. See generally R. Marlin Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, Law & Contemp. Probs., 5, 7-19 (Winter 1987).

4. For a discussion of the "linkage" programs adopted in Boston and San Francisco, both of which linked the right to construct new commercial space to the construction and financing of new housing, see generally Robert Collin and Michael Lytton, *Linkage: An Evaluation and Exploration*, 21 Urban Law. 413, 414, 417-21 (1990). For criticism of these programs as impermissible redistributive programs, see Comment, *Mitigating Price Effects with a Housing Linkage Fee*, 78 Cal. L. Rev. 721 (1990).

5. See, for example, Steven B. Schwanke, *Local Governments and Impact Fees: Public Need, Property Rights, and Judicial Standards*, 4 J. Land Use & Envir. L. 215, 217-23, 245-47 (1989).

6. See, for example, *J.E.D. Associates, Inc. v. Town of Atkinson*, 121 N.H. 581, 432 A.2d 12 (1981) (analogizing exactions to extortion).

The Court's decision in *Nollan* intensified the debate over exactions and impact fees.[7] The Court held that a government may not condition approval of a permit on a landowner's sacrifice of an interest unrelated to the government's reasons for requiring the permit.[8] The Court thus imposed what appear to be serious constitutional limits on municipal power to use exactions: The municipality can exact money from a developer only if it can demonstrate that its exaction is related to the harms caused by the developer's project.

A number of scholars have sought to explain, or to justify, the *Nollan* Court's apparent hostility to exactions.[9] In the most recent, and perhaps most significant, contribution to the debate over exactions, Professor Vicki Been suggests that the Court and the defenders of *Nollan* have ignored an important constraint on municipal power to exact fees from developers: market forces.[10] Professor Been's thesis is that because developers can choose from among a variety of municipalities, competition among municipalities restricts the power of each municipality to "extort" money from developers.[11] Professor Been acknowledges that the *Nollan* opinion responds to two dangers posed by land use exactions—unfair redistribution of wealth and inefficient deterrence of socially beneficial development.[12] She argues, however, that competitive pressures protect against both of these dangers.[13] Whenever a municipality sets its exaction price too high, developers will simply look elsewhere.[14]

Professor Been notes that if market forces adequately constrain the

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7. See Stewart E. Sterk, Nollan, *Henry George, and Exactions*, 88 Colum. L. Rev. 1731 (1988); Theodore C. Taub, *Exactions, Linkages and Regulatory Takings: The Developer's Perspective*, 20 Urban Law. 515 (1988); Schwanke, 4 J. Land Use & Envir. L. 215 (cited in note 5); Note, *Municipal Development Exactions, the Rational Nexus Test, and the Federal Constitution*, 102 Harv. L. Rev. 992 (1989).

The *Nollan* case also spawned a set of articles discussing the unconstitutional conditions doctrine more generally. See Richard A. Epstein, *Foreword: Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 Harv. L. Rev. 4, 62-63 (1988); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 Harv. L. Rev. 1413 (1988).

8. *Nollan v. California Coastal Commission*, 483 U.S. 825, 837 (1987) (stating that "[i]n short, unless the permit condition serves the same governmental purpose as the development ban, the building restriction is not a valid regulation of land but 'an out-and-out plan of extortion' ").

9. See Epstein, 102 Harv. L. Rev. at 62-63 (cited in note 7), Sullivan, 102 Harv. L. Rev. at 1463-64 (cited in note 7), Sterk, 88 Colum. L. Rev. at 1742-51 (cited in note 7).

10. Vicki Been, *"Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine*, 91 Colum. L. Rev. 473 (1991).

11. Id. at 478, 509-545.

12. Id. at 504 (discussing overcharging and overregulation as principal dangers posed by exactions). Professor Been also notes that exactions pose a threat of underregulation, but recognizes that the *Nollan* doctrine does not serve to protect against underregulation and the concomitant threat of favoritism.

13. See id. at 511.

14. Id. at 514-28.

conduct of municipalities, the case for imposing legal con-
straints—particularly as a matter of constitutional law—is a weak one.[15]
Having made her point forcefully and eloquently, Professor Been then
challenges those who would impose constraints on municipal power to
explain why market forces are inadequate to eliminate the potential for
municipal abuse of the exaction process.[16]

This article takes up Professor Been's challenge. My thesis is three-
fold. First, municipalities do not inevitably compete for residents; for
many communities, exclusion, not competition, is a principal land use
objective. Second, even when municipalities do compete, each munici-
pality has the capacity to extract rents from landowners—and to redis-
tribute the rents to other constituents—as long as land has economic
value. For those concerned about the evils of rent-seeking, then, exac-
tions remain problematic even if competition among municipalities does
not result in inefficient allocation of land. Third, the uniqueness of
many municipalities, particularly central cities, gives them monopoly
power on developers. As a result, these municipalities are in a position
to charge developers more than the marginal costs imposed by develop-
ment and thus to create misallocation of land.

II. DO MUNICIPALITIES COMPETE FOR RESIDENTS?

Professor Been theorizes that if municipalities must compete for
new residents and businesses, competition will restrain municipal abil-
ity to collect exactions on new development. But why should municipal-
ities compete for new residents and businesses? The proliferation of
novel land use controls over the past three decades suggests that, for
many municipalities, the goal is to *avoid* new residents, not to attract
them.[17] Indeed, *Nollan* is unlikely to impede significantly municipalities
bent on closing their doors to all but wealthy residents and clean indus-
try.[18] *Nollan* does, however, highlight an important truth: Municipal of-
ficials, because they are ultimately accountable to their own
constituents, often have little incentive to consider the impact of their
decisions on outsiders. By focusing on competition as a constraint on
municipal behavior, Professor Been's article might lead casual read-
ers—or those seeking to justify a laissez faire attitude towards exclu-
sionary practices—to believe that a modern-day "invisible hand" will
unwittingly transform self-interested municipal officials into agents for

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15. Id. at 543-45.
16. Id. at 545.
17. Indeed, Professor Been recognizes that exactions can be a tool for those seeking to ex-
clude undesirable residents. Id. at 483.
18. See notes 7-9 and accompanying text.

the common good. This Section of this Article is designed to set the record straight. Whatever other advantages competition has, competition will not induce municipal officials to admit new residents or businesses who consume more in services than they contribute in taxes.

This Section first explores the theoretical basis for assuming that municipalities compete for new development. It then shows that in practice, municipalities have often sought to exclude rather than to compete. Finally, this Section reveals how municipalities might use exaction policy as a weapon for pursuing an exclusionary strategy.[19]

A. *The Tiebout Hypothesis and the Failures of Competition*

Professor Been's argument relies heavily on a controversial but influential theory developed in a 1957 article by Charles Tiebout.[20] Tiebout argued that competition among municipalities would regulate the municipal provision of public goods because potential residents would "shop" among municipalities to find one that provided the mix of public goods best suited to their desires.[21] Professor Been builds on Tie-

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19. My focus is on municipal *power* to use exactions for exclusionary purposes, not on how actual municipalities will use that power. Much of the economic literature, not surprisingly, treats the municipality as if it were a single rational economic actor, maximizing the aggregate welfare of existing community residents. For instance, Tiebout assumed that "communities below the optimum size seek to attract new residents to lower average costs. Those above optimum size do just the opposite." Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. Pol. Econ. 416, 419 (1956). See also Dennis Epple and Allan Zelenitz, *The Implications of Competition among Jurisdictions: Does Tiebout Need Politics?*, 89 J. Pol. Econ. 1197 (1981) (assuming a profit-maximizing local government); Michelle J. White, *Fiscal Zoning in Fragmented Metropolitan Areas* 38-56 in Edwin S. Mills and Wallace E. Oates, eds., *Fiscal Zoning and Land Use Controls* (Lexington Books, 1975) (discussing municipal incentives to engage in fiscal-squeeze zoning); Truman F. Bewley, *A Critique of Tiebout's Theory of Local Public Expenditures*, 49 Econometrica 713, 719 (1981) (characterizing the assumption that local governments maximize profits as "bizarre," but nevertheless proceeding to analyze as if governments maximized profits).

The model of a municipality as a rational economic actor, however, is suspect. The public officials who make municipal decisions are politicians, not automatons. Even if some relentlessly seek to maximize aggregate community wealth, many will not. A model of municipal behavior that treats a municipality as a single entity acting in its own self-interest fails to capture the diversity of municipal politics and the variation in constituent interests. For more extensive discussion of the prevailing motivations of municipal officials in the land use context, see Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 Yale L. J. 385, 404-10 (1977). See also Susan Rose-Ackerman, *Beyond Tiebout: Modeling the Political Economy of Local Government* in George R. Zodrow, ed., *Local Provision of Public Services: The Tiebout Model After Twenty-five Years* 75 (Academic, 1983) (stating that "[m]uch empirical work in this area has too uncritically accepted median voter models or monopoly models which assume the governments maximize 'economic welfare' "); Julius Margolis, *Public Policies for Private Profits: Urban Government*, in Harold M. Hochman and George E. Peterson, eds., *Redistribution Through Public Choice* 289, 317 (Columbia, 1974) (noting the difficulties facing urban officials whose revenue comes from non-resident businesses, but whose voters are drawn from the poor).

20. Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. Pol. Econ. 416 (1956).

21. Id. at 418.

bout's theory and asks, in effect, why not assume that competition among municipalities regulates exactions just as competition regulates provision of public goods?

Tiebout addressed a problem of enduring importance: How can governments meet constitutent desires about provision of public goods? A pure public good is one which is available either to all residents or to none and one which costs no more to provide for all residents than for one.[22] Army protection is an example of a pure public good. Once the army is established, all residents benefit from the resulting protection against attack, protection that costs no more to provide for a million residents than for a thousand.[23]

How can a government decide which public goods to provide? Because public goods, if they are provided at all, must be made available even to those who do not pay for them, the market cannot serve as a mechanism for measuring constituent preferences. As a result, influential economists had concluded that it was always impossible to determine whether a government was providing an efficient level of public goods—the level that reflected the desire of constituents.[24] Tiebout, however, countered that even if constituents within a municipality cannot pick and choose from among the public goods they purchase, constitutents dissatisfied with the mix offered by the municipality can choose to move.[25] If enough different municipalities coexist within the same geographical area, competition among them should shape the mix of public goods provided by each municipality.

Because pure public goods cost no more to produce for an infinite number of residents than for a single resident, a municipality concerned only about minimizing the per-resident cost of public goods would *always* compete for more residents. But the economies of scale inherent in provision of pure public goods would ultimately lead to natural monopoly, with a single municipality rather than many competing ones.[26]

When a municipality can provide services for additional residents only at additional cost—as is the case for all goods except pure public

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22. One introductory economics text defines a public good as "[a] good whose benefits can be sbared by many without loss to any individual, and from whose benefits it is not easy to exclude people." Kelvin Lancaster, *Modern Economics* 730 (Rand McNally, 1973).

23. A lighthouse is, perhaps, the classic example of a pure public good. It is impossible to exclude anyone from the services of a lighthouse once the lighthouse is established, and use of the lighthouse by one ship does not decrease the services available to other ships. See id. at 220-21.

24. See Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 Rev. Econ. & Statistics 387 (1954); Richard A. Musgrave, *The Voluntary Exchange Theory of Public Economy*, 53 Q. J. Econ. 213 (1939).

25. Tiebout, 64 J. Pol. Econ. at 418 (cited in note 19).

26. For a more thorough explanation for why natural monopoly results when costs per unit of production decline over the entire range of outputs, see George J. Stigler, *The Theory of Price* 221 (MacMillan, 3rd ed. 1966).

goods—the nature of intermunicipal competition changes. Instead of competing to attract all new residents, some municipalities will compete to avoid all new residents, while others will compete to attract only "desirable" new residents. Most services provided by local governments do not qualify as pure public goods.[27] Parks, roads, and water systems become congested with increased population. School costs increase with additional students even if schools are not filled to capacity. With additional residents comes the potential for additional crime, requiring more police protection.

Tiebout recognized these realities in his assumption that "[f]or every pattern of community services . . . there is an optimal community size."[28] For Tiebout, the optimum would be "defined in terms of the number of residents for which this bundle of services can be produced at the lowest average cost."[29] Thus, Tiebout explicitly recognized that some communities could be too big and would be better off restricting new residents, or shedding old ones, rather than competing for new entrants.[30] Hence, Tiebout assumed that communities larger than the optimum size do not, and *should not*, from an efficiency standpoint, compete for more residents.[31]

But Tiebout's hypothesis does not address differences in wealth among potential residents. Even municipalities smaller than the optimum size will not compete for certain potential residents, namely those unwilling or unable to cover the marginal cost of the public services they consume. If municipal governments furnished only pure public goods, municipalities would welcome even those residents because, by definition, it would cost nothing to make the public goods available to a larger number of people. Hence, so long as newcomers could contribute any amount, however small, to the public treasury, existing residents

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27. See Edwin S. Mills and Wallace E. Oates, *The Theory of Local Public Services and Finance: Its Relevance to Urban Fiscal and Zoning Behavior*, in Mills and Oates, *Fiscal Zoning and Land Use Controls* at 3 (cited in note 19) (noting that "Tiebout's local public services are not pure Samuelsonian public goods"). Mills and Oates also wrote that:

> [T]he defining characteristic of a pure public good is that no additional inputs are required to extend the existing per capita consumption to additional citizens. The marginal cost of providing a given per capita output to additional citizens is thus zero for a pure public good, neither a realistic description of most services provided by local, or other, governments nor what Tiebout had in mind.

Id. See also Eitan Berglas, *Quantities, Qualities and Multiple Public Services in the Tiebout Model*, 25 J. Pub. Econ. 299, 299-300 (1984).

28. Tiebout, 64 J. Pol. Econ. at 419 (cited in note 19).

29. Id.

30. Tiebout hypothesized a community with a defined stretch of beach and demonstrated how including too many people in a community with limited beach area would be nonoptimal. Id. at 419.

31. Id. at 419-20.

would benefit from their entry. As we have seen, however, Tiebout recognized that many municipal services are not pure public goods. When the municipality can provide public services to additional residents only at additional cost, existing residents will only be willing to accept new entrants who can contribute more than the marginal cost of providing them with services. Some new residents will fail that test, even if the municipality is smaller than Tiebout's optimum size (that is, even if the average per-resident cost of providing public services is declining with each additional resident).

Thus, no municipality has an incentive to compete for poor residents. Even if they consumed no more public services than wealthier residents, poor residents might be unable to cover the marginal cost associated with providing their own public services. Additionally, on the whole, the poor are likely to consume more public services than the wealthy. Poverty may breed crime. And the children of poor and uneducated parents may require more intensive educational attention than other children. An influx of poor residents, therefore, could significantly increase the per-resident cost of public services.[32] No municipality has a financial interest in competing for development that will generate additional costs without generating the revenue to cover those costs.[33] Hence, municipalities might compete only for the most desirable development such as homes for the wealthy and industry that brings in revenue without consuming municipal resources.[34]

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32. See Wallace E. Oates, *On Local Finance and the Tiebout Model*, 71 AEA Papers & Proc. 93, 95-97 (1981), questioning the soundness of Tiebout's assumption that the provision of public services is subject to an ordinary U-shaped cost curve. Oates argues that the characteristics of the individuals who comprise the community—not just the number of individuals—are significant in determining the cost of providing public services. He notes, for instance, that the characteristics of students and their families often explains achievement levels in local schools, and that "population characteristics are typically the major explanatory variables in equations seeking to explain crime rates." Id. at 96.

33. One might, therefore, conclude that exclusion of the poor is efficient. But the poor must live somewhere, and as long as society remains committed to providing them with public services, residents of wealthier communities will pay for those services somehow, perhaps through higher federal and state taxes designed to subsidize municipalities with insufficient tax bases to provide for their own public services. If richer municipalities cannot escape paying for the public service needs of poorer residents, integrating the poor into wealthier communities may prove more efficient than a system of exclusion accompanied by higher state or federal taxes. Yet, no individual municipality, acting alone, has any incentive to pursue a policy of economic integration. Indeed, much of the criticism of the Tiebout model emphasizes the likelihood that Tiebout-style competition will lead to ultimately undesirable exclusion of the poor from wealthier municipalities. See, for example, Gary J. Miller, *Cities by Contract* 132-40 (MIT, 1981) (noting that Tiebout-style competition would lead high-income persons to congregate together, a result that might be "efficient," but only because low-income persons have no chips with which to bargain); W. Norton Grubb, *The Dynamic Implications of the Tiebout Model: The Changing Composition of Boston Communities, 1960-1970*, 10 Pub. Finance Q. 17 (1982).

34. On one level, this sort of exclusionary competition is not inefficient. If a municipality

B. Evidence: Growth Controls and Exclusionary Zoning

The history of land use controls supports the theory that municipalities often seek to avoid rather than attract new residents, especially if those potential residents are less socioeconomically desirable than current residents. New Jersey's landmark case, *Southern Burlington County NAACP v. Township of Mount Laurel*,[35] illustrates the point. Mount Laurel Township's 1964 zoning ordinance allocated 29.2 percent of the township's land area to industrial use. On these 4,121 acres—more than 40 times the land area actually occupied for industrial purposes at the time that *Mount Laurel* was tried—no residential development was permitted.[36] The ordinance zoned virtually all of the township's remaining land for single-family homes.[37] The largest single residential district, comprising more than half of the municipality's land area, permitted only homes built on half-acre lots.[38] The ordinance did not provide for multiple-family building anywhere within Mt. Laurel although a planned unit development (PUD) enactment, repealed by the time *Mount Laurel* was decided, had resulted in approval of a substantial number of rental apartment units and attached townhouses.[39] Even these units, however, were designed to attract highly educated and trained residents and to limit the number of school-aged children residing there.[40] Indeed, the municipality explicitly required that the developer pay tuition costs in the event that the number of children in these projects exceeded 0.3 per multifamily unit.[41]

In defending its ordinance, the township argued that these provisions, which would clearly operate to exclude people of moderate means, were justified as a device to protect the municipal tax rate.[42]

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exacts from potential residents a charge equal to the marginal cost imposed on the municipality by those residents, the municipality's exaction policy will force potential residents to internalize the externalities their entry would otherwise impose on existing residents.

Whether this exclusion of residents unwilling to pay is efficient more globally, however, is less clear. Some potential residents will not be willing or able to pay for the costs they impose on any community. Each community, therefore, would be better off excluding these persons. But what is efficient for each community might not be efficient for the state as a whole: There must be some-place within the state in which these persons would impose relatively fewer external costs than if they located in other communities. From this more global perspective, it might be efficient for persons to locate in a particular community even if the person would impose negative externalities · on the community.

35. 67 N.J. 151, 336 A.2d 713 (1975).
36. 336 A.2d at 719.
37. Id.
38. Id. at 719-20.
39. Id. at 720-21.
40. Indeed, the resolutions approving the project included language reassuring residents about the educated population base the projects would attract. Id. at 721.
41. Id. at 721-22.
42. Id. at 730-31.

The New Jersey Supreme Court held that this justification was inadequate, and that the state constitution required each municipality to provide its fair share of housing for low and moderate income persons.[43] Although the *Mount Laurel* decision was revolutionary in legal circles, it hardly revolutionized housing production in New Jersey. Indeed, eight years after the original *Mount Laurel* decision, the New Jersey Supreme Court, in *Mount Laurel II*, acknowledged widespread noncompliance with the original decision and lamented "Mount Laurel's determination to exclude the poor."[44]

Communities in other states have proven equally determined to exclude the poor, as the (often unsuccessful) legal challenges to exclusionary zoning have demonstrated.[45] In the quest to avoid new residents, municipalities have not limited themselves to large lot zoning and other traditional techniques. The City of Petaluma, 40 miles north of San Francisco, imposed a limitation on the number of development-unit permits it would issue each year. The Ninth Circuit sustained the Petaluma plan against constitutional challenge.[46] The Town of Ramapo, in Rockland County at the edge of the New York metropolitan area, enacted a system prohibiting development of land until the developer's parcel could accumulate enough "points" to qualify for a permit.[47] Points were allocated according to a formula that emphasized accessibility to various municipal services. For some landowners, development might not be permitted until completion of the town's capital plan—eighteen years after enactment of the point system.[48] The New York Court of Appeals, while condemning "community efforts at immunization or exclusion," sustained the Ramapo plan as a "temporary" restriction on development.[49] Like exclusionary zoning ordinances, these quota and phasing plans have proven to be effective methods for excluding unwanted new residents. More important for present purposes, they illustrate municipal attitudes toward new residential development that are entirely inconsistent with the notion that municipalities invariably compete for residential development.

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43. Id. at 732.

44. *Southern Burlington County NAACP v. Township of Mount Laurel*, 92 N.J. 158, 456 A.2d 390, 410 (1983).

45. See, for example, *Suffolk Housing Serv. v. Town of Brookhaven*, 70 N.Y.2d 122, 517 N.Y.S.2d 924, 511 N.E.2d 67 (1987); *Kurzius, Inc., v. Incorporated Village of Upper Brookville*, 51 N.Y.2d 338, 434 N.Y.S.2d 180, 414 N.E.2d 680 (1980); *Fernley v. Board of Supervisors*, 509 Pa. 413, 502 A.2d 585 (1985); *Surrick v. Zoning Hearing Board*, 476 Pa. 182, 382 A.2d 105 (1977); *Kropf v. City of Sterling Heights*, 391 Mich. 139, 215 N.W.2d 179 (1974).

46. *Construction Industry Ass'n v. City of Petaluma*, 522 F.2d 897 (9th Cir. 1975).

47. *Golden v. Planning Board of Town of Ramapo*, 30 N.Y.2d 359, 334 N.Y.S.2d 138, 285 N.E.2d 291 (1972).

48. 334 N.Y.S.2d at 144.

49. Id. at 152-53.

Of course, municipalities often do compete for some forms of development, particularly industrial and commercial development likely to bring jobs to the area.[50] A municipality is hardly likely to impose a substantial exaction on a potential employer the municipality wants to attract. Competition, then, may sometimes constrain municipal ability to impose exactions.[51] But the basic point—illustrated by the exclusionary zoning and growth control cases—is that most municipal services are not pure public goods. Hence, municipalities can lower the per-resident cost of public services only if the new residents can pay an amount equal to or greater than the marginal cost of providing additional services. Because many potential residents will be unable to make such a contribution, municipalities will not compete for those residents.

C. *Exactions and Exclusion*

Municipalities shun some forms of development because they create more costs than benefits. But suppose the developer compensates municipal residents for the external costs generated by the development. Municipalities might then be willing to compete for development that otherwise would appear undesirable. Exactions and impact fees, by compensating residents for external costs, may induce municipalities to compete for development they otherwise would seek to avoid.[52]

Suppose, for instance, a new residential development would require improvements to the municipal sewer system, expansion of existing schools, and additional police and fire protection. Suppose further that the development would not generate enough in ordinary tax revenues to cover these additional costs. If exactions were forbidden, the municipality would have two choices. It could either approve the project and force existing residents to bear the additional costs, or it could reject the project. If, however, municipal officials were granted authority to impose an exaction or impact fee on the developer, the municipality could approve the project without forcing existing residents to bear the costs generated. The municipality could set an exaction price high enough to compensate residents for present and future costs generated

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50. For various analyses of state and municipal competition for jobs and industry, see Gary P. Green and Arnold Fleischman, *Analyzing Local Strategies for Promoting Economic Development,* 17 Policy Stud. J. 557 (1989); Robert Guskind, *The Giveaway Game Continues,* Planning, 4 (February 1990); Dennis O. Grady, *State Economic Development Incentives: Why Do States Compete?,* 19 State & Local Gov't Rev. 86 (1987).

51. Even if the municipality were to impose an exaction on the potential employer's proposed use of land, the employer would be unlikely to bear the cost of the exaction unless the exaction were greater than the difference in value between land used for this purpose and land used for other purposes. See part II.A.

52. See generally William A. Fischel, *The Economics of Land Use Exactions: A Property Rights Analysis,* Law & Contemp. Probs., 101, 104-06 (Winter 1987).

by the development. Competition with other municipalities would place an upper limit on the exaction price the municipality could collect.[53]

Suppose, however, that municipal exaction policy is designed not to generate municipal revenue, but to deter unwanted development. For example, in *Mount Laurel* the township had required developers of multiple family housing to provide central air conditioning in all apartments.[54] A central air conditioning requirement, like other requirements that developers provide amenities, does not directly augment the municipal treasury, but it does increase the price of housing, making it less likely that "undesirable" lower-income residents will move into the community. Moreover, a municipality could impose an exaction, ostensibly to generate municipal revenue, but in reality aimed at discouraging the development subject to the exaction. Does a regime which fails to limit municipal use of exactions enable municipalities to exclude unwanted development that the municipality otherwise would be required to permit?

If state law permits municipalities to pursue exclusionary land use policies directly—through large lot zoning or various forms of growth control—exactions do not expand municipal opportunity to exclude "undesirable" development. No matter how high the exaction demanded by the municipality, the exaction is no more likely to deter development than an ordinance that absolutely prohibits the unwanted development. The situation is different, however, if the state, either by statute or judicial decision, has imposed limits on exclusion.[55]

To avoid enacting prohibitions on large lot zoning or development moratoria, a municipality might zone land for apartments or some other intensive use, but then institute an exaction or impact fee policy designed to discourage the unwanted development. Whether the fee would have the desired effect depends on the economics of the situation: If intensive development were far more profitable than alternative uses of the land, even a relatively stiff exaction would fail to deter a developer, but if the developer could reap nearly equal profits by sub-

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53. Requiring developers to provide amenities or public facilities generally brings one other efficiency advantage: the developer, unconstrained by municipal bureaucracy or by arcane bidding and contracting rules, may be able to complete the facilities in less time and at lower cost than any government entity. See, for example, Alan Finder, *New York Hopes to Learn from Rink Trump Fixed*, N.Y. Times, at B1, col. 4. (Nov. 21, 1986) (detailing obstacles that prevent government from operating as efficiently as a private developer in completing a municipal skating rink).

54. *Southern Burlington County NAACP v. Township of Mount Laurel*, 67 N.J. 151, 336 A.2d 713, 722 (1975).

55. Although a number of states have enacted statutes purporting to control exclusionary zoning, those statutes have often proven ineffective. See Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 Colum. L. Rev. 1, 69-71 (1990). To the extent that state controls on exclusionary zoning prove ineffective, municipalities need not resort to exactions to pursue exclusionary policies.

stituting a use not subject to an exaction, the exaction might well have the deterrent effect intended by municipal officials.[56]

Of course, a legislature or court that has restricted exclusionary zoning practices might also scrutinize a municipality's exaction policy to prevent any exclusionary effect. The New Jersey courts would certainly do so.[57] It is not clear, however, that other courts would follow suit. First, in states that have acted to control exclusionary zoning, the controls are generally statutory, and the statutes, while requiring municipalities to permit low-income housing, often say nothing explicit about exactions.[58] Moreover, most courts have traditionally sustained exactions and impact fees when municipalities have demonstrated a substantial relationship between the fees imposed and the actual costs generated by the new development.[59] And even if a particular municipality imposes an exaction that exceeds those costs, courts may be unwilling to scrutinize the numbers very closely. In other words, a determined municipality might well be able to use a carefully designed exaction policy to avoid legislative or judicial restraints on exclusionary zoning.[60]

Competition, as we have seen,[61] would not inhibit a municipality's ability or inclination to pursue subversive exclusionary policies. Unfor-

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56. For more extensive discussion of the economics of this situation, see part II.A.2.

57. Indeed, as early as *Mount Laurel I*, 67 N.J. 151, 336 N.E.2d 713 (1975), the court stressed the exclusionary effect of the township's exactions. And in *Mount Laurel II*, the court went further, requiring municipalities to remove all exactions not necessary to health and safety in order to meet their obligations to provide low-cost housing. *Southern Burlington County NAACP v. Township of Mount Laurel*, 92 N.J. 158, 456 A.2d 390, 441 (1983) [*Mount Laurel II*].

58. See, for example, Or. Rev. Stat. Ann. § 197.307(3) (1991 Replacement) (requiring municipalities to permit "needed housing" within "zones with sufficient buildable land to satisfy that need," but not requiring municipalities to provide incentives for such housing, nor prohibiting the discriminatory use of exactions); N.H. Rev. Stat. Ann. ch. 674:32 (1986 Replacement ed.) (prohibiting exclusion of manufactured housing from municipalities, but making no provision requiring incentives to build such housing). See generally Briffault, 90 Colum. L. Rev. at 69-71 (cited in note 55) (describing ineffectiveness of state statutory controls on exclusionary zoning).

59. See, for example, *Contractors & Builders Ass'n v. City of Dunedin*, 329 So.2d 314 (Fla. 1976) *Jordan v. Village of Menomonee Falls*, 28 Wis.2d 608, 137 N.W.2d 442 (1965). See generally John J. Delaney, Larry A. Gordon and Kathryn J. Hess, *The Needs-Nexus Analysis: A Unified Test for Validating Subdivision Exactions, User Impact Fees and Linkage*, Law & Contemp. Probs. 139 (Winter 1987).

60. See also Charles Siemon, *Who Bears the Cost?*, Law & Contemp. Probs. 115, 126 (Winter 1987) (characterizing exactions as "the latest sheepskin for the wolf of exclusionary zoning").

Of course, it is also true that a determined municipality could use exactions for inclusionary purposes, as some cities have in creating "linkage" programs. Moreover, when courts or legislatures mandate inclusionary zoning programs, municipalities might use exactions to finance those programs, as, for instance, by imposing mandatory set-asides on developers, or by offering developers bonuses for developing low-income housing. See, for example, *Southern Burlington County NAACP v. Township of Mount Laurel*, 92 N.J. 158, 456 A.2d 390 (1983).

61. See notes 27-34 and accompanying text.

tunately, the *Nollan* nexus test[62] also does little to eliminate this problem. So long as a municipality could show that a new development would generate costs that would not be offset by ordinary taxation—and housing for the poor will inevitably generate such costs—an exaction to cover additional costs would satisfy the *Nollan* nexus requirement and, therefore, probably would be constitutional. The exaction, if imposed, would instantly doom any low-cost housing project. To inhibit exclusion, legal controls on exactions must be far more stringent than those articulated in *Nollan*. They must at least limit the categories of costs a municipality could recover through exactions.

III. DOES COMPETITION MATTER? THE ECONOMIC EFFECTS OF INTERMUNICIPAL COMPETITION

The preceding Section established that municipal officials may use exactions not only to raise revenue, but also to exclude unwanted development. Professor Been's article focuses on the concern that municipalities will actually collect exorbitantly high exactions.[63] In it, she suggests that competition among municipalities will restrict municipal ability to collect exactions, and she criticizes those who would constrain municipal exaction power.[64] Both Professor Been and those she criticizes are right. Professor Been is right that perfect competition among municipalities would reduce, if not eliminate, municipal power to collect exactions that distort the housing market. But competition among municipalities will have little effect on municipal ability to capture economic rents associated with land, leading instead to claims of unfairness by existing landowners and to rent-seeking behavior.

A. *Exactions in a Competitive Market: Exactions and Rent-Seeking*

Competitive markets are those in which no single supplier controls enough of the market to affect the price of the goods he supplies.[65] That is, in a competitive market, each supplier faces a horizontal demand curve. Each supplier is a price-taker who will be unable to sell any goods if he charges more than the market price.[66] The market dictates

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62. See notes 7-9 and accompanying text.

63. Professor Been expressly reserves discussion of another problem associated with exactions—"underregulation", or selling development rights too cheaply. Been, 91 Colum. L. Rev., at 505 (cited in note 10).

64. Id. at 478, 532-33, 545.

65. See, for example, Richard H. Leftwich, *The Price System and Resource Allocation* 26 (Dryden, 4th ed. 1970) (listing as a requirement of pure competition that "[e]ach buyer and each seller of the product involved must be so small in relation to the entire market for the product that he cannot influence the price of whatever it is he is buying or selling").

66. Id. at 104-05.

the price the supplier can reap on each unit sold; the supplier need only decide how many units to produce.[67] In general, the supplier will continue to produce units until the marginal cost of an additional unit exceeds the market price for the good.[68]

Suppose now that the housing market were composed of enough land developers, spread into enough municipalities, to assure that each developer is a price-taker. Suppose further that a single municipality were to impose on developers a fee of $1,000 for each residential unit built within the municipality. What effect would such an exaction have? In a competitive market, the answer depends in part on the alternative land uses available to landowners and developers. But unless the land is almost as valuable for other purposes as it is for residential purposes, the exaction should have no effect on the price or supply of housing. As the next section will demonstrate, the principal effect of the exaction will be to transfer wealth from landowners to the municipality.[69]

1. The Effect of a Nondiscriminating Exaction

Suppose that a municipality were to impose a $1,000 tax or an exaction on every acre of land within the municipality, independent of the particular use to which the acre is put. Or, equivalently, suppose that the municipality imposes an exaction only on residential construction, but that the only market for land within the municipality is for residential construction. In either event, no one can derive benefit from the land without paying the exaction. What effect would such an exaction have on the market for land?

Because, by hypothesis, the housing market is competitive, potential residents will pay no more for housing in this municipality than in a variety of other municipalities. To compete with landowners in other municipalities, then, a landowner in the exaction-imposing municipality

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67. Id. at 106.

68. Id. at 184.

69. Much economic literature has focused on the incidence of property taxation generally. For a survey that attempts to reconcile seemingly inconsistent conclusions, see Peter Mieszkowski and George R. Zodrow, *Taxation and the Tiebout Model: The Differential Effects of Head Taxes, Taxes on Land Rents, and Property Taxes*, 27 J. Econ. Literature 1098 (1989). The principal debate has been between those who espouse the "classical" view that property taxation is a form of neutral benefits taxation, see, for example, Bruce W. Hamilton, *Zoning and Property Taxation in a System of Local Governments*, 12 Urban Stud. 205 (1975), and those who subscribe to the "new" view that property taxes are a distortionary and redistributive tax on capital, see Mieszkowsi and Zodrow, 27 J. Econ. Literature at 1010-1013.

Despite their superficial similarity, exactions differ fundamentally from ordinary property taxes because they are not assessed based on the value of improvements to land. For that reason, the debate over property tax incidence is only marginally relevant to determining the incidence of exactions.

will have to reduce her land price by the full $1,000 of the exaction. Since, by hypothesis, the only market for the land is for uses subject to the exaction, the landowner's only choices are to take the reduced price offered by potential developers, or to leave the land unused. Because the market is assumed to be competitive, all residential developers will be willing to pay the same reduced price, but no more; at any higher price, developers will operate only in other municipalities. Hence, so long as the landowner has no alternative uses for her land, the landowner will bear the full brunt of the exaction.[70] The resulting reduction in the price of land will have no effect on production of land because land supply is, for all practical purposes, constant. The landowner's return on his land is, as Henry George emphasized,[71] economic rent, and the exaction scheme operates to transfer that economic rent from the landowner to the municipality.

Put in other terms, the supply of land, represented by S on Figure 1 below, is generally inelastic. The price developers will pay for that land is P_1—the price at which the demand curve (D) intersects with that supply curve. If a municipality were to impose an exaction of $1,000 on each unit of housing developed, developers would be willing to pay $1,000 less for each unit of land, reflecting the lower net price they would be able to collect from buyers of housing. Hence, the de-

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70. Professor Been recognizes the point. Been, 91 Colum. L. Rev. at 541 (cited in note 10) (noting that the landowner bears the full cost of exaction when the demand for land is relatively elastic and the landowner has no alternative uses for land). See also Richard P. Adelstein and Noel M. Edelson, *Subdivision Exactions and Congestion Externalities*, 5 J. Legal Stud. 147 (1976). Adelstein and Edelson summarize the point as follows:

Capital theory teaches that the price of land equals the present value of net rents from the most advantageous use to which it can be put. If those net rents are altered, whether by land exactions, fees, or subsidies, the price of land should adjust accordingly. Therefore the owner of land at the time such regulations are promulgated (who may not yet be the developer and who almost certainly will not be the home buyer) will receive the capital gain or loss.

Id. at 160. See also John J. Kirlin and Anne M. Kirlin, *Public Choices—Private Resources* 61, 68 (Cal. Tax Found., 1982) (suggesting that the incidence of development fees, although initially borne by developers, will ultimately be shifted to landowners).

Analysts who question whether developers can shift the incidence of exactions to landowners ignore or deemphasize the "economic rent" aspect of any return on land. It is elementary price theory that immobile resources receive only the residual available after more mobile resources have been paid whatever is necessary to keep them from being put to other uses. See, for example, Leftwich, *The Price System and Resource Allocation* at 295 (cited in note 65). Yet some analysts, while acknowledging that developers might leave a competitive market unless land prices are reduced by the cost of impact fees, nevertheless conclude that landowners would not bear a large share of the impact fee burden. See Forrest E. Huffman, et al., *Who Bears the Burden of Development Impact Fees?*, 54 J. Am. Plan. Ass'n 49, 51 (1988). In support of their conclusion, they invoke unspecified "property tax incidence theory", and irrational behavior by landowners—including a failure by landowners to consider the time-value of money. Id. These same analysts also note, more cogently, that uncertainty about the amount of any future exactions may make it more difficult for developers to shift the full incidence of impact fees to landowners. Id.

71. Henry George, *Progress and Poverty* 165-72 (Robert Schalkenbach Found., 1979).

mand curve will shift downward from D to D', reducing the price developers will pay to landowners by an amount equal to the $1,000 exaction. Because the supply of land is inelastic, the reduction in price does not affect that supply. Any return the landowner receives on the land is economic rent; the exaction simply transfers rent from landowner to municipality.

Figure I
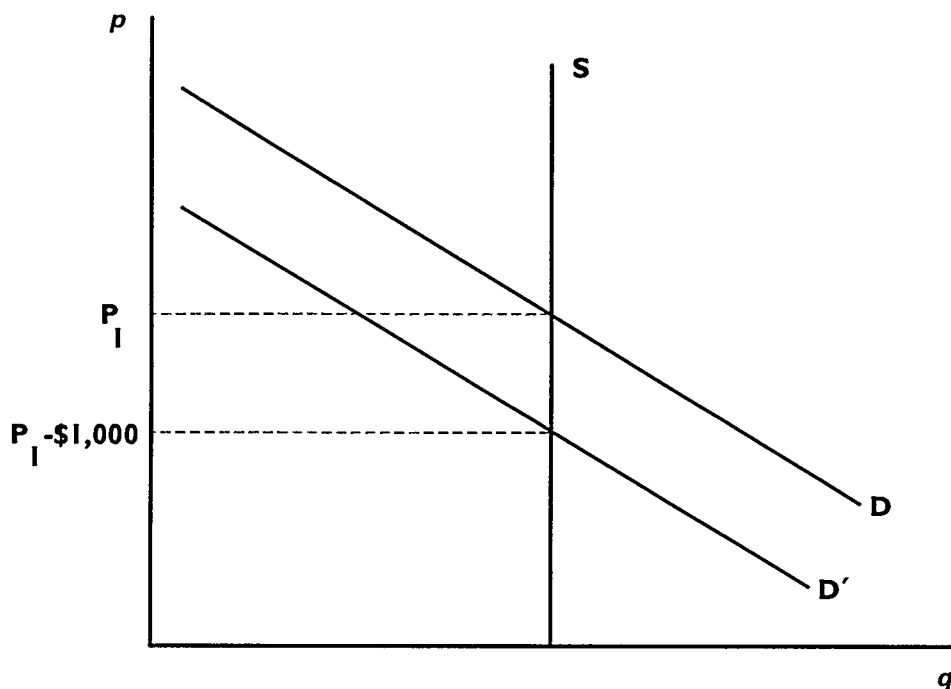
2. Exactions that Discriminate Among Uses

Municipalities typically do not impose exactions equally on all potential land users. Rather, exactions are generally imposed on some uses, or developments of land, and not on others. A municipality might, for instance, impose an exaction on new housing, but not on agricultural land use. The exaction might differentiate between residential and commercial uses, and it almost certainly will apply only to new, rather than existing, construction. How does this discrimination among uses affect the analysis developed in the preceding section?

For simplicity, assume that land is in demand for only two uses: residential construction, potentially subject to an exaction, and agricul-

tural use, exempt from exactions. The supply of land available for residential construction is now a function of the demand for agricultural land; when demand for agricultural land is high, developers must compete for land by paying higher prices. In other words, devoting land to residential construction now carries with it an opportunity cost. As a result, the supply curve facing a residential developer will not be a single vertical line; instead, landowners will be willing to supply more land for residential development at higher prices than at lower prices.

The precise shape of the supply curve for residential land will depend on the degree of competition in the land market. But in a perfectly competitive market, each landowner in the municipality faces a horizontal demand curve from potential users of agricultural land. At price X, agricultural users will pay to devote all available land to agricultural purposes; at any price above X, those users will not pay for any land within the municipality, but will instead farm elsewhere. In this situation, the supply curve facing potential residential developers will consist of two discontinuous vertical lines (See Figure 2). At any price above X, all land within the municipality will be available for residential development; at or below the price of X no land will be available, because it will all be devoted to agricultural uses. If we assume that the demand curve for residential use, like the demand curve for agricultural use, is horizontal (reflecting perfect competition among landowners in various municipalities), and if we assume that the land is more valuable for residential construction than for agricultural use, the residential construction demand curve will intersect the vertical supply curve at a point X_1, representing a price higher than X. In this situation, the difference in price between X_1 and X represents economic rent. If the municipality were to impose an exaction for residential construction in an amount less than X_1 - X, the exaction would simply transfer wealth from landowner to municipality. The economic effect would be equivalent to the effect—discussed in the preceding section—of an exaction imposed on all land within the municipality. If, on the other hand, the municipality were to impose an exaction in an amount greater than X_1 - X, all land would be devoted to agricultural use, and the municipality would collect no exactions. A municipality seeking to maximize exaction revenues, therefore, would not impose such an exaction.

Figure 2
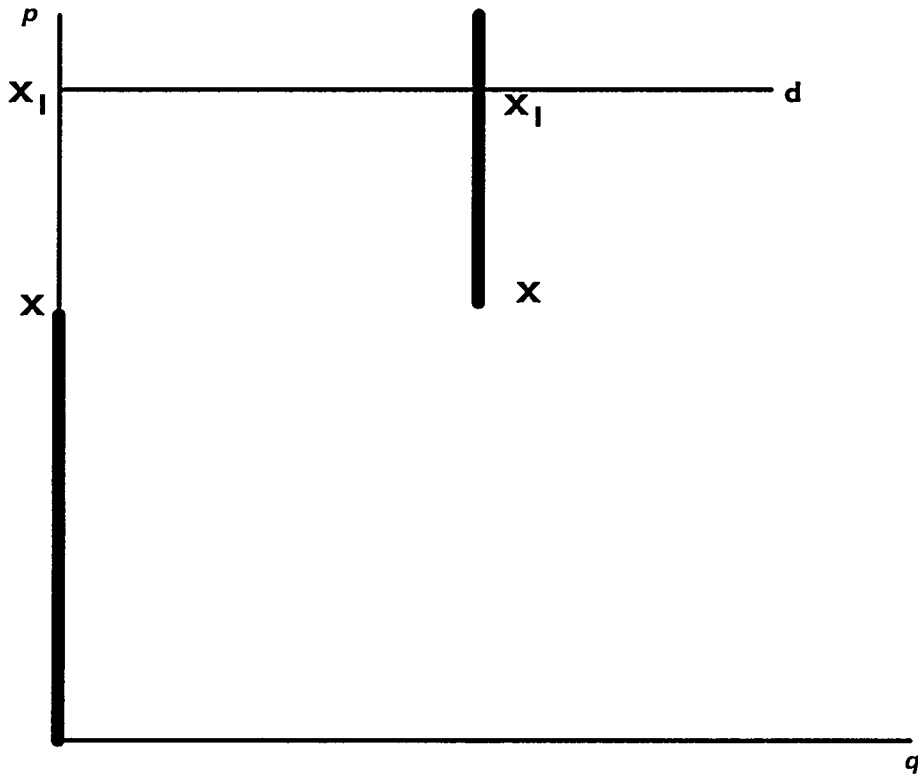
The discussion so far has assumed that the municipality intervenes in the land use process only by imposing exactions on particular land uses. But, of course, most municipalities also regulate land in other ways, including, in particular, the zoning process. Zoning makes it significantly easier for the municipality to impose more substantial exactions even if the zoning ordinance permits the most efficient use of land. Consider, for instance, a parcel of land most valuable for office building construction, but also valuable for residential construction. If the municipality were to impose an exaction on office construction but not residential construction, the municipality could collect the exaction only if the exaction amount were smaller than the difference between the parcel's value for office construction and its value for residential construction. But if the municipality zones the land for commercial use only, the municipality has eliminated the alternative use. As a result, the landowner will be willing to pay a higher exaction because the land-

owner cannot consider the more attractive residential use alternative. In terms of the diagram presented above (Figure 2), the zoning ordinance lowers the price (X) at which the landowner would withdraw the land from the office market, and, therefore, raises the maximum exaction $(X_1 - X)$ that the landowner would be willing to pay. Hence, zoning, even if never used to prohibit efficient use, can be used to augment the municipality's power to extract rents from landowners.[72]

3. Externality-Reducing Exactions

So far, we have assumed that municipalities only impose exactions to raise revenue. But, of course, municipalities often use exactions to recover infrastructure costs created by new development.[73] In these cases, the municipality impose the exaction to assure that the developer internalizes costs that he might otherwise pass on to existing residents.

Note, however, that the landowner will bear the full cost of any exaction regardless of the municipality's motive for imposing it. Suppose, for instance, the exaction reflects the high cost to the municipality of providing sewage facilities for the new development. From the homebuyer's standpoint, a home in this municipality is still no better than a home in another municipality where sewage can be provided more cheaply. From the developer's perspective, then, profits in this municipality will be equal to profits elsewhere only if the developer can buy the land at a price low enough to compensate for the cost of the exaction. Hence, the price the landowner will be able to reap from the developer will be diminished by the full amount of the exaction.[74]

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72. This, in large measure appears to be the concern articulated by Justice Scalia in footnote 5 of his opinion for the Supreme Court in the *Nollan* case:

One would expect that a regime in which this kind of leveraging of the police power is allowed would produce stringent land-use regulation which the State then waives to accomplish other purposes, leading to lesser realization of the land-use goals purportedly sought to be served than would result from more lenient (but nontradeable) development restrictions.

Nollan v. California Coastal Comm'n, 483 U.S. 825, 837 n.5 (1987).

See also William A. Fischel, *The Economics of Land Use Exactions*, Law & Contemp. Probs., 101, 107-08 (Winter 1987) (analogizing sale of land use regulations to use of artificially low speed limits to collect revenue from "unwary nonresidents").

73. See Been, 91 Colum. L. Rev. at 483 (cited in note 10).

74. The significant difference between exactions calculated to compensate existing residents for externalities imposed by new development and exactions not so calculated is that externality-based exactions promote efficient land use, while other exactions do not. The difference has proven important in legal doctrine. State case law has generally upheld exactions and impact fees that permit municipalities to recover documented costs generated by new development. See, for example, *Jenad, Inc. v. Village of Scarsdale*, 18 N.Y.2d 78, 218 N.E.2d 673, 271 N.Y.S.2d 955 (1966); *Jordan v. Village of Menomonee Falls*, 28 Wis.2d 608, 137 N.W.2d 442 (1965). Justice Scalia's opinion in *Nollan*, with its emphasis on the relation between condition and permit approval, suggests that the Supreme Court would have no difficulty sustaining externality-based exactions against constitutional attack. For an analysis of linkage programs which suggest that they are im-

4. Exactions and Dealmaking in a Competitive Market

The preceding sections have assumed that the municipality provides landowners and prospective developers with advance information about exactions or impact fees. That is, the municipality might, either by formal enactment or through a less formal mechanism, adopt a schedule of fees. In fact, however, pre-set standards rarely determine the amount of municipal exactions; instead, exactions are generally the product of dealmaking between municipality and developer.[75] Developers may not know the exaction fees until they seek municipal approval for their projects. This section examines whether imperfect advance information about exactions threatens either to distort land markets or to increase the risk of unfairness to landowners or developers.

First, consider the effect of uncertainty on the developer's behavior at the time he seeks approval for his project. If the developer has already purchased the land on which he hopes to build, the excess of the purchase price over the land's value for uses which will not require payment of an exaction is a sunk cost. So long as the exaction demanded by the municipality is smaller than the difference between the land's value for exaction-related purposes and the land's value for other purposes, the developer is better off going ahead with his project regardless of the purchase price the developer originally paid to the landowner.

Consider now the effect of uncertainty on negotiations between the developer and the landowner. Without knowing how much the municipality will exact as a condition for approving a project, the developer has no basis for deciding how much to offer the landowner for the land.[76] If the legal system does not constrain municipalities in setting exaction prices, the developer might well expect the municipality to impose an exaction just less than the difference between the value of the

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permissible because they do not redress any externality problems, see Comment, *Mitigating Price Effects with a Housing Linkage Fee*, 78 Cal. L. Rev. 721 (1990).

The significant controversy generated by *Nollan,* and by Professor Been's article, focuses on those municipal exactions that cannot be directly related to costs generated by new development.

75. Siemon, Law & Contemp. Probs., Winter, 1987, at 115, 123-24 (cited in note 60); Bauman and Ethier, *Development Exactions and Impact Fees: A Survey of American Practices,* Law & Contemp. Probs. at 51, 56-57, esp. n.18 (noting a survey which demonstrated that most off-site exactions were negotiated rather than specified in regulations).

"Development agreements," in which exactions form part of a broader deal between developer and municipality, are perhaps the most extreme form of land use control by dealmaking. See generally Michael H. Crew, *Development Agreements After* Nollan v. California Coastal Commission, 22 Urban Law. 23 (1990); Judith Welch Wegner, *Moving Toward the Bargaining Table: Contract Zoning, Development Agreements, and the Theoretical Foundations of Government Land Use Deals,* 65 N.C. L. Rev. 957 (1987).

76. Compare Huffman, et al., 54 J. Am. Plan. Ass'n at 51 (cited in note 70).

To avoid uncertainty, the landowner might seek a commitment from the municipality before buying the land. Compare Adelstein and Edelson, 5 J. Legal Stud. at 161 (cited in note 70).

land for the projected development and the value of the land for uses which do not require an exaction. But if the developer forms such an expectation, he might insist either that any purchase agreement be conditioned on the amount of the exaction the municipality demands or that the landowner share in payment of any exaction.[77] If these more complex transactions increase the cost of doing business, the value of land for development purposes will decline, and with that decline will come diminished municipal ability to collect exactions. So long as the land market remains perfectly competitive, however, neither developers nor landowners will have the opportunity to collect exactions from their customers, housing consumers. Any increase in price to consumers will drive those consumers to other municipalities, resulting in reduced municipal revenue from exactions.

Thus, even if municipalities use dealmaking rather than rulemaking as the mechanism for setting exaction prices, exactions are unlikely to affect the supply of housing. When deals, not rules, serve as the basis for setting exaction levels, municipal officials will have the opportunity to discriminate among developers. They could permit "favored" developers to proceed with relatively small exactions, while demanding substantially more—up to the economic rent associated with the land—from "disfavored" developers.[78] Finding means to combat this sort of discrimination has been a major focus of land use scholarship during the past 30 years;[79] a legal rule that would permit municipal officials to collect whatever they can bargain for would increase municipal discretion to play favorites.[80]

5. Exactions and Rent-Seeking

As shown above,[81] in a perfectly competitive market, competition among municipalities assures, as Professor Been predicts,[82] that exac-

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77. Alternatively, the developer might choose to bear the risk of municipal exactions, gambling that the municipality will exact less than he and the landowner anticipate.

78. See generally Sterk, 88 Colum. L. Rev. at 1747-51 (cited in note 7).

79. See Carol Rose, *Planning and Dealing: Piecemeal Land Controls as a Problem of Local Legitimacy*, 71 Cal. L. Rev. 837, 853-57, 893-910 (1983) (suggesting that "voice," together with the potential for "exit," rather than close judicial scrutiny of rezoning decisions, should serve as a check against arbitrariness); Daniel Mandelker, *The Role of the Local Comprehensive Plan in Land Use Regulation*, 74 Mich. L. Rev. 899, 972 (1976) (suggesting that mandatory planning may provide a check against arbitrariness); Charles Haar, *"In Accordance with a Comprehensive Plan"*, 68 Harv. L. Rev. 1154, 1174 (1955) (arguing that requiring a comprehensive plan gives courts a standard against which to measure zoning decisions).

80. Siemon, Law & Contemp. Probs. at 124 (cited in note 60). Professor Been recognized these dangers, but classified them as dangers of underregulation, and reserved them for future treatment. Been, 91 Colum. L. Rev. at 505-06 (cited in note 10).

81. See notes 66-72 and accompanying text.

82. See Been, 91 Colum. L. Rev. at 511 (cited in note 10).

tions will not distort housing markets. Because landowners alone will bear the burden of exactions, municipal exaction policies will not operate to increase housing costs.

The above analysis also reveals, however, that even in a perfectly competitive market, exactions increase opportunities for rent-seeking behavior. If exactions were prohibited, individuals and groups seeking to acquire the rents associated with land would have to buy the land, presumably with money derived from productive activity. But if municipal officials are free, through liberal use of exactions, to confiscate some or all of the economic rent associated with land, those same individuals and groups might find it easier to acquire rent by directing their energies into lobbying efforts or campaign contributions—activities that do not add to the pool of social wealth.[83]

Competition among municipalities does not limit the opportunities for rent-seeking. A developer obviously cares about the price of obtaining land for development, but whether that price is paid to the landowner or to the municipality, in the form of an exaction, is a matter of indifference to the developer. Hence, competition from other municipalities would, in a competitive market, provide no impediment to rent-seeking behavior.[84]

Moreover, the volatile nature of the housing market, and hence the land market, increases municipal opportunity to capture rents. Because new construction makes up such a small percentage of the overall housing market,[85] a modest increase in demand for housing increases substantially the demand for new housing.[86] That increase in demand, in turn, increases the demand for land, and hence the economic rent available to the landowner.[87] In times of peak construction, therefore, mu-

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83. See generally Sterk, 88 Colum. L. Rev. at 1744-46 (cited in note 7); Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. Chi. L. Rev. 703, 713-14 (1984).

84. Professor Been's analogy to corporate charters, where competition did limit rent-seeking by state governments, see Been, 91 Colum. L. Rev. at 533-39 (cited in note 10), is an imperfect one. Individuals and groups seeking corporate charters possess mobile capital; if a particular state offered unattractive terms, they could look elsewhere. Landowners, by contrast, have no alternative but to deal with the municipality in which their land is located. The difference is critical; it explains why competition may be inadequate to prevent municipalities from rent-seeking through exaction policies.

85. In the 1970s, for instance, housing starts averaged 2.6% of the nation's total housing stock. Edwin Mills and Bruce Hamilton, *Urban Economics* 212 (Scott, Foresman, 4th ed., 1989).

86. The American housing industry has grown and shrunk by as much as 50% over a two-year period. Id. at 211. As Mills and Hamilton point out, to increase the housing stock by just over 1% in a single year would require a 50% increase in new construction. Id. at 212.

87. Indeed, the volatile nature of the housing market may also enable *developers* to collect economic rents—rents the municipality would then be able to capture. Developers tend to work with little permanent staff and few financial commitments. Id. Suppose that, in the short term, existing developers cannot substantially increase their housing production capacity, and new developers do not or cannot enter the market (either because start-up costs prevent them from entering

nicipalities have significantly enhanced opportunities to capture land rents.

Professor Been is well aware of the problems associated with rent-seeking.[88] This Article does not seek to editorialize on the evils of rent-seeking. Virtually all redistribution of wealth is the product of rent-seeking, and unless one opposes all redistribution, it is difficult to treat all rent-seeking as undesirable. The point is that for those who do view rent-seeking as an evil, legal constraints on municipal power to impose exactions may remain warranted.

B. *Exactions in an Imperfect Market*

The preceding section demonstrated that competition prevents municipalities from collecting exactions that would alter the market allocation of land. Professor Been's article focuses on the effect of competition among municipalities, but even if an entire region were composed of a single municipality, competition in the market for land within the municipality would prevent the municipality from collecting exactions that would alter market allocation. So long as landowners within the municipality face horizontal demand curves (as they might if there are numerous sellers of equivalent land within the municipality), the entire burden of any collectable exaction[89] would fall on the landowner.

Suppose, however, the market for land within the municipality were not perfect. Suppose that neither the supply of land within the municipality nor competition from other municipalities suffice to create a horizontal demand curve for land. What impact would an exaction

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in time to take advantage of peak demand, or because the volatility of the industry makes the long-run prospects of entry unattractive). In these circumstances, existing developers would find themselves able to profit more from sales to homebuyers than from investing their time and capital in any other endeavor. That is, the developers would reap what appears to be economic rent.

Because of the volatility of the housing market, however, high profits in boom times may be necessary to keep developers from quitting the business during slow times. Hence, in the long run, these profits may not be economic rents, and municipal attempts to capture them may result in increased housing prices.

On the other hand, conventional wisdom holds that a little land or a little cash will allow anyone to become a homebuilder. Landis, *Land Regulation and the Price of New Housing*, APA Journal, at 9 (Winter 1986). If conventional wisdom is correct—a contention Landis disputes—there are no entry barriers in the homebuilding industry, and thus no opportunities for economic rents.

88. Been, 91 Colum. L. Rev. at 492 (cited in note 10).

89. As discussed earlier, if the municipality were to impose an exaction on some uses but not others, the impact of the exaction would fall entirely on landowners as long as the exaction did not exceed the difference between the demand price for the use subject to the exaction and the demand price for other uses. If the municipality were to impose a greater exaction, it would not be able to collect the exaction because landowners would simply shift to exaction-free uses. See part II.A.2.

then have?

First, if the amount of the exaction were known, and if the exaction did not discriminate among uses, the exaction would fall entirely upon the landowner and would not alter allocation of land among various uses, even if the market for land were noncompetitive. Because the supply of land is inelastic, a downward shift in the demand curve to account for the exaction will simply reduce the equilibrium price for land, regardless of the shape of the demand curve facing landowners.

If, however, the exaction discriminates among uses (as most exactions do), the situation is different. Assume for simplicity that the demand for land can be divided into two components: demand for uses on which the municipality contemplates imposing an exaction (D_1 on Figure 3), and demand for other uses (D_2). Although the total supply of land within the municipality (S_T) is fixed, the supply for uses that might become subject to the exaction is not; that supply is a function of the demand for other uses. In other words, at any price P, the supply of land available for uses subject to the contemplated exaction will be equal to the total quantity of land *minus* the quantity demanded at price P for other uses. Assuming that landowners face downward-sloping demand curves for both exaction-related uses and other uses, the supply curve for exaction-related uses will have an upward slope (S_1).

Figure 3
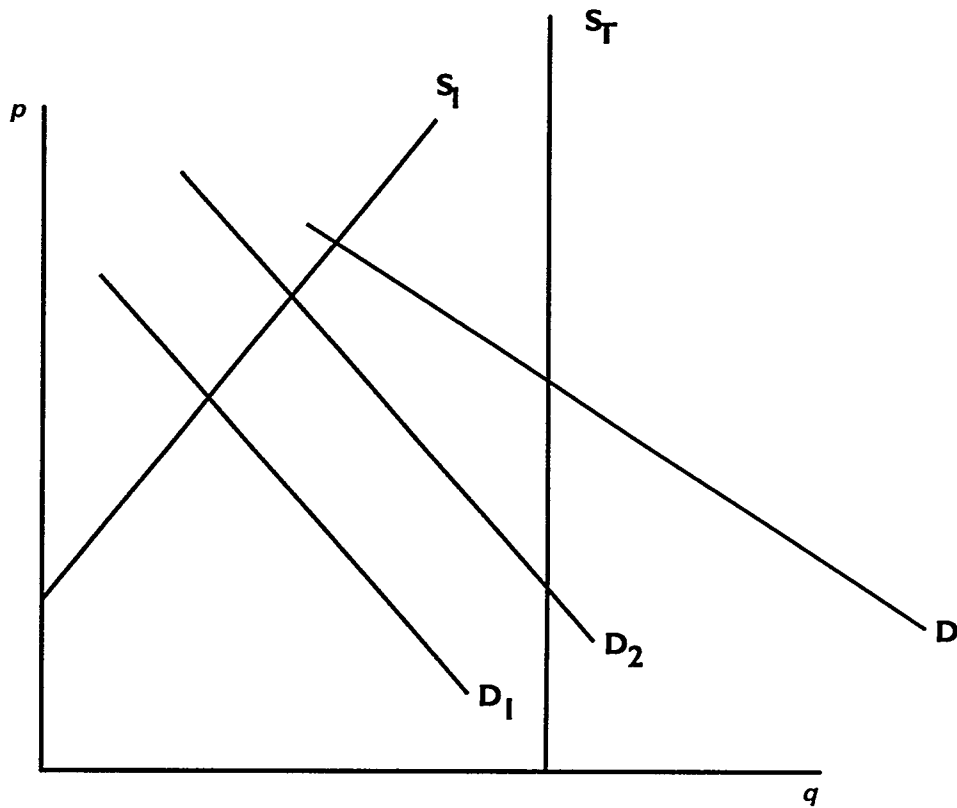
Suppose now that the municipality imposes the exaction. The demand curve for uses subject to the exaction will shift downward (from demand curve D_B to demand curve D_A on Figure 4). That is, each developer of a use subject to the exaction will be willing to buy the same quantity of land as before the exaction so long as the price of land decreases by the amount of the exaction. Again, it makes no difference to the developer whether the landowner or the municipality collects her money; she is concerned only with the ultimate cost of the land. Now, however, the shift in the demand curve affects the quantity of land sold for purposes subject to the exaction: As the developer reduces the price she is willing to pay to the landowner, the landowner sells more land for uses not subject to the exaction. Instead of selling q_B units for purposes subject to the exaction, the landowner will sell only q_A units. Although the developer will pay less money (p_{BL}) to the landowner, the total price paid by the developer—including the exaction paid to the munici-

pality—will rise from p_A to p_{BT}. This rise will, in turn, cause a shift in the supply curve that faces the developer's customers, resulting in a rise in the price (and decrease in supply) of housing or other uses subject to the exaction.

Figure 4
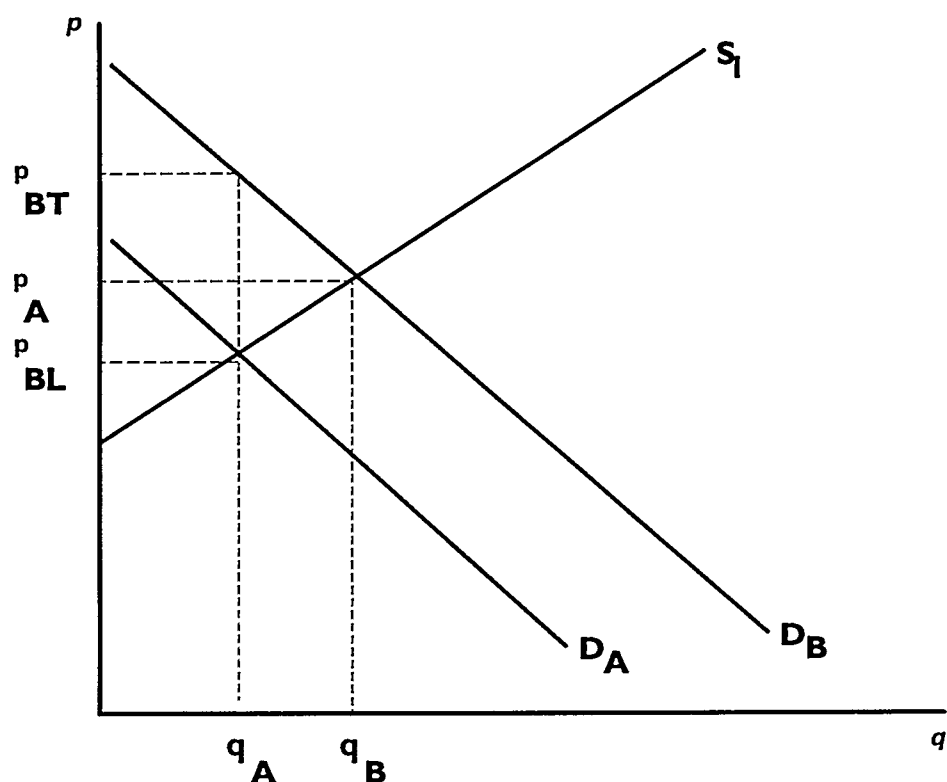
Nollan's nexus requirement does not, however, prevent a municipality from exploiting monopoly power to increase price and decrease supply of housing within its borders. Even if exactions were forbidden entirely, municipalities could, if not constrained by law, impose development quotas or restrictive zoning requirements that would reduce the supply of housing in the community and increase its cost.[90] This exercise of monopoly power would benefit existing homeowners by inflating the price of used housing.[91]

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90. For the classic discussion, see Ellickson, 86 Yale L. J. at 394-99 (cited in note 19).
91. Id. at 400.

Exactions, however, increase the incentives for municipalities to exercise monopoly power. First, many interest groups within the municipality have reasons to support the imposition of exactions; by contrast, only homeowners benefit substantially from growth controls that preclude construction of new housing.[92] Second, exactions provide an immediate return to existing homeowners (in the form of lower taxes or increased services), while those homeowners must wait until they sell their homes to realize the pecuniary gains associated with a restrictive zoning ordinance. Third, large lot size requirements and other restrictive zoning controls generate costs that benefit no one; by contrast, all costs generated by exactions are immediately transferable to existing residents.[93] Because exactions enable municipalities to exploit monopoly power more efficiently than conventional zoning controls, legal constraints on the power to impose exactions may be particularly important.[94]

The basic point is this: So long as landowners face downward-sloping demand curves, exactions have the potential to distort land use within any municipality. Unless competition among municipalities transforms downward-sloping demand curves into horizontal ones, intermunicipal competition does not eliminate the potential for inefficiencies induced by exactions.

IV. How "Perfect" is Competition Among Municipalities?

In exploring the ability of a revenue-maximizing municipality to impose exactions and impact fees, the discussion so far has demonstrated that even when land markets are characterized by perfect competition, municipalities have the power, through the use of exactions, to capture economic rents associated with land. Moreover, when competition in land markets is imperfect, municipalities can impose exactions that go beyond the capture of rents and that lead to the substitution of inefficient for efficient uses of land.

For those whose unease about exactions stems from concerns about rent-seeking, perhaps the case for limiting municipal power to impose

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92. In homogeneous suburbs where homeowners dominate local politics, this difference may be insignificant. But, as Ellickson points out, many municipalities, especially larger ones, are governed by coalitions of interest groups. Id. at 407-410. In any municipality where homeowner interests are not in complete control, exactions increase the incentive for exercise of the municipality's monopoly power.

93. Id. at 396-97.

94. See William Fischel, *Exploring the Kazinski Paradox: Why is More Efficient Regulation a Taking of Property?* (U. Cal. Berkeley Law & Economics working paper #10, forthcoming 1992). Professor Fischel argues that takings jurisprudence should provide greater protection against efficient regulation than against inefficient regulation because political processes will constrain inefficient regulation.

exactions is already compelling. But for those concerned about inefficient allocation of land and consequent price inflation in the markets for housing, offices, and the like, an obvious question remains: How competitive are land markets? If, as Professor Been suggests,[95] land in one community is largely interchangeable with land in neighboring communities, intermunicipal competition may bring horizontal demand curves to land markets, even when a single municipality's limited supply of land might suggest some monopoly power. This section, then, considers several factors that might influence the degree of intermunicipal competition.

A. The Effect of Municipality Size on Competition: the Case of Central Cities

If a metropolitan area were composed of a large number of homogeneous municipalities, competition among them might well constrain municipal power to impose inefficiency-creating exactions.[96] But municipalities within most metropolitan areas are not uniform. Most metropolitan areas are dominated by a central city whose size and character differ significantly from those of neighboring municipalities.[97]

While competition from neighboring suburbs may limit the central city's power to collect market-distorting exactions from residential developers, it is less likely to constrain exactions on commercial development. For many businesses, suburbs furnish at best a poor substitute for the central city. Transportation networks that converge on the central city provide the city with a significant advantage over suburban locations in the competition for employers. Public transportation systems make city employment feasible for lower-paid employees who lack access to suburban work sites. Moreover, in some industries—law comes to mind—the prestige associated with a central city location may be

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95. Been, 91 Colum. L. Rev. at 510 (cited in note 10) (suggesting that consumers perceive most communities as having close substitutes).

96. Although, as already demonostrated, competition will not constrain municipal power to compel transfer of economic rents for landowners. See notes 65-88 and accompanying text.

97. Social science literature emphasizes the ways in which the economic and political foundations of central cities differ from those of suburbs. See, for example, Julius Margolis, *Public Policies for Private Profits: Urban Government*, in Harold Hochman and George Peterson, eds., *Redistribution Through Public Choice* 289, 317 (Columbia, 1974) (noting an imbalance in central cities between the economic base (nonresident businesses) and political power (voting strength of the poor), an imbalance not found in suburban communities); David F. Bradford and Wallace E. Oates, *Suburban Exploitation in Central Cities and Governmental Structure*, in id. at 43 (noting that competition among municipalities leads better-off city dwellers to prefer suburbs where they will be among the less well-off residents); David F. Bradford and Harry H. Kelejian, *An Econometric Model of the Flight to the Suburbs*, 81 J. Pol. Econ. 566, 567 (1973) (noting a "vicious circle" facing central cities: "the more rapidly the middle class families move to the suburbs, the greater is the incentive for the exodus of those remaining").

critical even if other locations would be equally convenient.[98] The comparatively high cost of downtown office space reflects, to a large degree, these competitive advantages.[99]

To some extent, of course, the market for office space—more so than the market for residential space—is national rather than regional. If the cost of business in New York becomes too high, a company might relocate to Atlanta or Houston. Hence, the availability of office space in other central cities may act as a constraint on each city's monopoly power. For businesses with a local or regional base, however, relocating out of the area is not a realistic alternative. And for the national firms that require offices in every major city, a threat to move elsewhere would not be a serious one.

The availability of suburban office space (and space in other cities) does impose some constraints on the central city. Virtually all participants in the market for office space will move from the city to the suburbs if the price differential becomes too great. But *every* monopolist faces similar constraints. A local utility with a monopoly on the gas supply, even if free from government regulation, would face the possibility that consumers would shift to oil if gas prices climbed too high. If a monopolist telephone company raised prices too much, consumers would make more extensive use of express mail. The complete absence of substitutes is not a necessary condition for monopoly power; a supplier of goods and services possesses monopoly power whenever substitutes are imperfect. And the price differential between city and suburban office space indicates that, for consumers of commercial office space, the suburbs remain an imperfect substitute for the city. Hence, competition from the suburbs will not eliminate the central city's power to collect market-distorting development exactions.

As demonstrated earlier,[100] however, even if there were no competi-

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98. See, for example, Scott Chase, *Cost of Office Space Seen Creating "Three-Tiered" Market,* Washington Post, October 12, 1981, p. 17 (noting that downtown office space is likely to be occupied by financial institutions, service companies (including law firms) and executive headquarters willing to "pay exorbitant rents for prime downtown office space" in order to assure "high visibility" and "prestige"); Anthony De Palma, *Office Development Surges in Suburbs,* New York Times, May 25, 1986, sec. 8, p. 1, col. 3. (stating that executives and dealmakers stay in prestigious Manhattan locations, but back offices go elsewhere.)

99. The significant price differential betwee office space in central cities and office space in suburban areas refiects the higher value of central city land (except to the extent that construction costs are higher in cities). This higher land value is itself economic rent. For discussions of rent differentials between office space in cities and suburbs, see Anne Swardson, *Troubling Signs of an Office Exodus,* Washington Post, September 30, 1991, p. F1 (noting a $10/square foot difference between the city and the suburbs); David Dunlap, *Back-Office Tenants Slipping Out of Town,* New York Times, April 22, 1984, sec. 8, p. 1, col. 6 (stating that office rents in Manhattan range from $30-55; comparable suburban space rents for $15-35).

100. See notes 70-80 and accompanying text.

tion among municipalities, municipally-imposed exactions could not, by themselves, produce distortions in land allocation so long as competition within any particular municipality assures that individual landowners face horizontal demand curves for each potential use of land. In a large city, the number of landowners likely will suffice to assure that demand curves are horizontal.

The problem, however, is that if a city does not face competition from other municipalities, it can combine the use of exactions and zoning to distort land allocation and maximize municipal revenue. For instance, the municipality can, through zoning, significantly reduce the supply of land for office construction.[101] That reduction in available supply will result in an increase in price for the remaining parcels zoned for office construction. Since the municipality can impose an exaction of any amount between the value of land for office construction purposes and the value for other purposes, the zoning ordinance may increase the municipality's ability to collect exactions by raising the value of all land zoned for commercial purposes.

Figure 5 illustrates the problem. Suppose the supply of land for office construction purposes, before zoning, is represented by two disjointed lines, S. This supply curve reveals that at all prices below P_1, landowners will devote their land to some use other than office construction; at prices above P_1, landowners will devote all land to office construction purposes. Assume that the demand curve for office construction land is represented by D, which intersects the supply curve S at point A. The city has capacity to impose an exaction in an amount equal to P_A - P_1, and to collect those exactions on Q_A units. Thus, the city's total revenue would be represented by the rectangle $ACJE$. Suppose now that the city zones only Q_B units of land for office construction. The supply curve for office construction now shifts to S'.[102] The new equilibrium price for office construction land will rise to P_B. The city will now be able to collect an exaction equal to the rectangle $BFGH$—which, depending on the slope of the demand curve, may be significantly greater than $ACJE$.

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101. For instance, when high demand for office space in New York City's garment district led to increased costs for the garment industry, the city acted to protect the garment industry by creating a "preservation" district—including 8 million square feet in 105 buildings—to be used for manufacturing. See *Real Estate Board, Inc. v. City of New York*, 157 A.D.2d 361, 556 N.Y.S.2d 853 (1990) (sustaining the ordinance against attack as violative of the state's environmental statute).

102. The discontinuity in S' may come at a price lower than the discontinuity in S, because the zoning ordinance may, by restricting the supply of land for office construction, increase the supply of land (and hence decrease the equilibrium price) for other purposes. If so, uses other than office construciton will not provide an attractive alternative until the price drops to P_2, a price below P_1.

Figure 5
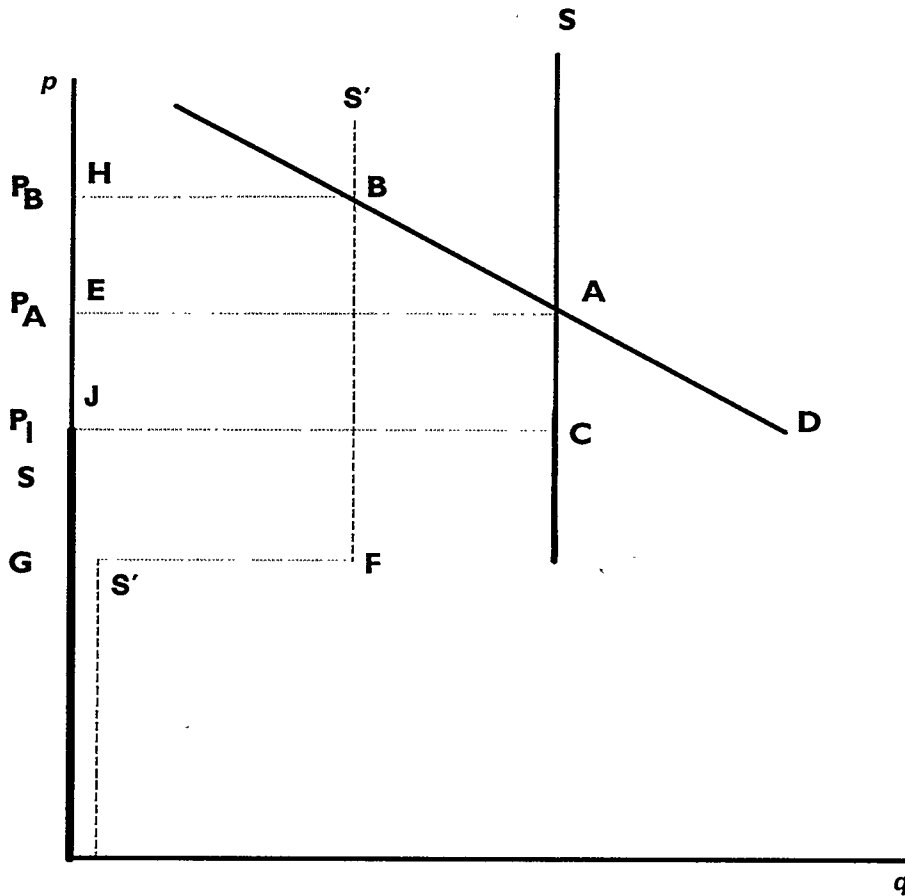
This opportunity is only available to a city without significant competition from other municipalities. If landowners in other municipalities could provide substitutes for land that is subject to the exaction, the city's decreased supply of land for office construction purposes would not lead to an increase in price; developers would simply develop elsewhere. Only if there is no good substitute for city land will zoning restrictions expand the city's opportunity to collect exactions.

One might well object that these opportunities for a monopolistic city to create distortions in the land market may result not from the city's exaction policy, but rather from the city's restrictive zoning ordi-

nance.[103] The objection, however, ignores two important facts. First, political opposition might prevent the city from enacting an overly restrictive ordinance if the exaction is available as a mechanism to assure continued development.[104] Second, giving the city a right to impose an exaction increases the city's incentive to enact the restrictive zoning ordinance.[105] If the city seeks to maximize revenue, the restrictive zoning ordinance benefits the city only to the extent that it increases opportunities to collect exactions.[106]

Hence, unless a city is faced with significant competition from neighboring municipalities, rules permitting even a large city to make liberal use of exactions can provide incentives that result in a misallocation of land. For some uses—particularly commercial ones—suburban land is a poor substitute for downtown land. Even in a large municipality, restrictions on use of exactions, therefore, may be desirable to avoid distortions in land markets.

B. Uniqueness and the Tiebout Hypothesis

Professor Been's thesis rests substantially on Tiebout's argument that competition would regulate the municipal provision of public goods because potential residents would "shop" among municipalities to find one that provided the mix of public goods best suited to their desires.[107] Paradoxically, however, Tiebout's theory undercuts Professor Been's hypothesis: If Tiebout was correct, a sorting process would make municipalities sufficiently unique to prevent competition among them from constraining the municipal imposition of exactions.

Tiebout argued that residents and potential residents dissatisfied with the mix of public goods offered by one municipality remain free to

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103. Compare Fischel, Law & Contemp. Probs. at 111 (cited in note 52).

104. Professor Kreimer has made the point that often political and practical realities make it impossible for government to deny benefits across the board, while the same realities would not prevent selective denial. As Professor Kreimer puts it, "[i]t is only this practical or political resistance that makes the government's possession of the greater power at all tolerable. Allowing the government to deny benefits to some, but not all, of the populace gives it a power that is nowhere implicit in the power to deny benefits absolutely." Seth F. Kreimer, *Allocational Sanctions: The Problem of Negative Rights in a Positive State*, 132 U. Pa. L. Rev. 1293, 1313 (1984).

105. See *Nollan v. California Coastal Commission*, 483 U.S. 825, 837 n.5 (1987); see also Fischel, Law & Contemp. Probs. at 106 (cited in note 52). Professor Fischel's view is that the problem can best be solved by invalidating overly restrictive zoning ordinances, not by restricting municipal power to collect exactions.

106. Of course, municipalities use zoning for purposes other than revenue generation; in particular, zoning enables municipalities to reduce externalities by separating incompatible uses. The point here, however, is that the potential for increased revenue through exactions gives municipalities an incentive to use the zoning process for purposes other than externality reduction.

107. Been, 91 Colum. L. Rev. at 506-528 (cited in note 10).

choose a different municipality.[108] If enough different municipalities co-exist within the same geographical area, competition among municipali-ties should shape the mix of public goods provided by each of them.[109] A municipality that offers an unattractive package will find it difficult to draw the residents necessary to pay for the public goods it does offer.

Competition among municipalities, according to Tiebout, will not be limited to price. Although competition will induce municipalities to provide services at the lowest possible price,[110] they will also compete by offering different packages to satisfy the tastes of different consum-ers.[111] Just as a seller of private goods might seek to develop a "market niche"—to appeal to a particular subset of consumers—municipalities will offer packages of public goods designed to satisfy particular con-sumer tastes. Thus, some communities will appeal to residents who want better schools and parks and who are willing to pay higher taxes for them. Other cities will appeal to those concerned only about schools or only about parks, or to those more concerned about taxes than about the quality of any public services.

With enough municipalities, this competition for residents would permit each potential resident, by choosing among municipalities, to buy precisely the desired quantity of public goods. Moreover, Tiebout-style competition assures cost control for municipal services; if one mu-nicipality taxes more than another for the same services, fewer poten-tial residents will choose to locate within that municipality's borders (or, alternatively, prices for land within the municipality will decline, resulting in political pressure on municipal officials to keep costs down).[112]

The Tiebout model assumes that consumers can costlessly move from one municipality to another in pursuit of fiscal policies to their liking.[113] The model also assumes that consumers have adequate infor-mation about municipal policies and practices.[114] These unrealistic as-sumptions raise questions about the Tiebout model.[115] But if the

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108. Tiebout, 64 J. Pol. Econ. at 420 (cited in note 19).

109. Id.

110. Id.

111. Id. at 420, 421.

112. Id. at 422, n.18.

113. Id. at 419. One survey of actual consumer behavior concludes, however, that "so few citizens intended to invoke the exit response that it hardly appears to constitute a major form of political participation." David Lowery and William Lyons, *The Impact of Jurisdictional Bounda-ries: An Individual-Level Test of the Tiebout Model*, 51 J. Pol. 73, 92-93 (1989).

114. Tiebout, 64 J. Pol. Econ. at 420.

115. See Wallace E. Oates, *On Local Finance and the Tiebout Model*, 71 Am. Econ. Rev. 93, 93 (1981) (suggesting that "[t]he pure [Tiebout] model . . . involves a set of assumptions so pa-tently unrealistic as to verge on the outrageous"); Lowery and Lyons, 51 J. Pol. at 91-95 (cited in note 113).

Tiebout model captures the decisionmaking process for anyone, it does so for new residents without preexisting ties to any particular municipality—residents choosing from among the many municipalities in a metropolitan area. Those potential residents are the principal customers for housing developers and, derivatively, for landowners. And empirical work suggests that consumers do choose municipalities, at least in part, based on the offered package of goods and services.[116]

To the extent that the Tiebout model accurately portrays the municipal housing market, the model suggests that suburbs are *not* fungible. The Tiebout model assures efficient expenditures on public goods only if municipalities offer tax and service packages that are sufficiently varied to give potential residents a significant opportunity to "vote with their feet." But if each municipality offers a unique set of taxes and services, then each muncipality possesses a degree of monopoly power: Potential residents will be willing to pay more for housing in the community than the marginal cost of producing that housing.[117] To the extent that cross-elasticity of demand is small, neighboring municipalities will not eliminate each other's monopoly power. For instance, Scarsdale and Yonkers, adjacent municipalities in suburban Westchester County, New York, may be neighboring municipalities, but they are not good substitutes—at least for potential residents concerned about perceived school quality or property tax rates.[118]

In other words, the existence of Tiebout-style "competition" would serve not to constrain municipal ability to demand exactions from developers, but rather to increase the likelihood that municipal exactions will distort the housing market. By responding to consumer demand in ways that make each of them unique, municipalities make it easier for developers to pass the cost of exactions on to housing consumers, thus increasing housing cost and decreasing the quantity of housing produced.[119]

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116. See Wallace Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. Pol. Econ. 957 (1969); Gerald McDougall, *Local Public Goods and Residential Property Values: Some Insights and Extension*, 29 Nat'l Tax J. 436 (1976).

117. How much monopoly power a municipality enjoys will be a matter of degree. As Tiebout recognized, "[i]n so far as there are a number of communities with similar revenue and expenditure patterns, the solution will approximate the ideal 'market' solution." Tiebout, 64 J. Pol. Econ. at 421 (cited in note 19).

118. Indeed, a Scarsdale post office address can make a home more valuable—even if the home, located within Yonkers, receives all of its services from the city of Yonkers. See Elsa Brenner, *Yonkers ZIP Code Plan Could Change Addresses*, N.Y. Times sec. 12WC, p. 1, col. 1 (June 30, 1991).

119. Of course, if a metropolitan area included enough virtually identical communities or a broad enough spectrum of similar communities, competition could still operate to constrain exaction-induced distortion of housing markets. Tiebout himself recognized that if no perfect substi-

V. CONCLUSION

Embedded in local government finance are significant equity and efficiency questions.[120] What efforts should government make to assess taxes or fees against those who derive particular benefit from government services? How should tax burdens be apportioned between businesses and residents? Will particular revenue-raising schemes discourage economic activity that would be of substantial benefit to municipal residents? For the most part, the American legal system leaves resolution of these critical questions—questions which often generate significant conflict within municipalities—to the political branches of government. Tax law remains subject to few constitutional limits.[121]

Most local finance questions pit one municipal interest group against another. Against this background, exactions and impact fees are an attractive source of revenue for many municipalities. Because exactions often can be collected from outsiders who are not a part of the political community, exaction revenues can help diffuse fiscal tensions that might otherwise plague a municipality. Moreover, exactions and impact fees rarely appear as a blatant grab for money; municipalities can always point to costs that new development generates and justify the exaction or impact fee as a means of recouping those costs.

But exactions also raise the possibility of abuse: Inequitable "taxation without representation," accompanied by the efficiency losses that might result from the reduction in housing supply or the increase in the cost of housing, or of commercial construction. In light of this potential for abuse, the *Nollan* opinion, together with other commentary on exactions and impact fees, suggests that the political branches cannot be trusted to pursue equitable and efficient exaction policies, and that municipal decisions should be subjected to constitutional or other legal scrutiny.

In her thoughtful and provocative article,[122] Professor Been suggests that these concerns are misplaced—that even if local politicians had an instinct to misbehave, market forces would constrain their be-

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tutes exist for particular communities, "the failure to reach the optimal preference position and the substitution of a lower position becomes a matter of degree." Tiebout, 64 J. Pol. Econ. at 421 (cited in note 19).

120. These questions are far from new. In the nineteenth century, similar questions arose in connection with special assessments. See Stephen Diamond, *The Death and Transfiguration of Benefit Taxation: Special Assessments in Nineteenth Century America*, 12 J. Legal Stud. 201 (1983).

121. But compare Frank Michelman, *Takings, 1987*, 88 Colum. L. Rev. 1600, 1614, n.63 (1988) (suggesting that the *Nollan* doctrine might point toward greater constitutionalization of tax law).

122. See Been, 91 Colum. L. Rev. 473 (cited in note 10).

havior, making legal intervention unnecessary. Professor Been is right to criticize those whose analysis of exactions did not take competition into account—much as Tiebout was right to criticize Samuelson and Musgrave for failure to take competition between municipalities into account. Been is also right that vigorous competition among municipalities will constrain municipal power to collect exactions that would distort housing and commercial construction markets.

Unfortunately, however, competition will provide only limited protection against municipal abuse. Even vigorous competition provides virtually no protection against the municipal extraction of economic rents from landowners. Moreover, when competition is imperfect, municipalities retain economic power to collect exactions that would distort the housing and commercial construction markets. Finally, municipalities might adopt confiscatory exaction policies not to collect revenue, but to insulate themselves against new or unwanted development.

These cautions do not diminish the value of Professor Been's impressive contribution, nor do they require federal constraints on municipal exaction policy. First, as Professor Been notes, even if the chance to "exit" is not adequate to protect landowners against municipal abuse, "voice"—the opportunity to participate in political processes—may be sufficient.[123] Moreover, to the extent that abusive local exaction policies are directed against outsiders, state law constraints on municipal authority to collect exactions might well suffice to curb any abuses. Alternatively, one might conclude that the difficulty of establishing standards to govern municipal behavior make it appropriate to tolerate "extortionate" exactions. But whatever policy response one supports, the basic point remains: competition alone will not prevent municipalities from imposing exactions that significantly exceed the external costs imposed by new development.

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123. Id. at 477.