Vanderbilt Law Review

Volume 40
Issue 1 *Issue 1 - January 1987*

Article 2

1-1987

# The Political Economy of Co-Financing America's Urban Renaissance

Robin P. Malloy

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*Robin Paul Malloy**

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## I. INTRODUCTION AND PERSPECTIVE

America's urban centers are experiencing a renaissance of sorts tbat reflects the vitality of a renewed interest in the city. Dynamic growth and revitalization of the central city have emerged since the 1970s as key focal points for investment and development, replacing years of investing primarily in suburbanization.[1] The emerging activity in America's urban downtowns has been more than an isolated or segmented investment in office buildings. With strong political support and the emergence of an affluent group of new urbanites, some central cities are said to be transforming into entirely new urban environments where people not only work, but live, shop, and entertain.[2]

This renewed interest in revitalizing America's downtowns,

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* Assistant Professor of Law, Indiana University School of Law - Indianapolis. B.S. in Economics, Purdue University (The Krannert School of Management). J.D., University of Florida. LL.M., University of Illinois. I wish to thank Paul N. Cox, Michael H. Hoeflich, and Margaret A.P. Malloy for their willingness to listen to, discuss, and comment on my early approaches to this Article. I also wish to thank my research assistant Shandon Vickers Whistler for her efforts.

1. *See* Mickens, *The City Fights Back - Downtowns On The Rebound*, URB. LAND, May 1986, at 11.

2. The Urban Land Institute (ULI) has called this reemergence of the central city a "renaissance." *Id.*

and in urbanization in general, is important for a number of reasons. Among these reasons is a vibrant city's ability to give strong identification and pride to local residents and politicians while also providing the financial support necessary for varied educational, cultural, and political activities that otherwise would not be available in smaller communities.[3] The most significant reason for promoting the revitalization of America's urban centers, however, involves the recognition that cities are a necessary, if not sufficient, basis for fueling long-term economic growth, job creation, and capital formation.[4] The economic strength of urban centers and the extended regions that surround them is essential, not only for improving the local standard of living, but for improving regional and national economic prospects as well. Cities provide the closely knit environment necessary for the incubation of many small business enterprises. Only in the womb of the urban environment can the small business enterprise or entrepreneur have access to extensive sources of resource capital, flexible use of technology, close relationships with other similarly innovative firms, and close interchange of workers and ideas with others possessing different kinds of expertise.[5]

Cities and the health of their economies depend on a dynamic market interaction that allows the nature of the business activity within the city region to change over time.[6] For instance, a city

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3. *See* Lawrence, *Constitutional Limitations on Governmental Participation in Downtown Development Projects,* 35 VAND. L. REV. 277, 294-300 (1982). In exploring the constitutional framework of co-financing arrangements, the author discusses a number of benefits that derive from urban development. In particular, he points to expanded cultural and job opportunities from larger, more densely populated urban areas. *Id.* at 295-96. Despite these benefits, the author also recognizes that some co-financed downtown redevelopment projects add little, if anything, to the city's export base and arguably may not create new jobs because they merely locate in the downtown area projects that might be developed elsewhere. *Id.* at 295. When tbis relocation process is tbe result of co-financing, the local government support for downtown projects results in subsidies for downtown businesses at the expense of suburban competitors. *Id.* at 295.

4. *See generally* J. JACOBS, CITIES AND WEALTH OF NATIONS (1984). This book represents a marvelous addition to the understanding of urban life. Jacobs stresses the significant role that dynamic city regions play in contributing to the national wealth. Without strong urban economies, the national economy would suffer. Jacobs argnes that cities are tbe necessary lifeblood of a national economy. It is clear from the book, however, tbat merely having centers of dense population does not mean a strong and vibrant city region exists. Instead, Jacobs argues that a city region alone is not sufficient; the proper type of city economy also must be present. This requires an urban economy that is dynamic, facilitates import-replacing activities, and allows for the formation of private capital and the free flow of people, ideas, and capital.

5. *See id.* at 39-44.

6. *Id.* at 42.

once dependent on industrial manufacturing of steel may need to replace that activity with a new source of enterprise based, for example, on computer technology. Likewise, as textile or shoe manufacturing moves from cities in the northern United States to cities in the southern United States or overseas, the northern cities must replace their source of commercial activity or confront economic and political decline. The northern city that has lost its textile manufacturing now may find that it has a comparative advantage in electrical technology because of the presence of a world class university. Thus, the city that once relied on jobs and dollars generated by textiles to import electronic technology and other goods now finds that it can replace its economic base by replacing its former imports with the local manufacture and exporting of those local goods.[7]

This cycle of import replacement is a dynamic process that is the product of natural market forces and the inducement of environments favorable to the free flow of capital, technology, labor, and ideas.[8] As a setting for this cycle, the urban environment must be viewed as a microcosm of the larger national or international marketplace. Programs or efforts to revitalize urban centers must be of a nature that stimulates an entrepreneurial spirit conducive to job formation and experimentation rather than being structured investments in static attempts to preserve the status quo.[9] This realization is vital to evaluating current programs designed to stimulate continued urban revitalization and to providing constructive recommendations for future efforts.

For American cities, the current economic and political cli-

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7. *Id.* at 40-71. *See generally* Gorlow, *High-Tech Location Decisions and Corporate Dynamics*, URB. LAND, Dec. 1984, at 14-16; Porter, *Research Parks: An Emerging Phenomenon*, URB. LAND, Sept. 1984, at 6-9. These brief articles highlight some of the location factors for attracting high-tech companies. The presence of a distinguished university is one such factor. This example illustrates the need of a dynamic city to take comparative advantage of its local assets and to recognize that over time the economy, as a dynamic process, will rearrange those relative comparative advantages. As a result, new economic activities will need to emerge to replace former activities.

8. *See* J. JACOBS, *supra* note 4, at 45-58 (giving an example of the import-replacing function and the dynamics of the urban economic structure necessary to facilitate that activity).

9. *See id.; see also* Hatch, *Italy's Industrial Renaissance*, URB. LAND, Jan. 1985, at 20-23. This article outlines the tremendous amount of economic growth in the northeastern and central regions of Italy as a result of an urban redevelopment program that stresses incubation of small scale enterprises. The numerous small scale enterprises encourage entrepreneurs and flourish on dynamic interaction with other small businesses. The entrepreneurial structure of the redevelopment process encourages flexibility and experimentation that leads to an enhanced economy.

mate for revitalization presents special challenges for financing desired development projects.[10] In the current era of Gramm-Rudman and New Federalism, cities are finding little help from the former New Deal programs of a more activist and financially sound federal bureaucracy.[11] As a result, cities have had to be more resourceful and have been forced to implement local incentive programs in order to accomplish their desired objectives. The most significant current incentive programs involve "public/private partnerships" that encourage pooling the efforts and resources of government and private enterprise for the mutual attainment of particular developmental objectives. Because most of these programs really involve sharing the cost of the desired project, they can fall under the general rubric of "co-financing."

The elated embracing of co-financing programs is illustrated by the literature applauding its alleged results in real estate project after real estate project and in city after city.[12] Co-financing

10. In this context the notion of "desired" development projects does not necessarily mean "desirable" development projects.

11. The Gramm-Rudman legislation, while having difficulties as a result of court interpretations, does provide an indication of the fiscal attitudes now gripping the nation's capital. *See* 13 Hous. & Dev. Rep. (BNA) 682, 719 (1986) (concerning Gramm-Rudman budget reductions); *id.* at 729, 768 (discussing court challenge to Gramm-Rudman and setting out HUD housing cuts under Gramm-Rudman); 14 Hous. & Dev. Rep. (BNA) 135 (1986) (concerning the Supreme Court's rejection of procedures for automatic spending cuts under Gramm-Rudman). New Federalism is part of the Reagan administration's vision of reviving the concept of states' rights and emphasizing local, rather than federal, solutions to local problems. *See infra* notes 144-52 and accompanying text. New Deal programs refer to the traditional "welfare stato" approach to solving local problems with big budget federal programs. *Id.*

12. *See, e.g.,* G. Stout & J. Vitt, Public Incentives and Financing Techniques for Codevelopment (1982); ULI, Joint Development: Making the Real Estate - Teansit Connections (1979) (examining ways to assist development by improving public financing of transportation facilities); R. Witherspoon, Codevelopment: City Rebuilding by Business and Government (1982) (providing basic background on the codevelopment process); Bamberger & Parham, *Leveraging Amenity Infrastructure: Indianapolis's Economic Development Strategy,* Urb. Land, Nov. 1984, at 12-18 (discussing various co-financing and incentive programs Indianapolis used to encourage redevelopment); Brereton & Ashcroft, *Road Building, Texas Style,* Urb. Land, June 1986, at 22-25 (discussing developing basic infrastructure through public/private partnerships); Goodman & Nutting, *A Tale of Four Cities: Investment Activity in "Dying" Downtowns,* Urb. Land, March 1985, at 32-33 (considering Cleveland, Milwaukee, Detroit and Indianapolis); Gregerman, *Federal, State, and Local Economic Development Initiatives,* Urb. Land, July 1984, at 21-25 (giving an overview of public incentives for redevelopment); Levitt, *Louisville, Kentucky: A Commitment to Development,* Urb. Land, June 1985, at 2-6 (describing the public and private sectors' meeting to redevelop downtown Louisville); Mandelker, *Public Entrepreneurship: A Legal Primer,* 15 Real Est. L.J. 3 (1986) (covering some basic concepts involved in co-financing without evaluating such activities' implications beyond the basic "how to" steps for guiding their continued use); Ratner, *Charleston Town Center,* Urb. Land, June 1985, at 16-17; Roark, *Devel-*

has emerged from the "popular wisdom" as the answer to continued revitalization efforts in America's cities. Yet little, if anything, has been written analyzing the political, economic, and philosophical foundation of co-financing programs. The purpose of this Article, therefore, is to examine the political, economic, and philosophical issues arising from co-financing and to do so from the perspective of classical liberalism. Understanding the classical liberal perspective is vital to a full appreciation of the problems confronting those who seek to stimulate the urban economy while preserving the market environment necessary to give rise to economic growth and prosperity. In order to aid this understanding, a brief description of classical liberalism is merited.

Classical liberalism is a political and economic philosophy typified by a strong belief in individual liberty.[13] In general, the philosophy embraces a free market approach to law and social policy as the best method of insuring the greatest possible sphere of personal liberty for the individual.[14] Classical liberalism is not, however, a philosophy that requires the completely unfettered operation of a laissez faire economy. To the contrary, it is a philosophy founded upon high standards of moral conduct and human dignity that transcend purely utilitarian cost and benefit calculations and simplistic notions that equate morality with wealth maximization and market efficiency.[15]

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*opment In The Meadowlands*, URB. LAND, March 1985, at 10-14 (describing public agency as correcting past mistakes and leading developing with private projects); Schwanke, *Riverplace, Minneapolis*, URB. LAND, Nov. 1985, at 2-7 (describing public and private co-financing arrangements allowing a new $111 million mixed use project to be constructed); Sedway Cooke Associates, *Joint Development*, URB. LAND, July 1984, at 16-20 (explaining the benefits of public co-financing arrangements); Walker & Zeller, *Promoting Public/Private Initiatives for Preservation*, URB. LAND, Nov. 1985, at 12-16; Wishneff & Eckel, *Roanoke, Virginia: Revitalizing the Medium-Sized City*, URB. LAND, Nov. 1985, at 22-27; *Public/Private Partnerships - The Key To The Rebirth of Downtown Retailing*, URB. LAND, June 1984, at 26.

13. *See* Malloy, *Equating Human Rights and Prosperity Rights - The Need for Moral Judgment in an Economic Analysis of Law and Social Policy*, 47 OHIO ST. L.J. 163-77 (1986). Classical liberals are a diverse collection of scholars typified by a strong belief in individual liberty. *Id.* at 163. One of the founding fathers of classical liberalism was Adam Smith, and his views bave been expanded on by notable recent scholars such as Friedrich Hayek and Ludwig Von Mises of the "Austrian School" of economics and Milton Friedman of the "Chicago School" of economics. *Id.* at 163. For a basic introduction to the Austrian School, see A. STRAND, THE CAPITALIST ALTERNATIVE: AN INTRODUCTION TO NEO-AUSTRIAN ECONOMICS (1984). My theory of classical liberalism derives from many sources, but primarily represents a blending of "Libertarian Philosophy" and the philosophy of the "Austrian School of Economics."

14. *See* Malloy, *supra* note 13, at 164.

15. *Id.* at 163-77. Even Adam Smith's great work, AN INQUIRY INTO THE NATURE AND

Generally speaking, classifying classical liberals as either "liberals" or "conservatives," as those terms typically are understood in the United States, would be inappropriate.[16] The term "classical liberal" derives from the British liberal tradition of Adam Smith and David Hume and is espoused by such notable contemporaries as Friedrich Hayek, Ludwig Von Mises, and Milton Friedman.[17] In this context, a liberal is one who advocates freedom of the individual and reduction of governmental power and control. Over the course of American history, however, the promoters of an active role for government at the expense of individual autonomy acquired the label "liberal." This role reversal has been the most pronounced since the 1930s, when the term "liberalism" came to be associated with a readiness to rely on state intervention and paternalism, rather than on private voluntary arrangements, to achieve certain social objectives.[18]

To the extent that classical liberals are not understood properly to be liberals, classical liberals are likewise not conservatives. Conservatives, unlike classical liberals, do not quarrel with liberals over the issue of how the power of government should be limited to protect personal liberty, but rather concern themselves with who should wield government power.[19] Friedrich Hayek, for instance, has described his disassociation with conservatism on the basis that

> it neither understands those spontaneous forces on which a policy of freedom

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CAUSES OF THE WEALTH OF NATIONS, (1776), cannot be read in isolation from his earlier work, THE THEORY OF MORAL SENTIMENTS (1759). Together, these works not only give us a theory of human behavior in the marketplace; they also reveal Smith's underlying helief that self-interest and happiness within society depend upon high standards of moral conduct. *See* Malloy, *supra* note 13, at 167 (*citing* A. SMITH, THE THEORY OF MORAL SENTIMENTS 265-75 (E. West ed. 1976)). Classical liberals that follow the teaching of Smith continue to recognize the need for moral judgment in order to protect individual liberty. Malloy, *supra* note 13, at 167. Individual liberty is linked to natural law concepts and the idea of inalienable rights. *Id.* Economic arrangements can be limited in order to protect individual liberty, and thus a totally unfettered laissez faire economy is not the sole ohjective of classical liberalism. *Id.*

16. *See* F. HAYEK, THE CONSTITUTION OF LIBERTY 397-411 (1960).

17. *See, e.g., id.*; F. HAYEK, THE ROAD TO SERFDOM (1944); F. HAYEK, LAW, LEGISLATION AND LIBERTY; Vol. 1 - RULES AND ORDER (1973); Vol. II - THE MIRAGE OF SOCIAL JUSTICE (1976); Vol. III - THE POLITICAL ORDER OF A FREE PEOPLE (1979) [hereinafter collectively F. HAYEK, LAW, LEGISLATION AND LIBERTY]; L. VON MISES, HUMAN ACTION (2d ed. 1963); L. VON MISES, PLANNING FOR FREEDOM (1952); L. VON MISES, LIBERALISM IN THE CLASSICAL TRADITION (3d ed. 1985); M. FRIEDMAN, CAPITALISM AND FREEDOM (1982); M. FRIEDMAN, BRIGHT PROMISES, DISMAL PERFORMANCE (W. Allen ed. 1983); M. FRIEDMAN & R. FRIEDMAN, FREE TO CHOOSE (1980); M. FRIEDMAN & R. FRIEDMAN, TYRANNY OF THE STATUS QUO (1984).

18. M. FRIEDMAN, CAPITALISM AND FREEDOM 5-6 (1982).

19. *See* F. HAYEK, THE CONSTITUTION OF LIBERTY 401-03 (1960).

relies nor possesses a basis for formulating principles of policy. Order appears to the conservatives as the result of the continuous attention of authority, which for this purpose, must be allowed to do what is required by the particular circumstances and not be tied to rigid rule. A commitment to principles presupposes an understanding of the general forces by which the efforts of society are co-ordinated, but it is such a theory of society and especially of the economic mechanism that conservatism conspicuously lacks.[20]

Thus, in an effort to recapture the original meaning of "liberalism" as stressing individual freedom from unnecessary coercion by the state, the terms "classical liberal" and "classical liberalism" are used in this Article to refer to liberalism in the British tradition, as distinguished from the current ideology of both conservatives and liberals.

From the perspective of classical liberalism, this Article will critically analyze current co-financing arrangements being used to facilitate real estate development in America's central cities. This perspective not only should provide an understanding of the various co-financing techniques themselves, but also should shed some light on how these programs affect traditional notions of individual liberty and the relationship between state and private enterprise in a primarily capitalistic society. In order to accomplish this objective, Part II of this Article will proceed with a discussion and description of co-financing activities. Part III will consider the political and economic dynamics of co-financing arrangements and the significance of President Reagan's New Federalism. Part IV will assess the philosophical constraints on co-financing. Finally, the Article will conclude with recommendations for restructuring co-financing arrangements in a manner that would allow for continued urban activity while protecting the free flow of capital, technology, labor, and ideas that is necessary for the economic and political well-being of our cities and our nation.

## II. THE NATURE OF CO-FINANCING

Urban revitalization is a complex problem even for cities lucky enough to be experiencing a renaissance of broadly based economic, political, and social renewal. Revitalizing many aging American cities requires a tremendous expenditure of public and private resources. Revitalization does not mean merely arranging funding for a new downtown office building. A lone office building, or just

20. *Id.* at 401. The postscript chapter to this book is titled "Why I Am Not a Conservative." *Id.* at 397-417. *See also* M. FRIEDMAN, *supra* note 18, at 4-6. Both Hayek and Friedman make affirmative efforts to distinguish themselves from conservatives.

about any other specific real estate project, by itself is insufficient to revive the lifeblood of a city facing industrial and commercial decline, a deteriorating and neglected housing stock, shrinking or vandalized recreational land use, and a crumbling infrastructure.[21] Revitalization efforts must be broadly based and must integrate the need for enhanced infrastructure with the need for restoration or new development of commercial, industrial, and residential facilities. This integration must be accomplished while preserving recreational and artistic amenities sufficient to offset the dissipating influences of the less congested lifestyle available in the urban fringes.

The size and scope of necessary revitalization efforts for many cities pose monumental policy questions. First and foremost among these policy questions is a choice of whether urban planning efforts should strive for outcome specific results or merely for attaining a general political, economic, and legal environment conducive to revitalization. In other words, in the context of a dynamic, multi-urban national economy, can local politicians and urban planners be expected to select and promote the best revitalization plans on a project-by-project, neighborhood-by-neighborhood basis, or are revitalization efforts best realized by creating a foundation for market-directed revitalization based on an enhanced free flow of capital, technology, labor, and ideas? Before answering this question, one must analyze the co-financing arrangements currently being used to facilitate urban renewal.

For purposes of general discussion, the current offerings in co-financing programs can be grouped under two major headings: acquisition, development, and construction assistance (ADC assistance)[22] and tax related assistance. These two broad categories are in no way meant to be definitive, nor are they meant to assert mutual exclusivity. Rather, these groupings are designed to facilitate a quick and shortened discussion of the nature of co-financing programs before this Article addresses the more complex issues pertaining to their use.

ADC assistance programs involve both direct and indirect

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21. *See generally,* Lawrence, *supra* note 3, at 299.

22. "ADC assistance" is a term derived from the concept of ADC loans. These loans are used for *acquisition, development,* and *construction* of a project. Acquisition involves assembly of the necessary land. Development refers to land improvement requirements such as sewer lines, grading, and paving. Construction refers to the process of constructing the primary land improvement that defines the project as a hotel, shopping center, or other project.

methods of co-financing particular revitalization projects. The major subcategories of ADC assistance require public and political involvement in making direct loans or grants, sharing acquisition or land improvement functions, undertaking provisions for collateral-support structures and services, and using condemnation powers to effect parcel assembly.

Making direct loans to a real estate project involves the city in a capacity similar to that of a more traditional commercial lender. The city uses public funds to help finance a project to be developed by a private developer that the city selected.[23] In return for carrying part of the financing costs of the project, the city, like other commercial lenders, will require a return on the loan. The city may receive its return by taking a percentage of the income the property generates, such as a percentage of rent in an office building or retail center. In addition, the city may be given a right to share in the property's future appreciation in the same manner as a commercial lender would exercise an "equity kicker" option in a commercial loan.[24] In this way, the city shares in the project's potential income flow and equity appreciation while also hoping that the project itself will spur additional revenues for the city by increasing job opportunities and property taxes.

In a time of governmental austerity, grants are becoming less reliable as a source of revitalization funds. Nonetheless, they have played, and continue to play, an important role in co-financing real estate projects. Major grant programs generally rely on federal funds being made available for local projects.[25] Various cities apply

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23. *See* Lawrence, *supra* note 3, at 304-10 (discussing various ways for a local government to subsidize a transaction for a private developer). Making direct loans is merely a variation on the theme of subsidizing a private developer. This Article will show that Indianapolis has provided loan money, as well as other forms of co-financing, to private developers. *See infra* notes 97-116 and accompanying text.

24. "Equity kicker" refers to a lender's right to share in the equity appreciation or income flow from the project. The equity kicker is provided in addition to payment of principal plus interest. *See, e.g.,* M. MADISON & J. DWYER, THE LAW OF REAL ESTATE FINANCING ¶¶ 2.01(3), 2.02(1), 3.04(3)(a), 8.09(3), 11.02(1), (1981) (discussing various approaches to the use of equity kickers).

25. *See* Lawrence, *supra* note 3, at 288-93; [2 Ref. File] Hous. & Dev. Rep. (BNA) §§ 20, 22, 30 (1986) (describing various federal housing programs and the programs' requirements); [3 Ref. File] Hous. & Dev. Rep. § 50 (1986) (describing various state housing finance programs and requirements). *See also* Gregerman, *Federal, State, and Local Economic Development Initiatives,* URB. LAND, July 1984, at 21-25 (providing a brief overview of program possibilities); Greene, *Urban Development Action Grants: Federal Carrots for Private Economic Revitalization of Depressed Urban Areas,* 3 URB. L. & POL'Y, 235 (1980) (noting that the UDAG program tries both to encourage economic development in urban areas and to encourage resource coordination between public and private entities); Williamson, *Com-*

for limited grant or subsidy money on the basis of specific, project oriented guidelines. These guidelines typically require evidence that the proposed development will provide housing or jobs for a certain number of low-income people or that the grant will be an essential element in the renewal of a blighted neighborhood.[26] Through the grant process, local city politicians aid private developers in constructing certain qualified projects by combining local resources with funds from the federal government in order to share the costs with the developer. Grant programs generally do not require a sharing of income or equity appreciation between the public and private parties, but do carry restrictions limiting the profits the private developer reaps.[27] Thus, for instance, a private developer may receive a grant or other federal assistance to construct low cost rental housing, but then may be restricted in the amount of rent that it may charge.

Public sharing of acquisition or land improvement functions can take several forms. The city voluntarily can purchase desirable land for a project and then, as owner, structure long-term lease provisions that reduce the private developer's overall project costs.[28] Alternatively, the city voluntarily might acquire the property and then arrange a sale of the fee ownership to the private developer either on an installment contract basis or by sale with a purchase money mortgage with terms favorable to the developer.[29] Favorable terms that extend payments and allow for low nominal interest rate equivalents amount to favorable subsidies to the developer. In yet another variation of this general scheme, the city might acquire the land and undertake basic site improvement, such as removing existing undesirable structures and upgrading sewage and utility service facilities, before turning the property over to the developer.[30] This process allows the city to subsidize the private developer with public resources by undertaking activi-

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*munity Development Block Grants,* 14 URB. LAW 283 (1982); Nolon, *Reexamining Federal Housing Programs in a Time of Fiscal Austerity: The Trend Toward Block Grants and Housing Allowances,* 14 URB. LAW 249 (1982).

26. *See* Lawrence, *supra* note 3, at 288-93.

27. *See, e.g.,* [3 Ref. File] Hous. & Dev. Rep. (BNA) § 50:0013 (1983) (describing a number of restrictions on developers using mortgage revenue bonds, such as a cap on home purchase prices, mortgage interest rate arbitrage, and the makeup of home buyers); [2 Ref. File] Hous. & Dev. Rep. (BNA) § 30 (1981) (providing guidelines and restrictions on multifamily housing projects).

28. *See* Lawrence, *supra* note 3, at 304-10.

29. *Id.*

30. *Id.*

ties that otherwise would be required of the developer to complete the project.

By undertaking to provide for collateral-support structures and services, the city indirectly subsidizes the selected private developer's construction of an approved project. The best and simplest example of this activity would be when the city agrees to construct a multilevel parking garage adjacent to the site for the private developer's hotel, office building, or retail center.[31] In this way, the developer acquires the construction of a necessary amenity, but at no personal expense. Likewise, the city provides a significant subsidy to the private developer in exchange for the developer's commitment to the approved project.

Finally, the city's condemnation powers can be used to assemble a parcel sufficient for project development.[32] Through condemnation the city can assist the developer in several ways.[33] First, condemnation provides a mechanism for acquiring property at public expense by compensating the involuntary grantor. Once the city acquires the property, it then can make the property available to the developer through any acquisition-sharing method or land improvement function. Second, condemnation proceedings allow the city to eliminate any "hold out" problems when parcel assembly involves the acquisition of valuable property rights from more than one owner.[34] The hold out problem and parcel assembly are particularly troublesome for the large-scale project in a downtown center. The urban setting often means that numerous fee ownership interests, leasehold estates, easement rights, air rights, and other rights will be involved. The large-scale urban developer, therefore, is greatly assisted by a reduction in the cost of coordinating numerous voluntary exchanges for these valuable development rights and also is able to avoid the "blackmail" prices and "won't sell at any price" problems of hold out owners.[35]

Tax related assistance also is a major part of co-financing efforts to revive urban centers. The major subcategories of tax related assistance include the following: tax abatement, enterprise

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31. *Id.* at 311-18.

32. *Id.* at 279-300. *See also* Mandelker, *supra* note 12, at 4-10 (discussing the use and advantages of the power of eminent domain in assisting urban redevelopment).

33. *See supra* note 32.

34. The hold out problem will be discussed more fully *infra* at text accompanying notes 70-78.

35. Blackmail prices will be discussed more fully *infra* at text accompanying notes 70-78.

zones, tax increment financing, and bonds.

Tax abatement schemes focus on attempts to lure specific businesses or construction projects to a city by means of a scheduled reduction in real property taxes and other local service fees and tax assessments.[36] In exchange for the city's concessions on taxes, the incoming business or project developer agrees to operate its facility for a given period of time and attempts to predict a favorable impact on local job creation and a long-term enhancement of the local tax base.[37] The trade-off, in other words, involves a short-term city subsidy to the private enterprise in exchange for a less than certain long-term benefit of greater local job opportunities and eventual additions to the city coffers as the abatement period is phased out.

Enterprise zones, in a sense, are nothing more than better structured approaches to tax abatement. The enterprise zone concept has been used and promoted with varying evidence of success in Great Britain and the United States.[38] Enterprise zones take on

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36. *See* Papke, *The Effects of Tax Policy on Economic Development*, KRANNERT PORTFOLIO 4-5 (1986) (noting that while tax abatement and incentives can encourage business location decisions, it is difficult to know how large a concession is needed or merited relative to actual economic gains); Miley & Schneider, *Is Tax Abatement Worth The Gamble?*, Indianapolis Star, Feb. 2, 1986 at 8, col. 1. In 1985 Indiana gave to private businesses a tax abatement worth $24 million, which covered $255 million of assessed property value. In 1984 Indianapolis approved 100 of 108 applications for real estate tax abatement. Some businesses in Indianapolis have received millions of dollars in tax abatement benefits. One office building, for instance, will receive an estimated $7 million in abatement benefits over a ten year period. *Id.*

37. *See supra* note 36.

38. *See* Boeck, *The Enterprise Zone Debate*, 16 URB. LAW. 71 (1984). This article illustrates the vast political, ideological, and administrative debate that underlies much of the discussion of enterprise zones. Do the zones, for instance, encourage a new form of state planning, or do they stimulate a market alternative to state planning? The author describes the experience of enterprise zones in Puerto Rico as a failure. *Id.* at 81-83. *See also* Callies & Tamashiro, *Enterprise Zones: The Redevelopment Sweepstakes Begins*, 15 URB. LAW. 231 (1983). This article provides an overview of enterprise zone initiatives in both the United States and Great Britain, and provides a chart of economic activity that has been fostered in various enterprise zones in Great Britain. *Id.* at 276-77. The authors also describe the enterprise zone concept as involving "a locally nominated, federally designated and economically deteriorated urban area into which commercial activity is to be attracted (and jobs thereby created) by means of a partial roll-back of federal and local taxes and elimination of local regulations." *Id.* at 231. *See also* Solomon & Solomon, *Enterprise Zones, Tax Incentives and the Revitalization of Inner Cities: A Study of Supply Side Policy-Making*, 3 DET. C. L. REV. 797 (1981) (exploring the problems of industrial migration and urban underemployment as a basis for assessing the implications of business incentives provided through enterprise zones); Unger, *Enterprise Zones: Some Perspectives on Anglo-American Developments*, 5 URB. L. & POL'Y 129 (1982). This article compares British and American efforts on enterprise zone legislation. The idea of enterprise zones is said to have originated in Britain and to have been advocated first by Professor Peter Hall on June 15,

an attraction superior to that of most simple tax abatement schemes because enterprise zones combine nonlocal subsidies with local incentives.[39] Usually, to qualify as an enterprise zone, a designated city area must have certain specified levels of high unemployment and urban blight.[40] Once the guidelines for qualification are met and enterprise zone status is ascertained, a qualified investor or employer that moves to or expands its operations within the zone is eligible for favorable tax treatment.[41] This favorable tax treatment serves to subsidize investment in the enterprise zone vis-a-vis other areas unable to offer similar reductions in tax obligations. In essence, the operative goal of using enterprise zones is to reduce a substantial element of business cost—tax liability—in exchange for business investor's making investments in the locations and within the guidelines prescribed by the government. Ultimately, a continuing question about enterprise zones is the extent to which they foster new investment and new job opportunities as opposed to merely shifting business from outside the zone to within the zone.[42]

Tax increment financing (TIF) is another new co-financing method currently being used to facilitate urban redevelopment projects.[43] This method of co-financing allows the city to raise rev-

1977. *Id.* at 134. Professor Hall received his inspiration for the concept from his observations of the economic success of such free market urban economies as Hong Kong and Singapore. *Id. See also* Freilich, Frye & Carpenter, *The New Federalism—American Urban Policy in the 1980's: Trends and Directions in Urban, State and Local Government Law*, 15 URB. LAW. 159 (1983) [hereinafter Freilich, *The New Federalism*]. The authors take a rather negative view of the Reagan administration's efforts to address urban problems. They see enterprise zones as the one viable program being offered as a solution to urban economic difficulties. *Id.* at 188. *See also* Note, *Enterprise Zones: New Life for the Inner City*, 4 HARV. J.L. & PUB. POL'Y 243 (1981) (providing good basic reference background on the urban problems allegedly addressed by enterprise zones); *see generally*, *Enterprise Zones* 18 LAND USE DIG. 1 (1985) (calculating that at the time of the article, 26 states and more than 450 cities had adopted enterprise zones).

39. *See supra* note 38.

40. Solomon & Solomon, *supra* note 38, at 803-23; Boeck, *supra* note 38, at 85-130; Note, *supra* note 38, at 266-91.

41. *See supra* note 40.

42. *See* Hall, *Housing, Planning, Land and Local Finance: The British Experience*, 6 URB. L. & POL'Y 75 (1983). In practice, enterprise zones tend to shift business from outside the zone to inside the zone and therefore provide little lasting benefit to the overall urban economy. *Id.* at 83. *See also* Helyar & Johnson, *Tale of Two Cities—Chicago's Busy Center Masks a Loss of Jobs In Its Outlying Areas*, Wall St. J., Mar. 16, 1986, at 1, col. 1. This article discusses Chicago city politicians' long attention to the urban downtown. As a result, the suburbs have suffered while the downtown center is active from government-related subsidies and incentives.

43. *See* Mandelker, *supra* note 12, at 3-21. Professor Mandelker sets out the basic requirements and guidelines for the use of tax increment financing. *Id.* at 15-21. *See, e.g.,*

enue through offerings in the bond market. The revenue from the bonds then can be used to assist a private developer in completing a desired project.[44] The source of revenue the city will use in retiring the bonds is the anticipated incremental increase in ad valorem taxes generated by the presence of the new project in the downtown area.[45] In other words, the city, having designated the appropriate location for its project and having selected a developer, floats a bond issue to finance the project. The issue is backed by an expectation that the new project, in fact, will stimulate significant economic activity so that tax revenues from the area will increase to a level sufficient to carry the cost of the bond obligation.

A final tax related assistance program involves the use of industrial development bonds (IDBs).[46] IDBs are used to en-

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Schneider, *City Builds Its Development Plans on Tax "Financing"*, Indianapolis Star, June 1, 1986, at C3, col. 1 (viewing TIF as a key in Indianapolis' redevelopment efforts and essential as a response to the shrinking supply of federal money); Schneider, *Moldthan Warns About Tax Increment Bonds*, Indianapolis Star, June 19, 1986, at C5, col. 3. In this article, a taxpayer's watchdog group cautions about the use of TIF and its potential to backfire. The latest debate in Indianapolis concerned a $23 million bond issue to be sold to assist in the construction of a project that includes a 13 story office building and a 1,100 car underground parking garage. *See also*, *Taxpayers in Some Communities May Pay More in Tax Increments*, 19 LAND USE DIG. 5 (1986). This article reports on a study of nineteen municipalities in Milwaukee County, Wisconsin. Nine of the nineteen municipalities used TIF; the study found that residents of cities that did not have TIF subsidized taxpayers in cities that did. *Id.* at 12.

44. *See* Mandelker, *supra* note 12, at 3-21.

45. *Id.*

46. *See id.* at 10-14 (discussing IDBs); Fening & Russo, *The Impact of Industrial Revenue Bonds on Job Generation and Economic Development*, 8 CURRENT MUN. PROB. 143-45 (1981). Sales of tax-exempt bonds to finance private businesses were as bigh as $7 billion in 1979 and cost the federal government as much as $1 billion in lost tax revenue. *Id.* at 143. The typical business assisted by IDBs and IRBs employed 28 new full-time people and 13 part-time people, and the majority of jobs were in the sales, clerical, service, and operations categories. *Id.* at 144. *See also* Cook, *The Continuing Evolution of Industrial Development Bond Financing*, FLA. B. J., Jan. 1985, at 61 (noting increase in the volume of IDBs nationwide to $44 billion); Ide & Ubell, *Financing Florida's Future: Revenue Bond Law in Florida*, 12 FLA. ST. U.L. REV. 701 (1985) (discussing the use of revenue bonds and the public purpose doctrine); Note, *Industrial Development Bonds: A Proposal for Reform*, 65 MINN. L. REV. 961 (1981) (discussing IDBs and the public purpose doctrine); Case Comment, *Industrial Development Bonds: The Demise of the Public Purpose Doctrine*, 35 U. FLA. L. REV. 541 (1983). *See also* INDIANA CONTINUING LEGAL EDUCATION FORUM, REAL ESTATE DEVELOPMENT & HOUSING LAW I-32 (1986). The new tax act will diminish the value of IDBs. Under the new tax provision, if five percent or more of the bond proceeds are used in a private trade or business they will not be tax exempt. A developer still might find a taxable IDB useful, however, if the city has access to better financial markets. Furthermore, municipal bonds used for a public purpose remain non-taxable. As such, a city might continue to use bonds for the construction of support facilities such as a public parking garage adjacent to a developer's office building. In this way, municipal bonds can continue to play a role in the public/private partnership of co-financing.

courage the development of both industrial and commercial projects.[47] Like TIF schemes, IDBs rely on the city to issue a municipal bond.[48] The IDB receives tax-exempt status and, therefore, allows the city to generate money for acquisition, development, and construction activities at a lower cost of funds than if the private developer had to secure these financial resources from private lenders.[49] Thus, the city can assist the developer by offering lower cost terms of purchase, lease, or financing than would be available without the tax related subsidy. The funds to repay the IDB are not generated from incremental increases in the local tax base, as with TIF, but rather come from the project itself in terms of a share in the income the project generates.[50]

The best example illustrating an arrangement allowing the city to share in the income generated by an IDB project is a downtown commercial use, such as a shopping center or an office building. Instead of selling the property to the private developer, the city can use its IDB-supported acquisition of the land to structure a long-term ground lease with the developer. In this arrangement, the city acts as ground lessor and the developer as ground lessee. The IDB's tax subsidy allows the city to arrange the developer's lease terms at a very favorable rate. The city then can pay off the IDB through the rental income flow under the ground lease, which may include provisions for additional rent percentages keyed to the success of the project.

This brief overview of both ADC and tax related assistance efforts illustrates the broad nature and flexibility of co-financing alternatives. Although each specific type of co-financing arrangement comes with its own peculiar set of legal guidelines and pitfalls, two overriding areas of legal concern exist for purposes of this Article. First, what is the scope of liability that should attach to the city when it acts in a co-financing capacity with a private developer to complete a "quasi-public/private" real estate venture? Second, what is the scope of constitutional limits on city involvement in co-financing arrangements?

At least from the standpoint of formulating the inquiry, the first issue of liability is relatively straightforward. Should a city be

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47. *See* Mandelker, *supra* note 12, at 10.

48. *Id.*

49. *See* Mandelker, *supra* note 12, at 12; Cook, *supra* note 46, at 61 (stating that a private developer taking advantage of an IDB can obtain an interest rate of between 65% and 75% of the market prime rate).

50. *See* Mandelker, *supra* note 12, at 10.

liable for its activities when those activities include acting in a proprietary and managerial capacity in the development of real estate projects?[51] Many of the co-financing techniques described in this Article reveal that the city can be involved heavily in planning, structuring, and supervising a co-financed real estate venture. It also is evident that the city often expects a monetary reward of one sort or another keyed to a project's ultimate success. This financial reward can be direct, as in lease payments under a ground lease when the city is the ground lessor, or it can be indirect, as in expected increases in real property taxes. The anticipated increase in real property taxes may be the return necessary to justify the city's co-financing efforts to local residents, or it may provide the necessary basis for meeting the debt service on a bond issue. In either event, the city, in its own way, has a financial stake in the success of its real estate projects similar to that of a private developer.

Given that the city voluntarily undertakes to compete in the primarily private activity of real estate development and that it acts in many respects like a private developer, the city ought to be held legally accountable to the same extent that any private developer would be if it were performing the co-financing functions undertaken by the city.[52] For individuals who contract with or are injured on the premises of a project co-financed by the city, the choice of available remedies or defendants should not change merely because the owner of the underlying fee interest in the project is the city rather than a private development corporation. In other words, if a city is going to be a real estate developer by taking credit for successful projects and participating in project management and profit, then the city should be a developer in the ful-

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51. *See generally* Malloy, *The Interstate Land Sales Full Disclosure Act: Its Requirements, Consequences, and Implications for Persons Participating in Real Estate Development*, 24 B.C.L. REV. 1187 (1983) [hereinafter as Malloy, *ILSFDA*]; Malloy, *Lender Liability for Negligent Real Estate Appraisals*, 1984 U. ILL. L. REV. 53 [hereinafter Malloy, *Lender Liability*]. Both of these articles consider the amount of managerial and proprietary interests that various parties, especially lenders, have in real estate development projects. To the extent that a party exercises a proprietary or managerial role in a project, a commensurate degree of liability should attach to that conduct. Just as liability should attach to lenders or a developer's agents or business partners, so too should liability attach to a city when it engages in similar activities. *See also* M. MADISON & J. DWYER, THE LAW OF REAL ESTATE FINANCING ¶ 4.04(7) (1984) (describing potential lender liability in a joint venture setting); Malloy, *Creative Financing Exposes Lenders to Developers' Liabilities*, REAL EST. REV., Sum. 1986, at 60 [hereinafter Malloy, *Creative Financing*] (providing a quick overview of the potential for lender liability).

52. *See supra* note 51.

lest sense of the word.[53] This may mean expanding the liability of cities engaged in revitalization efforts. As long as the expansion of liability merely reflects the cost of engaging in such activities, however, it should pose no major problem to city planners. After all, it would seem that good city planning requires access to good and complete information on the cost of city activities, and potential liability factors should be included in evaluating the costs and benefits of a given project.

If a city is not to be held liable as a co-developer, however, then, at least in its co-financing activities, the city ought to be subject to the same legal scrutiny applicable to a real estate lender.[54] A real estate lender can be held liable for its project lending activity.[55] The best example of such activity involves construction loan financing or permanent loan financing when the lender takes an equity kicker option as part of its loan arrangement. The equity kicker requires the developer to share project profits with the lender as an additional incentive for the loan. In this way, the lender not only gets fees and interest payments on the loan, but also shares in the rewards of a successful project. The lender in most major construction loan situations also takes an active role, much like the supervisory role of a city engaged in co-financing activities, in approving and monitoring project plans, specifications, and completion requirements. It seems only fair that a lender actively seeking to improve its potential economic return on a project by sharing in the developer's success also should be legally accountable for the same risks and liabilities that justify its earning additional developer profits.[56] The same should hold true for a city engaging in similar activities. In short, then, the eco-

53. *Id.*

54. *Id.*

55. *Id.*

56. *See generally* Malloy, *ILSFDA*, *supra* note 51 at 1228-36 (discussing the implications of expanding developer-type liability to lenders and others); Malloy, *Lender Liability*, *supra* note 51, at 67-89. This part of the article focuses on theories of liability for lenders—especially when creative financing is used. Co-financing involves a city acting like a lender in providing creative financing and thus is the hasis for asserting similar treatment with respect to liability. In each situation, the effort is to treat the private lender or city co-financier as a truly equal memher of the development team, and this requires extending a greater degree of liability to them than traditionally has heen imposed. The grounds for not imposing developer liability on lenders, for instance, traditionally have been that lenders are mere passive sources of money. Because lenders exert supervisory control over much of today's current real estate development and hecause they share in ownership or equity participation, however, they are no longer passive lenders of money—they are active developers. *Id. See also* Malloy, *Creative Financing*, *supra* note 51.

nomic freedom to engage in these types of real estate projects must be accompanied by economic responsibility that attributes liability and risk to participants as a counterbalance to potential profit rewards.

The constitutional limits to city co-financing activities have been analyzed extensively by Professor David M. Lawrence[57] and recently commented on by Professor Daniel R. Mandelker.[58] Because this Article involves the broader discussion of political economy, the treatment of these unsettled and complex constitutional issues will be brief. It is important, however, to summarize the major areas of constitutional contention in order to facilitate an understanding of the broader political, economic, and philosophical issues arising from urban revitalization. Thus, discussion of constitutional limitations will focus on issues involving a city's liability for anticompetitive practices, the public purpose doctrine relevant to public expenditures, and the "takings" questions.

In coordinating and facilitating urban revitalization, city governments often make decisions that can be viewed as anticompetitive. To the extent that a city's activities are anticompetitive, they raise a constitutional question concerning local government liability for violation of the antitrust laws.[59] These anticompetitive practices emerge as part of the redevelopment process when the city aids specific developers either in project completion or in preventing competition in the vicinity of the completed project. For instance, the city might aid a chosen developer in the completion of a project by helping to acquire property and financing for the undertaking. In this way the developer joins with the city to gain a competitive advantage in completing the proposed project. In a sense, the result is more than a mere competitive advantage, for once the developer is selected, the city simply may use its govern-

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57. *See* Lawrence, *supra* note 3.

58. *See* Mandelker, *supra* note 12.

59. *See* Freilich, Donovan & Ralls, *Antitrust Liability and Preemption of Authority*, 15 URB. LAW. 705 (1983) [hereinafter Freilich, *Antitrust Liability*]; Bosselman, *Antitrust Decisions and Questions*, URB. LAND, Oct. 1985, at 34. According to the author:

> Responding to concern by local governments about their potential liability in such cases, Congress amended the antitrust laws in 1984 to relieve local governments and their employees acting in an official capacity from damage claims. (Local Government Antitrust Act of 1984, Section 3(a)). The act only prevents the award of damages, however, and does not preclude an injunction against the local government that violated the antitrust laws.

*Id.* at 34. *See also* Callies, *Land Use Controls: Of Enterprise Zones, Takings, Plans and Growth Controls*, 14 URB. LAW. 781, 789-92 (1982) (discussing antitrust problems for municipal activities); Freilich, *supra* note 38, at 215-18.

mental monopoly power over zoning and planning to prevent all others from competing.

Preventing competition also is a component of city planning and assistance that can continue to aid a private developer after a project is completed. This result occurs when the city has planned a revitalization district and determined, for instance, that it should contain one retail shopping facility or one major hotel complex. Once the developer is chosen for the project, a competitor has no room to enter the area unless the city revises the plans. The project's economic success might justify additional entry into the market area, but the city, having co-financed the original project and having a financial stake in its continued profitability, nonetheless may continue to deny competitors entry to the revitalization area.[60] This denial may not be permanent, but easily could extend for a substantial period of time during which the city fostered other selected projects in the area before allowing competitive forces to upset the progress and direction of the overall revitalization plan.

The constitutional issue that arises from a city's co-financing activity concerns state action immunity from antitrust laws. Under this antitrust exemption, there is room for a city to engage in anticompetitive activities essential to its governmental functions. When the city engages in proprietary activities or actively supervises private development projects, however, grounds may exist for finding a violation of the antitrust laws.[61] In some situations, it also may be possible to allege a conspiracy by the city and the selected private developer if the redevelopment plan in question is exposed as a sham to cover other motives such as political favoritism.[62] This possibility raises a serious concern for city governments and city officials who potentially could confront antitrust liability. It appears, however, that most city plans that exercise a minor degree of caution in assisting private developers will be upheld under current law as not violating the antitrust laws because a city has a recognized, legitimate interest in its economic welfare.[63]

A second constitutional issue for cities engaged in co-financing activities concerns the use of public funds and the application of the public purpose doctrine. Applying the public purpose doctrine

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60. If the success of the project would justify competitors' entry, then any efforts to prevent entry will provide the city and its selected co-developer with monopoly profits.

61. *See* Freilich, *Antitrust Liability, supra* note 59, at 718-24.

62. *Id.*

63. *Id.*

to public spending is similar to applying the public use doctrine in eminent domain proceedings.[64] That is to say, when public funds are used by the city, they must be used for a public purpose.[65] When a city expends funds directly or indirectly uses its credit to support a bond issue benefiting a private developer, the public purpose doctrine is called into question.[66] In both its direct and indirect forms, co-financing can involve the use of public funds to assist a private developer in completing and profiting from a project. As a result, challenges to the constitutionality of these practices have been raised.[67] For the most part, however, courts have found that revitalization and urban redevelopment do serve a public purpose, even when a city has decided that its ultimate goals best can be achieved by delegating much of the redevelopment effort to private parties.[68] Thus, even though public purpose remains an issue of constitutional debate, it has been fairly well decided in favor of city participation in co-financing activities.

The third constitutional issue associated with co-financing activities concerns the "takings" question, or the power of eminent domain. The exercise of the power of eminent domain raises questions concerning public use and, in that sense, is similar to the public purpose doctrine.[69] Eminent domain actions, also known as

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64. *See* Mandelker, *supra* note 12, at 10-11; Note, *supra* note 46, at 969-71; Case Comment, *supra* note 46.

65. *See supra* note 64.

66. *Id.*

67. *See* Mandelker, *supra* note 12, at 10-12. "Practically all of the cases have held that IDBs serve a proper public purpose when they are used for industrial development . . . . The use of IDBs for downtown commercial development has received less attention from the courts." *Id.* at 11. The author discusses some recent cases, including Urbana v. Paley, 68 Ill. 2d 62, 368 N.E.2d 915 (1977), and concludes that most downtown commercial development will be permitted under the public use doctrine even when a particular project is not part of an overall redevelopment scheme. Mandelker, *supra* note 12, at 11-12. *See also* ULI, *Public/Private Financing Arrangement for Hotel Survives Court Challenge*, 18 LAND USE DIG. 1 (1985) (citing Lartnec v. Fort Wayne-Allen Co., 603 F. Supp. 1210 (N.D. Ind. 1985)). The article reports that the federal district court upheld the use of development bond money and subsidies to aid a selected developer even when competitors challenged the subsidies.

68. *See* Mandelker, *supra* note 12, at 11-12; *see also* Lawrence, *supra* note 3, at 302-10.

69. *See* Lawrence, *supra* note 3, at 279-300 (discussing the use of eminent domain powers in property transactions to encourage urban revitalization); Mandelker, *supra* note 12, at 4-10 (describing problems arising when the power of eminent domain is used to assist private developers); D. HAGMAN, URBAN PLANNING AND LAND DEVELOPMENT CONTROL LAW 310-43 (1975) (providing good background on the topic of eminent domain); *see generally* R. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMIMENT DOMAIN (1985). In this book, Epstein applies a Chicago School approach—an economic analysis of law—to takings. His analysis centers on the assertion that the basic way to approach public takings is to analyze the situation in the context of a private action between two or more individuals.

condemnation proceedings, can be used to effect an urban revitalization program.[70] Basically, the various co-financing techniques discussed in this Article lend themselves to the application of condemnation powers to assemble sufficient and specifically located land parcels for a planned real estate project.

A city can use its condemnation powers to acquire private property for a planned real estate project and can do so in a way unavailable to the private developer acting alone. Through the power of condemnation, the city can avoid both the "hold out" seller and the "blackmail" price setter problems. The stereotypical hold out seller is the elderly person who refuses to sell her home because she has lived there all her life and does not want to move. The typical blackmail price setter is merely a speculator who wants to sell his property as the last parcel necessary to complete the real estate puzzle. By selling last, this blackmail seller seeks a purchase price that not only covers the value of the property, but includes a premium for its being the last necessary parcel to complete the property assembly. The blackmail price, therefore, is an attempt to take advantage of the buyer's prior costs in acquiring the other parcels. The blackmail price thus would not reflect the value of the parcel itself, but rather would reflect the parcel's value to the planned project.

In an urban setting, with many small lots and multiple owners of easements, there is likely to be a great risk of confronting either the hold out or the blackmail seller when undertaking a major real estate project. The private developer may not be able to convince all hold out sellers to change their minds. As to blackmail sellers, the developer either will have to pay higher prices as a cost of do-

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The state, according to Epstein, should he treated like a private citizen with the exception of a few very limited circumstances when there is true justification for the state to act without having to provide compensation. Epstein provides an interesting analysis of government and of the constitutional framework that supports our system of private property. In condemning most of the current "New Deal" and welfare programs as unlawful takings, he asserts that government has exceeded its intended limits as outlined in the Constitution. His analysis, however, while thought provoking and useful, provides no real guidelines for the moral imperatives confronting the concepts of inalienable rights, individual human liberty and diguity, and their interrelationships to private property rights. *See also*, Burch, Bozung, Miller & Hill, *Land Use Controls: Public Use and Private Beneficiaries*, 16 URB. LAW. 713 (1984); Callies, *supra* note 59, at 792-96 (discussing takings); Malone, *The Future of Transferable Development Rights In The Supreme Court*, 73 KY. L.J. 759 (1985) (discussing partial takings and the concept of transferable development rights).

70. *See* Lawrence, *supra* note 3, at 279-300; Mandelker, *supra* note 12, at 4-10; *see also* D. HAGMAN, *supra* note 69, at 400-10 (describing eminent domain as applied to urban renewal programs).

ing business or expend resources to hide the assembly process and to keep full information away from necessary sellers. All these considerations add to the cost and risk of completing a major downtown real estate project, but, to a certain extent, this cost can be reduced or subsidized by transferring it to the city.

The city can use its condemnation powers to acquire the private property of the potential hold out or blackmail seller. In addition, the city can acquire the property at a price that reflects the fair market value of the parcel itself, rather than at an inflated blackmail price. After acquiring the property from the private owners, the city can transfer it to a selected developer for the purpose of completing the desired project. This process of using the government's condemnation power to effect a taking of private property for transfer to another private party raises constitutional issues.[71] After detailed analysis, Professor Lawrence concludes that such activity is permissible under certain conditions.[72] For instance, the government permissibly may use its eminent domain power in an effort to bring urban renewal to a slum area or to assist downtown development that itself is viewed as a public use.[73] The government, however, may not use its condemnation power merely to assist the increased development of underdeveloped urban property that is not a slum area in the absence of a finding that the increased development in itself is a public use.[74]

The determination that increased downtown development is in itself a public use potentially can be problematic, but Professor Lawrence offers justifications that indicate that most revitalization projects would pass this test of constitutionality.[75] For instance, one public use justification is that downtown development can add to the city's tax base in a way that allows higher density use of the existing infrastructure, such as roads and utilities, rather than requiring the extension of services to outlying areas.[76] Second, many jobs created by downtown development projects will involve unskilled hotel, restaurant, or retail work, and many of the city's unskilled and unemployed live in or near the downtown area.[77] Thus, by encouraging downtown development, the city is promoting job

71. *See supra* note 69.
72. *See* Lawrence, *supra* note 3, at 320.
73. *Id.*
74. *Id.*
75. *Id.* at 293-300.
76. *Id.* at 295.
77. *Id.*

opportunities for those people living in the project area. Third, downtown development enhances the city's self-image and can foster cultural activities and specialized business opportunities generally not found in a nonurban setting.[78] Because these justifications are rather broadly based and easily asserted, it would seem permissible to use the government's condemnation power to assist private developers in most revitalization efforts.

As this discussion reveals, most types of co-financing activities involve several constitutional issues. These issues have evoked writing and discussion by legal scholars.[79] Once these issues are viewed for their practical effect, however, it becomes evident that they do not prohibit co-financing arrangements.[80] They establish guidelines and criteria for "proper" justifications for certain co-financing activities, but provide no real impediment to the activities' continued use. The current status of these constitutional guidelines, therefore, will be challenged in the recommendations section of this Article.

Having described the nature of co-financing activities and discussed some of the major legal issues associated with these activities, it is useful now to consider how one city has used a number of these techniques to foster its own "renaissance." This Article uses Indianapolis as an example. Although other cities, such as New York,[81] Philadelphia,[82] Washington,[83] Charleston, West Virginia,[84]

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78. *Id.* at 296.

79. *See, e.g., supra* note 69.

80. *See, e.g.,* Rosenthal v. New York State Urban Dev. Corp., 605 F. Supp. 612 (S.D.N.Y), *aff'd,* 771 F.2d 44 (2d Cir. 1985), *cert. denied,* 106 S.Ct. 1204 (1986); Lartnec Investment Co. v. Fort Wayne-Allen Co., 603 F. Supp. 1210 (N.D. Ind. 1985). Both of these cases illustrate the extent to which local governments can exercise political power without infringing on constitutional protections. Regarding both a takings situation and a question of public purpose financing, these cases hold that the city is free to act as long as it states a public reason for the action. In *Rosenthal* the court implies that even if the main focus of a redevelopment project is political, including the awarding of business and profit to friends of local politicians, the project still is permissible as long as the local politicians also have set out or asserted a public goal. 605 F. Supp. at 618.

81. *See, e.g., Rosenthal,* 605 F. Supp. at 612. This case involved a challenge to New York City's effort to revitalize Time Square. The co-financing project involves construction of several new high-rise structures at Time Square. In return for public assistance for the project, the private developer is constructing and operating the new buildings and will contribute money to the renovation of broadway theaters. The purpose of the revitalization efforts is to eliminate urban hlight in the area. The court said that the legislative process established this goal and set out the plans to achieve it. The co-financing activity therefore is not impermissible even if politicians also have as a motive the desire to make money for private developers. *Id.* at 618-19.

82. *See* Algatt & Lenney, *One Reading Center, Philadelphia, Playing the High-Risk Development Game,* URB. LAND, Jan. 1985, at 8. Philadelphia used almost $20 million in

Minneapolis,[85] and Louisville,[86] also have used co-financing techniques, Indianapolis was chosen because of the availability of information. Indianapolis also is a good illustrative city because the activities in the city have been broadly based and have involved major long-term development on a scale significant enough, considering the size of the city, to have a major impact on the urban center. Although these redevelopment projects, in actual size and number, might have only a minimal impact in New York City, they have a decidedly significant impact in a city like Indianapolis.

Indianapolis is a city of approximately 1,200,000 people located in central Indiana.[87] The city comprises eighty-four percent of Marion County's population, and the city and county share a primarily merged governmental structure.[88] As in most midwestern cities, manufacturing industries traditionally have played a major role in the Indianapolis economy.[89] In the 1970s and 1980s Indianapolis experienced a serious decline in its commercial and industrial base.[90] The experience in Indianapolis was similar to that of many other cities in the Nation's "Rustbelt."[91] Between 1970 and 1980, Indianapolis lost about 45,000 residents, and from 1979 to

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Urban Development Action Grant money to build transportation support services to aid in an office building project. *Id.* at 9.

83. *See* Sedway Cooke Associates, *Joint Development*, URB. LAND, July 1984, at 16. Wasbington, D.C. used public resources to provide transit facilities as support for private development. The article includes similar examples for Los Angeles. *Id.* at 19.

84. *See* Rutner, *Charleston Town Center—An Urban Development Centerpiece in Charleston, West Virginia*, URB. LAND, June 1985, at 16. In supporting a private mall, Charleston used $14 million in Urban Development Action Grant money along with other incentives. *Id.* at 17.

85. *See* Schwanke, *Riverplace, Minneapolis: Mixed Use with a Good Splash of Housing*, URB. LAND, Nov. 1985, at 2. Public support for the $111 million project included $18 million through TIF used for land acquisition, demolition, construction, and street improvements; a $19 million bond; two mortgage revenue bond offerings totaling $55 million; and a general revenue bond of $6.7 million. *Id.* at 4-5.

86. *See* Levitt, *Louisville, Kentucky—A Commitment to Development*, URB. LAND, June 1985, at 2. Louisville is promoting many redevelopment projects, several examples of which are cited in the article. One example is the Louisville Galleria project, which had a total project cost of $142.5 million, of which city, state, and federal assistance accounted for $22.5 million. *Id.* at 3.

87. *See* Forstall & Starsinic, *The Largest U.S. Metropolitan Areas*, URB. LAND, Sept. 1984, at 32-33 (relying on 1982 figures derived from the Population Division, U.S. Bureau of the Census).

88. *See* Bamberger & Parham, *Leveraging Amenity Infrastructure—Indianapolis's Economic Development Strategy*, URB. LAND, Nov. 1984, at 12, 14.

89. *Id.* at 13-14.

90. *Id.*

91. *Id.* at 13.

1982, Marion County lost 35,000 jobs in the private sector.[92] Despite this decline, Indianapolis actively pursued continued downtown investment and a redevelopment strategy based on construction of amenity infrastructure and sports facilities.[93] As a result, since 1974 approximately one billion dollars has been invested in sports facilities and related downtown projects.[94] The downtown business district alone has some forty office, retail, hotel, and housing projects planned or completed in the last ten years.[95] All this revitalization activity shares one principal common denominator—the city's willingness to engage in and foster co-financing arrangements.[96] As a result, Indianapolis presents an opportunity to examine co-financing in practice. In later parts of this Article, it also will serve as an example of the political, economic, and philosophical questions that co-financing activities raise.

Through co-financing arrangements, the city of Indianapolis has become developer, equity partner, or landlord for a number of major downtown projects.[97] Its redevelopment ventures have put millions of dollars in taxpayer money at risk in real estate projects.[98] These projects, while intended to revitalize the city, are not charitable ventures, but rather investments in potentially profit-making activities.[99] The success and profit of these projects were not assured, and, in fact, most either have been marginally profitable or have provided no pay-out to the city in their first

92. *Id.* In addition, 4,000 more jobs were lost in 1983 by the closing of a Western Electric facility. *Id.* at 17.

93. *Id.* at 12-18.

94. *Id.* at 13.

95. *Id.* at 16.

96. *Id.* at 12-18. *See generally*, Goodman & Nutting, *A Tale of Four Cities: Investment Activity in "Dying Downtowns,"* URB. LAND, March 1985, at 32, 33. Support for real estate development projects is illustrated by the way Indianapolis spends its allocations of Community Development Block Grant Funds (CDBG). In 1985 Indianapolis spent about 50% of its CBDG funds on real estate development while the national average for other cities was only 11%, the remaining money being used for direct assistance to low and moderate income residents in accordance with the CBDG program's original objective. Johnston, *Housing Funds Go Elsewhere*, Indianapolis News, Nov. 17, 1986, at 25, col. 1.

97. *See* Swiatek, *Tax Dollars are Working Hard in City Real Estate Developments*, Indianapolis Star, Sept. 1, 1985, at I1-I2, col. 2; Bamberger & Parham, *supra* note 88, at 12-18.

98. *See supra* note 97.

99. The cbart that follows summarizes some of the co-financing activity in Indianapolis.

years of operation.[100] Only after a period of initial operations is the city expected to see any major returns on its investment. Any anticipated returns, of course, are subject to the risks of the general real estate market and to the marketing and management risks for each individual project.

Indianapolis' co-financing activities reveal more than a willingness to take risks with public funds; they reveal that these activities can be highly advantageous to select developers. A single developer, for example, is an owner of three major revitalization projects in Indianapolis.[101] This developer also is behind the city plan for 200 million dollars worth of construction for a downtown shopping mall that would comprise 1.9 million square feet of new and existing office space and would cover a two and one-half block

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| Project | City Role | Terms of Contract | City Income |
|---|---|---|---|
| Indiana Theater | fee owner and lender of $1.5 million for renovation | 6% interest for 35 years | 50% of profits from theater, plus annual rent of $30,000 and 4% of net income from the theater restaurant |
| Merchants Plaza (offices and the Hyatt Regency Hotel) | city floated $4.5 million in bonds to buy and prepare land, which it owns and leases | 60 year ground lease | $360,000 annual rent and 5-7% of gross revenue over $10 million |
| One North Capital (office building) | lender of $3.2 million for construction | 6% interest for 35 years | 50% of profits |
| Two West Washington (offices and shops) | lender of $1.2 million for renovation | 6% interest for 35 years | 50% of profits |
| Embassy Suites (Hotel and shops) | lender of $6 million for construction | interest free for 30 years | $200,000 annually and 25% of net cash flow |
| Union Station (Hotel and retail center) | fee owner and lender of $4 million for renovation | 6% for 25 years plus rent | annual rent of $200,000 to $290,000 and 50% of net cash flow |

*See* Swiatek, *supra* note 97.

100. *See, e.g., id.*. For example, the One North Capitol project was unprofitable in its first full year of operation, so the city received no income. Two West Washington has been unprofitable for the past two years and is not expected to show a profit until at least 1988. *Id.*

101. These projects are One North Capitol, Two West Washington, and Embassy Suites. *See supra* note 99.

area.[102]

The city is joining forces with this developer to assist in the downtown mall project. Its assistance includes an initial outlay of 4.5 million dollars to purchase property and to do preliminary construction work to enhance the project site.[103] The city also will purchase the necessary property for the mall from current owners or, in the alternative, use its power of eminent domain.[104] Additionally, the city plans to seek federal grant money for the redevelopment project and to provide a package of state and local tax incentives.[105] As a result, the developer will be able to construct a major downtown mall and earn substantial profits. Its profits will be enhanced by its ability to use substantial public resources to leverage its investment. For example, with city co-financing the developer will be able to share in the profits of a 200 million dollar mall. Even though the developer will share profits with the city, it stands to reap substantially more profit and prestige from a 200 million dollar mall than from being the sole proprietor of a much smaller mall. In addition, the city's co-financing position will enhance the ultimate chances of the project's success because the city will have an incentive to promote the mall by providing free advertising and good will for the developer. In addition to the projects outlined, Indianapolis has used a wide variety of co-financing techniques, including tax increment financing,[106] tax abatement,[107] and

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102. *See* Wildey & Schneider, *Will Downtown Shopping Mall Help Indianapolis?*, Indianapolis Star, Oct. 21, 1985, at C1, col. 1; *see also* Schneider & Wildey, *Circle Centre—Mall Plan Unveiling Slated for Tuesday*, Indianapolis Star, Oct. 20, 1985, at F1, col. 1.

103. *See* Schneider & Wildey, *Mall Project Seen as Magnet to New Business*, Indianapolis Star, Oct. 22, 1985, at C1, col. 1.

104. *Id.*

105. *Id.* at C8. Indianapolis hopes to get $15 million to $20 million in federal money for the project. The city also will arrange a package of tax ahatement and TIF to assist in the development of the mall. *Id. See also* Schneider, *Delays May Benefit Proposed Circle Centre Mall*, Indianapolis Star, July 20, 1986, at B5, col. 1. In addition to seeking federal grant money, the city hopes to subsidize the project by making 8% to 8.5% mortgage financing available. *Id. See also* Schneider, *Federal Loan Sought to Buy Ten Buildings for Downtown Mall*, Indianapolis Star, Dec. 8, 1985, at A1, col. 4 (discussing city efforts to raise $9.5 million to buy property needed to assemble the land for the mall).

106. *See* Schneider, *City Builds Its Development Plans on Tax Financing*, Indianapolis Star, June 1, 1986, at C3, col. 1; Schneider, *Moldthan Warns About Tax Increment Bonds*, Indianapolis Star, June 19, 1986, at C5, col. 3; Newland & Petrosky, *Hudnut Proposes New Plan for Downtown Construction*, Indianapolis Star, Oct. 10, 1985, at C7, col. 1. The city plans to borrow $23 million to finance projects related to hosting the 1987 Pan Am Games. The bulk of the money will come from TIF. *Id. See also* INDIANA CONTINUING LEGAL EDUCATION FORUM, REAL ESTATE DEVELOPMENT AND HOUSING LAW IV-6 (1986). Indiana also has adopted enterprise zones. Two significant features of the enterprise zone are the Indiana tax credit of up to $1,500 for each resident of an enterprise zone for whom a job is created

the full range of ADC assistance,[108] in its redevelopment efforts. As a part of its co-financing technique, the city has succeeded in incorporating federal and state assistance programs into its own redevelopment efforts.[109]

Indianapolis' best example of the incorporation of nonlocal monies into a co-financed project is Union Station, which opened to the public at the end of April 1986.[110] The Union Station project involved the sixty-five million dollar renovation of the old downtown train station that originally had been completed in 1888.[111] In 1986 the station reopened as a hotel and retail complex with more than 100 restaurants and stores and a 276-room Holiday Inn.[112] The project, which opened amidst much fanfare, including live television promotions on NBC's Today Show, brought praise to local city officials and to the primary private developer.[113] The project required the city, as owner of Union Station, to lend four million dollars to the private developer at below market interest rates.[114] In addition, the financial viability of the project turned on the availability of federal assistance. The project consumed 16.5 mil-

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and a credit, equal to five percent of the interest paid, against Indiana tax available to lenders making loans within an enterprise zone.

107. *See* Miley & Scbneider, *Is Tax Abatement Worth The Gamble?,* Indianapolis Star, Feb. 2, 1986, at B8, col. 1. (identifying major projects that have benefited from substantial tax abatements ranging into many millions of dollars).

108. *See* Swiatek, *supra* note 97; Bamberger & Parham, *supra* note 88. Co-financing arrangements have been used to develop and promote such projects as Market Square Arena (basketball), the Hoosierdome (football), and a world class olympic natatorium. Progress also is underway in building a downtown park and zoo at White River State Park. *Id.* *See also* Swiatek, *"Plot" Will "Thicken" When Work Begins On Lower Canal Project,* Indianapolis Star, Feb. 2, 1986, at I1, col. 2 (noting $7 million in federal funds obtained to begin work on a riverwalk similar to tbat in San Antonio, Texas).

109. Among the projects illustrated in the chart, *supra* note 99, for instance, all but Merchant's Plaza involved the use of $12.5 million in Federal Urban Development Action Grant money. *See* Swiatek, *supra* note 97, at I2.

110. *See* Stall, *State of the Union,* INDIANAPOLIS MONTHLY, April 1986, at 60-76. The station's grand opening was April 26, 1986. *Id.* at 60.

111. *Id.* In its prime the train station had served 200 trains a day. *Id.*

112. *Id.*

113. *See id.* at 60-76; Schneider, *Station Reopening To Be Major Gala,* Indianapolis Star, Feb. 16, 1986, at A1, col. 1; *Union Station,* Indianapolis Star, April 20, 1986, at K1-K16 (special section). The *Star* devoted a sixteen page special section of the Sunday paper to promoting the grand opening of Union Station on the following Saturday. The Today Sbow broadcast on NBC was one day before the grand opening. The local praise for the developer included a rags to riches story of a son of immigrant parents whose first entrepreneurial venture was a lawn-watering business. *See* Stall, *supra* note 110, at 74-75. The local hero, of course, stands to make a considerable profit from a venture that is substantially subsidized and promoted at the public's expense.

114. *See* chart, *supra* note 99.

lion dollars in federal money, of which twelve million dollars was a grant for mass transit, even though Union Station in its present form has very little to do with mass transit.[115] Additional federal assistance was provided in the form of a twenty-five percent historic preservation tax credit that allowed developers to recoup one out of every four dollars they put into the project.[116]

As these examples reveal, a city can use a variety of co-financing activities to encourage desired real estate development. These projects require risk taking, but cities rely on their potential success to generate an increased tax base and provide revenue for repayment of loans and revenue bonds. Indianapolis is just one city that has experimented with co-financing arrangements, but it provides a good example of the types of projects and arrangements that actually are used. Now, having described the nature of co-financing activities and having reviewed examples of their use in Indianapolis, this Article will assess the political, economic, and philosophical implications of these activities.

## III. The Politics and Economics of Co-Financing

Understanding the societal implications of co-financing arrangements requires more than describing and analyzing the nature of co-financing techniques. All too often the political and economic dynamics of the programs are ignored. This part of the Article will focus on some of the political and economic implications and underpinnings that support urban co-financing activities. The discussion first will consider the use of political means as an alternative to economic means in allocating scarce development resources. Second, "liberal New Deal" programs for redevelopment will be analyzed relative to the current trends of "conservative New Federalism." Finally, this part will assess whether or not the political and economic dynamics of co-financing truly facilitate the emergence of the prosperous urban environment necessary for

115. *See* Stall, *supra* note 110, at 74. Congressman Andy Jacobs was a vocal opponent of the Union Station renovation, and he was upset with the use of Federal Mass Transit Funds. He stated: "That money was meant for buses, not boutiques . . . . [A]t a time when student loans are cut and we are running up these God-awful deficits, I don't see the logic." *Id.* Of course, Jacobs eventually did see the logic and was responsible for assuring the continuation of a federal tax credit for the developers that was scheduled to be eliminated when the project still had $5 million in work left and the remaining tax credit was worth only $1.25 million. *Id.* at 74-75.

116. *Id.*

fueling long-term economic growth, job creation, and capital formation.

Allocation of resources in a society can occur either by economic or by political means.[117] In either case, the primary objective is to allocate a limited supply of resources between competing uses. The economic means for accomplishing this allocation is based on the operation of a marketplace of exchange. Although the marketplace of exchange can be a barter system, it typically is understood as a market in which price and currency act as the medium of exchange in order to facilitate transactions between numerous strangers offering a wide variety of goods and services in exchange for an equally wide variety of return goods and services. Thus, in this market people continually are interacting as both buyers and sellers; each buyer is at some point a seller and each seller is at some point a buyer. The price mechanism provides participants in the market with a ready source of information on the cost of certain actions relative to possible alternatives. Furthermore, in allocating the use of resources in the system, the market allows the buyer or buyers willing and able to pay the highest price to obtain the resources. Thus, resources are put to their most valued use.[118]

The political means, on the other hand, typically is a method of allocation employed when market allocation is thought to be undesirable. Exercise of the political means occurs through the power

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117. *See* A. NOCK, OUR ENEMY, THE STATE (2d ed. 1983). This book first appeared in 1935. It represents a classic challenge to the role of the state. For Nock the state is a vehicle for class exploitation rather than a means for organizing society within certain limits that protect individual liberty. By contrast, Nock refers to the limited entity that protects individual liberty as government. Nock argues:

> [T]here are two methods, or means, and only two, whereby man's needs and desires can be satisfied. One is the production and exchange of wealth; this is the *economic means.* The other is the uncompensated appropriation of wealth produced by others; this is the *political means.* The State, then, whether primitive, feudal or merchant, is *the organization of the political means.* Now since man tends always to satisfy his needs and desires with the least possible exertion, he will employ the political means whenever he can - exclusively, if possible; otherwise, in association with the economic means. He will, at the present time, that is, have recourse to the state's modern apparatus of exploitation; the apparatus of tariffs, concessions, rent-monopoly, and the like.

*Id.* at 46-47.

118. It is a basic assumption of economics that market allocations, by definition, are efficient and result in resources being put to their most valued use. Two excellent texts on basic economics are A. ALCHIAN & W. ALLEN, EXCHANGE & PRODUCTION—COMPETITION, COORDINATION, & CONTROL (1983), and R. LIPSEY & P. STEINER, ECONOMICS (4th ed. 1975). For a text on economic analysis applied to law and the notion of the marketplace and efficiency, see R. POSNER, ECONOMIC ANALYSIS OF LAW (3rd ed. 1986). Chapters 1 and 2 of Posner's work provide background on economic assumptions, and the remainder of the book applies an amoral and simplistic economic method to a variety of legal issues.

of government.[119] Having been entrusted with a monopoly on coercive power, government can direct resources to politically desired uses and, consequently, away from market allocations of resource use.[120] The government can do this by virtue of its taxing power, police power, and other powers that give it the ability to enforce redistribution of resources in a way not possible in the competitive marketplace. In this way, the political means can allocate resources not according to the highest bidder in the marketplace, but rather according to the most influential participants in the political process.

The political process in a democracy is a process of coordinating the desires and objectives of special interest groups within the society.[121] The incentives of the legislative process reward legislators who use the political means to favor highly motivated special interest groups at the expense of fragmented, diverse, and possibly unknown interests.[122] For example, legislated rent controls provide

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119. *See* A. NOCK, *supra* note 117, at 46-48.

120. *See* F. HAYEK, THE CONSTITUTION OF LIBERTY 20-21 (1960). Hayek discusses the evil of coercion and the conflict between coercion and individual liberty.

> Coercion, however, cannot be altogether avoided because the only way to prevent it is by the threat of coercion. Free society has met this problem by conferring the monopoly of coercion on the state and by attempting to limit this power of the state to instances where it is required to prevent coercion by private persons.The coercion which a government must still use for this end is reduced to a minimum and made as innocuous as possible by restraining it through known general rules, so that in most instances the individual need never be coerced unless he has placed himself in a position where he knows he will be coerced.

*Id.* at 21. *See also* L. VON MISES, HUMAN ACTION 280-81 (1966) (arguing tbat liberty is best preserved within society by putting coercive power in the hands of government and then restricting government by the rule of law); F. HAYEK, THE ROAD TO SERFDOM 72-87 (1944) (discussing the nature of general rules and the protection of individual liberty); F. HAYEK, LAW, LEGISLATION, AND LIBERTY, RULES AND ORDER - Vol.1 (1973).

> The thesis of this book is tbat a condition of liberty in which all are allowed to use their knowledge for their purposes, restrained only by rules of just conduct of universal application, is likely to produce for them the best conditions for achieving their aims; and that sucb a system is likely to be achieved and maintained only if all authority, including tbat of the majority of people, is limited in the exercise of coercive power by general principles to which tbe community has committed itself.

*Id.* at 55.

121. *See* A. NOCK, *supra* note 117, at 36-48; F. HAYEK, LAW, LEGISLATION, AND LIBERTY, *supra* nota 17. In this three volume work Hayek not only argues that the democratic process is a way of coordinating the desires and objectives of special interest groups, but he goes on to argue that, as such, democracy inevitably leads to socialism, statism, and the loss of individual liberty. *See also* M. FRIEDMAN & R. FRIEDMAN, TYRANNY OF THE STATUS QUO (1984). This book condemns the Reagan administration for continuing to use government as a political means to aid special interests despite Reagan's rhetoric to the contrary.

122. *See* F. HAYEK, LAW, LEGISLATION AND LIBERTY, *supra* noto 17; *see also* R. POSNER, *supra* note 118, at 491-507.

immediate and identifiable benefits to a known constituency. Current tenants have an intense, unifying interest in obtaining favorable rent controls, and once those controls are passed into law, the tenants become obvious recipients of any alleged benefits from controls. The full benefits of a rent control program go to only a small percentage of the population, whereas the costs of such a program are spread out at minimal levels to numerous people.[123] Not only are the costs spread out over a much larger group of people than those who receive the benefits, but many of the costs may be hidden to the casual observer. For instance, what legislative impact can potential future tenants have when they are deprived of rental housing because landlords find rental housing to be an undesirable investment under rent control?[124] The nameless future tenants affected by market divestment and a resulting shortage of housing are no match in the legislative process for the well-defined and motivated special interest group.

The rental housing situation under rent controls is no different from the effects of special interest legislation protecting a particular industry or labor union. For example, consider protective tariff legislation designed to protect the steel industry by reducing foreign imports.[125] This legislation is said to be needed to prevent "unfair competition," which is another way of saying it is needed to reduce competition and competitive pressure on American steel companies.[126] In this situation, the steel workers and the steel companies have a strong and somewhat unified interest in protecting their industry, which translates into protecting their jobs and their income. A protective tariff for the steel industry, however, means that United States steel purchasers will have to pay more for the steel they use, and all products using the higher priced steel will have an accordingly higher price to the ultimate consumer. In addition, to the extent that less of the cheaper, foreign steel is imported, the steel importing business will lose jobs.

123. *See* Hoeflich & Malloy, *The Shattered Dream of American Housing Policy - The Need for Reform*, 26 B.C.L. Rev. 655, 663-70, 681-83 (1985) (discussing rent regulations and their implications); H. Hazlitt, Economics in One Lesson 127-33 (1979) (discussing rent controls). This same problem occurs in class action lawsuits when numerous individuals with a small amount at stake are more difficult to organize than a single plaintiff with a great deal at stake. *See, e.g.*, R. Posner, *supra* note 118, at 534-40 (discussing class actions).

124. *See* Hoeflich & Malloy, *supra* note 123, at 655, 663-70, 681-83.

125. *See generally* M. Friedman, Bright Promises, Dismal Performance 359-72 (W. Allen ed. 1983) (discussing trade, protectionism, and embargoes); H. Hazlitt, *supra* note 123, at 74-84 (discussing how tariffs work and their short-term and long-term effects).

126. *See generally supra* note 125.

From the perspective of the legislative process, the problem is that the special interest group has a strong motive for invoking government intervention, while the diverse consumers, who may pay only pennies more for small consumer products using steel, will have little reason to be aroused. In the language of the now famous Coase Theorem, the consumer will have transaction costs that far exceed his own benefits from opposing the special interest legislation.[127] In addition, the legislative process cannot even identify workers who would have gotten jobs in an expanding steel importing business. In this manner, the legislative process provides a mechanism for using government power to benefit special interests at the expense of the general welfare.[128]

Applying this analysis to government participation in co-financing arrangements leads to a similar conclusion. Under current practices for facilitating urban revitalization through co-financing activities, special interest groups are using the political means to reallocate resources to their own uses.[129] This results in a

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127. *See* Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); *see also* A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 11-14 (1983) (providing a simple example of the Coase Theorem as applied to air pollution problems).

128. *See* A. NOCK, *supra* note 117, at 36-48; *see generally* F. HAYEK, LAW, LEGISLATION AND LIBERTY, *supra* note 17; H. HAZLITT, *supra* note 123.

129. *See* DOWNTOWN DEVELOPMENT RESEARCH COMMITTEE & INDIANA CHRISTIAN LEADERSHIP CONFERENCE, INDIANAPOLIS: DOWNTOWN DEVELOPMENT FOR WHOM? (1980) [hereinafter INDIANAPOLIS: DOWNTOWN DEVELOPMENT FOR WHOM?]. This book challenges the wisdom of current approaches to redevelopment in Indianapolis. The book argues that both the poor and minorities have suffered disproportionately from the results—such as neighborhood relocation and a lack of basic services—allowing the rich and powerful to benefit from public assistance. The book discusses numerous newspaper articles, and the authors link political contributions to obtaining favorable governmental support for desired real estate projects. One chapter entitled "Six Downtown Projects and How They Profit the Rich" discusses the relationship between the local rich and their exercise of the political means for their own benefit. *Id.* at 9-21. *See also* Bailey & Johnson, *Uncommon Favors—Political Clout Steers Much Government Aid to Trendy Apartments*, Wall St. J. August 25, 1986, at 1, col. 1. This article details the use of political clout, especially as exercised by Representative Dan Rostenkowski, in order to provide public funds and support for a massive new housing project in downtown Chicago. The project, known as Presidential Towers, displaced a number of local poor in order to make room for the biggest housing development every built all at once in the United States. The project consists of 2,346 apartments. Prime renters are young professionals with an average income of $41,700. The project features many upscale amenities such as bars, restaurants, a health club, a gourmet grocery, and round-the-clock guards. In addition to $67 million in government funds, the project benefited from Rostenkowski's efforts in Congress, which resulted in Chicago getting aid long before its appointed turn in a special lottery and in the entire project being exempted from the federal requirement that twenty percent of the units be set aside for low-income tenants. In contrast to the profits being made by friends and associates of Congressman Rostenkowski, the article depicts Chicago's lack of ability to meet the needs of its poor. Presidential Towers has become a "Yuppie" dream while Chicago is unable to maintain heat, water, and elevator service at many of

distortion of market allocations because allocations are made on the basis of pure political power rather than according to competitive criteria.

In the urban revitalization market, special interests employ the political means to aid current, established urban centers at the expense of suburban areas, emerging cities, and urban areas with less political clout. The political means, of course, involve co-financing, and as previously described in this Article, co-financing involves the use of public funds and resources in promoting specific, politically approved projects in designated locations. Cities such as Indianapolis, for instance, are able to encourage real estate development in their downtown centers by subsidizing the cost of projects. These subsidies reduce the cost of investing in Indianapolis relative to investing in an unsubsidized area or project. In this respect, public resources, which essentially are private resources captured by the government for its own use or allocation,[130] are used to assist one special interest group—the city of Indianapolis and its key constituents—at the expense of other, more diverse, and less visible interests. Significant in this public subsidy arrangement is that many of the funds and resources used to subsidize the Indianapolis incentives are provided not by the people of Indianapolis, who are most likely to benefit from the real estate development, but rather by diverse sources throughout the state of Indiana and across the United States.[131]

First, consider the various ways in which the federal government can subsidize local development for a selected city and project. The federal government, for example, can provide a city or project with grants through the Urban Development Action Grant (UDAG) program or with other direct subsidies through revenue sharing.[132] Funds necessary to support these grants and revenue sharing programs come from the general tax revenues or from printing additional money, which simply adds to the money supply and the national debt.[133] The tax-based funding method allows

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its low-income housing projects. Likewise, as the supply of upscale housing increases with projects like Presidential Towers, the supply of low income shelter is shrinking.

130. *See* H. Hazlitt, *supra* note 123, at 36; Indianapolis: Downtown Development for Whom?, *supra* note 129.

131. *See supra* text accompanying notes 21-50, 87-116 (discussing various types of co-financing arrangements and setting out the Indianapolis example).

132. *See supra* text accompanying notes 25-26 (discussing government grant programs).

133. *See* M. Friedman & R. Friedman, Free to Choose 253-70 (1980). In addition to raising taxes or printing money, the government also can enter the financial markets to

revenues raised from the entire national populace to be redirected to benefit the redevelopment efforts of any given locality, such as downtown Indianapolis. Likewise, tax-based funding can be accomplished indirectly by providing federal tax incentives for specific types of redevelopment, such as that occurring in enterprise zones, or by providing a twenty-five percent tax credit for historic preservation, as in the Indianapolis Union Station project.[134] By using the indirect tax-based funding approach, the federal government forgoes collecting tax dollars from certain special interest projects. This creates a financial incentive for that type of project, but means the federal government must raise required revenue from other taxpayers in order to make up for the incentives it provides the special interest group. The net result is that numerous taxpayers with diverse interests contribute incremental amounts to subsidy programs directed to identifiable and cohesive special interest groups. In the case of urban revitalization, this means subsidies to selected cities and projects.

Like these tax-based funding methods, general revenue sharing schemes allow the federal government to shift the receipts from one state or locality to another state or locality for the latter's benefit.[135] Additionally, the federal government can provide grant money and subsidies out of deficit spending. Deficit spending, however, is merely another form of tax-based funding, in that all Americans pay for its negative impact on the value of the dollar and on the national economy, while the special interest recipient reaps all the benefits.

State programs to assist particular urban centers serve much the same function as federal programs. To the extent that revenues generated on a statewide basis are used to benefit a particular city or project, a cross-subsidy benefits the special interest group able to employ the political means. Likewise, state tax incentives in the form of enterprise zones and tax abatement legislation serve the special interest groups at the expense of other, less organized

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borrow from the public. In so doing, the government must offer interest payments to investors, which must be included as part of the national debt. This increased interest obligation puts additional pressure on the government to attempt to offset the debt by increasing taxes or printing money. *Id.*

134. *See supra* text accompanying notes 110-16. Indianapolis used the 25% tax credit for historic preservation to make the Union Station renovation financially possible. Without this tax credit it is doubtful the project would have been completed despite the other publicly funded assistance made available to the developer.

135. *See* Hoeflich & Malloy, *supra* note 123, at 681-83.

interests.[136]

Federal and state subsidies can be used in yet another, even more indirect way to redirect revenues from one group of people to the benefit of another. Consider, for example, the city that seeks to proclaim a willingness to fund its own participation in a co-financed real estate project. Rather than relying on state or federal subsidies, it will provide only a locally funded loan subsidy for the new project. Even though this scheme may require people from throughout the city to subsidize the chosen project, it can be argued that on this smaller scale, local level at least those asked to pay—city residents—also will be the most likely to benefit from the project. To the extent that the city does not require local taxpayers to offset fully the loan financing subsidy for the project, however, the city may end up seeking non-project-related subsidies from federal and state sources for budget shortfalls such as welfare, health, and transportation programs.[137] In other words, the city can gamble on the local subsidy program because it knows that, ultimately, another level of government will step in with additional revenues to take care of any major shortfalls that might occur in its budget for essential services.

Given all the foregoing, one must ask who really gains from all this complicated cross-subsidy and co-financing activity. Is there really a cohesive notion of a city as a spècial interest group? A city, of course, represents a political vehicle for the expression of the political interests of its key constituents. In the realm of urban redevelopment, these key constituents are the politicians and business people most likely to benefit from the redevelopment efforts.[138] For example, in the Indianapolis illustration outlined

136. *See* Huddleston, *Taxpayers in Some Communities May Pay More in Tax Increments*, 19 LAND USE DIG. 2 (1986) Professor Jack Huddleston of the University of Wisconsin at Madison has examined the distrihution of development costs among taxpayers in nineteen municipalities—nine of which used TIF—in Milwaukee County, Wisconsin. He found that residents of cities that did not use TIF for real estate projects effectively subsidized taxpayers in cities that did use TIF. *Id. See, e.g., Enterprise Zones*, 18 LAND USE DIG. 1 (1985) (noting that 26 states and more than 450 cities have adopted their own enterprise zone programs); Callies & Tamashiro, *supra* note 38, at 231, 268-71 (discussing state enterprise zone initiatives).

137. The same process occurs in the housing policy area. Local governments can continue to pursue rent controls and other negative investment policies because they are able to tap federal resources to offset the consequences of bad local policy. *See* Hoeflich & Malloy, *supra* note 123, at 663-89. An interesting and ironic consequence of a policy of subsidizing downtown development is that the resulting increase in urban density may itself foster the need for further subsidies for related services such as mass transit.

138. *See generally*, INDIANAPOLIS: DOWNTOWN DEVELOPMENT FOR WHOM?, *supra* note 129. Business people, developers, and real estate professionals benefit not only from direct

earlier in this Article, it was revealed that a single developer group is involved in at least four major co-financed projects.[139] Such developers clearly benefit from the subsidies of co-financing activities. Likewise, real estate professionals—lawyers, brokers, and bankers—benefit from the increase in local business activity. So do local union workers, such as construction workers who find work at the new projects, and local workers employed to clean and service the new buildings. Local politicians also gain favor and enhance their reputations by pointing to the new buildings, activities, and projects generated for their local constituents.[140]

These results seem wonderful until it again is realized that the buildings, activities, and profits generated for a city like Indianapolis come at the expense of as much or more activity that could have occurred elsewhere but for the intervention of the political means. Thus, it should be seen as no great surprise or miracle that Indianapolis has become a comparatively richer or nicer place to live. This has been made possible, after all, by making other parts of the state and country comparatively poorer.[141]

Clearly, several conclusions can be drawn from this analysis of the economic and political implications of co-financing activities. First, the involvement of all levels of government in co-financing activities allows numerous direct and indirect wealth transfers to

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public subsidies that support their continued activities, but also from increased land values when they own land at or near the location of a major redevelopment project. *Id.*

139. *See supra* notes 99-105 and accompanying text.

140. *See* Helyar & Johnson, *Tale of Two Cities—Chicago's Busy Center Masks a Loss of Jobs In Its Outlying Areas*, Wall St. J., April 16, 1986, at 1, col.1. Chicago politicians have poured one billion dollars into downtown incentives for construction, and the resulting activity has been favorable to the politicians despite the fact the suburban areas are suffering. *Id. See also Review & Outlook—A Hunger for Money*, Wall St. J., Jan 28, 1986, at 30, col.1 (discussing how mayors use and rely on federal subsidies to satisfy the special interests of local friends and developers while claiming to be concerned with the poor and needy); *see generally Welfare for Developers*, Wall St. J., April 3, 1986, at 26, col.1. This editorial discusses the tremendous amount of "welfare" being given to developers and related real estate professionals by way of local access to federal UDAG subsidies. The article asserts that states and districts with influential congressman benefit greatly from the subsidies through extensive use of the political means. The editorial goes on to say:

> Of course, the UDAG boodle is defended on the ground that it helps the "poor." But 60% of UDAG funds have gone to commercial projects; developers promise new jobs but only two-thirds of those promised actually materialize, HUD estimates, and when you consider that UDAG money comes out of taxpayers' pockets, there is little reason to believe there is any net job "creation." Moreover, construction workers seldom are "poor."

*Id.*

141. *Id. See* H. HAZLITT, *supra* note 123, at 36 (discussing the predictable results of this process of wealth transfer).

occur between citizens and taxpayers. Second, the indirectness of the methods that can be employed to achieve this income redistribution makes it difficult to obtain good information on the actual costs and benefits of government involvement in co-financing activities.[142] Indeed, it is not only difficult to determine the true costs and benefits of these programs, it is nearly impossible to determine who bears these costs. It is relatively easy to point to the new office building or shopping center constructed in downtown Indianapolis. It is next to impossible, however, to determine which taxpayers actually paid for the project and, more importantly, which towns and people elsewhere in the state or country lost out on a real estate project or jobs because of the advantage Indianapolis gained from public funds. Third, the political means favors an allocation of resources to established cities. Therefore, it perpetuates a tyranny of the status quo because the established cities represent current, identifiable political and business interests that are better able to capture the energy of the legislative function and harness government power in the pursuit of their own special interest. As a result, established cities are able to use grants and other co-financing subsidies to attract and retain businesses that otherwise would relocate to new or economically more desirable communities. Finally, use of the political means results in resource allocations that do more than simply transfer wealth from "A" to "B." Presumably, to the extent that the political means redirects the investment and resource allocations of the marketplace, it results in a net social loss in that the resources no longer are used for their most valued and, therefore, most efficient purposes.[143] Thus, in addition to "A" losing wealth to "B," society suffers a net total loss because fewer total benefits can be derived from resources when those resources are used in an inefficient manner.

These conclusions, it seems, are essentially unaffected by the current political rhetoric of the Reagan administration and its New Federalism.[144] "New Federalism" is a political phrase meant to dis-

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142. *See generally* R. POSNER, *supra* note 188, at 602-09. Here Posner deals with state taxes and the incentive each state has to impose the burden of its taxes, so far as possible, on residents of other states. The discussion reveals that state taxing policy often leads to poor information for consumers and that, to the extent that the state can spread the burden of taxes to nonresidents, the state is able to tax people who have no vote in how the state operates. *Id.*

143. *See* H. HAZLITT, *supra* note 123, at 40-48.

144. *See generally* Freilich, *The New Federalism*, *supra* note 38 (taking a complete look at Reagan's New Federalism, including urban development issues, tax issues, school issues, civil rights issues, and housing issues); Bollinger, *The Historic and Proper Place of*

tinguish the Reagan vision from that of earlier "New Deal" liberal administrations. The distinction in vision, as applied to the way urban revitalization programs are conceived and administered, however, is more one of form than of substance.[145] To understand this distinction it is first necessary briefly to describe both approaches: New Deal and New Federalism.

The New Deal philosophy carries with it all the baggage of the "welfare state" that has grown up since the rapid expansion of federal government programs under the Roosevelt administration.[146] New Dealers generally are perceived as people who support an active federal government and who envision a need for federal answers or responses to both state and local problems. New Federalism, on the other hand, envisions a reduction in the role of the federal government and a countervailing increase in the role of state and local governments in resolving their own problems.[147] New Federalism is supposed to allow for diversity and experimentation, while returning control of government planning and expenditures to the people.[148] The notion of returning government

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*Central Governments in Urban Redevelopment: The U.S. View*, 6 URB. L. & POL'Y 53 (1983). Bollinger was Assistant Secretary for Community Planning and Development, United States Department of Housing and Urban Development, when he wrote this article. His article reflects a New Federalism philosopby by stressing a strong national economy and the return of many state and local issues to state and local government. He sees the federal urhan role as one of "urban facilitator," rather than provider, helping cities to be entrepreneurial and innovative in addressing their economic and community development needs. *Id.* at 54. *See also* Wingo & Wolch, *Urban Land Policy Under the New Conservatism*, 5 URB. L. & POL'Y 315 (1982) (arguing that the New Federalism is a conservative movement that favors commercial and industrial uses and rejects social welfare programs, all of which will lead to the "ghettoization" of the poor, the elderly, and the bandicapped).

145. *See generally* M. FRIEDMAN & R. FRIEDMAN, *supra* note 121. In this book the Friedmans argue that much of the Reagan administration's rhetoric is unfulfilled. In actuality, Reagan has become trapped by special interest groups just as surely as the welfare Democrats from which Reagan tries to disassociate himself. Although the special interests may have changed, the use of the political means and the tyranny of the status quo remain.

146. *See* M. FRIEDMAN & R. FRIEDMAN, *supra* note 133, at 91-127, 228-29 (discussing the growth of the welfare state and the expansion of the federal government).

147. *See* Bollinger, *supra* note 144; Wingo & Wolch, *supra* note 144 (discussing the emphasis on local involvement and participation).

148. The theory is that putting power in state and local government creates a check on the federal government's power. At the same time, to the extent that government is responsive to the electorate, it is likely to be most responsive at the local level. *See* M. FRIEDMAN, *supra* note 17, at 7-21. *But see* A. NOCK, *supra* note 117, at 29. According to Nock:

> [The] idea rests upon certain assumptions that experience has shown to be unsound; the first one being that the power of the ballot is what republican political theory makes it out to be, and that therefore the electorate has an effective cboice in the matter. It is a matter of open and notorious fact that nothing like this is true. Our nominally republican system is actually built on an imperial model, with our professional politicians standing in the place of the praetorian guards; they meet from time to

to the people is meant rhetorically to conjure up notions of small town meetings and participative government free of the excessive manipulation of the special interest groups that frequent the halls of the Nation's capital.[149]

Despite the different emphasis inherent in each governmental vision, there actually is very little difference between the New Deal programs and those of the New Federalism. Both approaches focus on use of the political means to attain politically desired outcomes; the only real difference between the two is the method by which benefits are bestowed upon favored special interest groups. Moving political decisionmaking from the Nation's capital to the fifty state capitals can affect the influence of specific special interest groups, but as long as the political means is used to reallocate the resources in the marketplace, the process of government expropriation from the many to the few will continue. For example, enterprise zones and many of the co-financing techniques used by the city of Indianapolis are considered programs consistent with the New Federalism. Yet, as this Article already has discussed, such programs thrive on special interest groups' ability to capture the use of the political means for their own benefit.

What then is the significance of the New Federalism? Besides the rhetorical appeal of the appearance of local, popular decisionmaking, the New Federalism is an effective method of transferring the power associated with the political means. New Deal programs concentrate political power at the national level by way of the federal government. By virtue of federal government sponsorship, programs and regulations have a uniform, national application. This means that "liberal New Deal" interests enjoying the support of a high concentration of legislative power and votes in the heavily

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> time, decide what can be "got away with," and how, and who is to do it; and the electorate votes according to their prescriptions.

*Id.* Nock's position could be supported in another light by John Kenneth Galbraith. Galbraith argues that the state possesses access to the means of power and that the state, through conditional power, gets people to respond to or believe in concepts that serve those in power without accurately portraying the real world. *See* J. GALBRAITH, THE ANATOMY OF POWER (1983).

149. Nock makes a further comment on the political process and its response to the rhetoric of returning government to the people.

> Republicanism permits the individual to persuade himself that the state is his creation, that state action is his action, that when it expresses itself it expresses him, and when it is glorified he is glorified . . . . Lincoln's phrase, "of the people, by the people, for the people" was probably the most effective stroke of propaganda ever made in behalf of republican state prestige.

A. NOCK, *supra* note 117, at 45.

populated, industrial states can be effected through the federal legislative process. Programs that capture the benefits of this political means are assured of no competition from individual states that might wish to reject a program. The individual states are not allowed to reject a program because the underlying problem addressed by the legislation is deemed to be of national, rather than state or local, concern. Given the political makeup of the federal government, it would be perfectly logical for the conservative special interest groups that support President Reagan to favor a shift in power over the political means from the national to the state level. In this way conservative special interests could employ the political means at the state and local levels in those states and communities in which they are well represented, even if at the national level they would lack sufficient votes to overturn or replace New Deal programs that they oppose. Thus, the key distinction between the New Deal and the New Federalism approaches is New Federalism's ability to shift political power to a forum more favorable to those special interest groups aligned with the current administration.

Although the rhetoric of New Federalism paints a picture different from that of the New Deal, it is evident that there is less to this alleged difference than meets the eye. Fundamentally, both political approaches seek to allocate resources according to the political means rather than the economic means. The result of the New Federalism, therefore, is not to change the relationship of the state to the individual, but rather merely to change the identity of the special interests likely to benefit from the exercise of the state's power.

This view of the political process currently supporting co-financing arrangements calls for an assessment of whether or not the political and economic dynamics of these programs ever actually can lead to an emergence of the prosperous urban environment necessary for fueling long-term economic growth, job creation, and capital formation. Jane Jacobs argues in her recent book, *Cities And The Wealth of Nations*, that government loan, grant, and subsidy programs can provide only short-term and short-lived benefits.[150] Furthermore, the spending on development loans, grants, and subsidies is in itself the entire benefit to be expected from these programs.[151] Thus, according to Jacobs, these programs can

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150. *See* J. JACOBS, CITIES AND THE WEALTH OF NATIONS 93-124 (1984).
151. *Id.*

play little part in the economic life of the revitalizing city other than that of temporarily reducing unemployment and alleviating poverty.[152] Examining the reasons behind this assessment of co-financing programs is necessary in order to appreciate its implications for formulating new approaches to urban redevelopment.

The economic strength of an urban center and its extended regions depends on the vitality of their import-replacing capacity. As described in the first part of this Article, import replacement is an essential part of long-term growth potential and capital formation. Cities are dynamic and not static; they must respond to changes in economic circumstances. Merely granting government sponsored incentives or transplanting industrial factories to new locations cannot turn an economically weak area into a prospering, import-replacing city region.[153]

In order to highlight the significance of import-replacing activities, Jacobs outlines the role that imports play in the city economy.[154] First, cities *use* their imports. That is, imports are consumed for uses within the city region.[155] Second, imports to a city region demonstrate the earning power of its export work. This is true to the extent that imports are purchased with funds *earned* by the city's export economy rather than with mere loans, grants, or subsidies made available from sources outside the region.[156] The source of the city's import funds is crucial, because only through developing its export productivity can a city nurture the dynamic interaction of suppliers and producers that is all-important to its economy.[157] Third, imports serve as candidates for replacement by local production.[158] But, as Jacobs points out, replacement cannot occur without the foundation of dynamic interaction that first

152. *Id.*

153. *Id.*

154. *Id.* at 119-122.

155. *Id.* at 119.

156. *Id.*

157. *Id.* at 119. Jacobs clarifies this point by offering the following comparison:

> Once we understand why unearned imports, whatever other usefulness they may have, are beside the point for catalyzing real economic development, we can understand, also, why the remittances that migrant workers send back to their poor home regions do so little to transform economic life there. Not having been earned right there, by city work, these benefits can play no part in economic life other than temporarily alleviating poverty. It is the same with all transfer payments from rich to poor regions. They alleviate poverty but inherently can do nothing to overcome the causes of poverty.

*Id.* at 122.

158. *Id.* at 119.

must be laid by the process of *earning* the imports.[159] In short, "development cannot be given. It has to be *done*. It is a process, not a collection of capital goods."[160]

In order to explain this process better, Jacobs illustrates her analysis with the example of northern Georgia and its ability in recent years to attract numerous transplant industries from other parts of the country. The transplant industries have added jobs and money to the regional economy, but Jacobs argues that they have done little to transform the Atlanta area into a truly prosperous import-replacing region.[161] Rather than encouraging import replacement, most of the transplant industries only have added to the servicing and distribution functions of the Atlanta region. The reason for this result is illustrated by Lockheed's Marietta works, which is one of the largest manufacturing complexes in the entire southeastern United States.[162]

Lockheed was founded as a fledgling enterprise based in Los Angeles.[163] During its early years, the company relied heavily on local suppliers and businesses to furnish equipment and to help develop new ideas and sources of capital for the new enterprise.[164] The local city economy also provided employees and consumers for Lockheed's products and services.[165]

By the time Lockheed was able to move to northern Georgia many years later, the company was in many ways self-sufficient.[166] It supplied many of its own items, services, and skills that formerly had been furnished by independent suppliers in the Los Angeles city region.[167] The company's marketing, servicing, and communications lines were so well developed that Lockheed could have placed a major manufacturing facility in almost any location.[168] Marietta, Georgia was the chosen location, but the facility transplanted there was tied to the major enterprise still headed in Los Angeles.[169] In short, Lockheed's Marietta facility provided jobs, but it did not interact with the local city region as a source of sup-

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159. *Id.*
160. *Id.* (emphasis original).
161. *Id.* at 94-96.
162. *Id.* at 94.
163. *Id.* at 95.
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.* at 95-96.
168. *Id.*
169. *Id.*

plies and services in the way that Lockheed originally had in Los Angeles. Lockheed did not help support the local producers of its requirements and thus failed to reproduce in northern Georgia, even in microcosm, the sort of economic growth that it had inspired in Los Angeles.[170]

In another example Jacobs discusses the Tennessee Valley Authority (TVA) and its inability to stimulate the emergence of an import-replacing city despite the investment of tremendous amounts of government money and resources.[171] She generally applauds the TVA administrators' skill and success in executing their mission and does not fault TVA itself for the continued poverty in the region.[172] Instead, she finds the fault to be inherent in the use of government loan, grant, and subsidy programs.[173] The many projects the TVA undertook in the region produced project-related jobs, but created no significant numbers or kinds of city jobs necessary for the accumulation of excess capital.[174] The region, rather than developing local producers for local needs, continued to depend on importing almost all its needs.[175] Furthermore, nearly all development continued to be financed with capital generated from outside rather than from within the region.[176] Thus, the government-related subsidies generated by the TVA

170. *Id.* at 96.

171. *Id.* at 110-23. Jacobs describes the TVA efforts as attempts to create an artificial city region. She also points out that Knoxville, Tennessee, a city in the middle of the TVA area and home of the University of Tennessee, never was able to capitalize on the influx of TVA money. Knoxville never emerged as a successful or prosperous import-replacing city. She also notes that the region itself contained abundant natural resources and that the native people had a history of self-reliance and hard work. Furthermore, because the area had not developed as part of the earlier plantation economy of the South, many farmers in the region owned their own land. Despite all these strengths and the influx of enormous amounts of federal money for the TVA, no import-replacing city emerged.

172. *Id.* at 110-23.

173. *Id.*

174. *Id.* at 114.

175. *Id.*

176. *Id.* Jacobs also uses the example of massive subsidy programs in southern Italy as a comparison to the TVA experience. *Id.* at 120-23. Historically, there has been a large gap between the wealth, prosperity, and job opportunities of the industrial regions of northern Italy and the impoverished, agricultural regions of southern Italy. Since the 1950s, the Italian government has provided loans, grants, and subsidies to build roads, power plants, schools, and housing to attract industries, and to subsidize agriculture in order to aid the southern part of the country. *Id.* at 120-21. Industrial transplants were located at Bari and close to Naples. Although this massive Italian effort produced certain benefits, as did the TVA program, the long-term results have done little to decrease the basic poverty in the region, and the gap between northern and southern Italy is said to have increased over the time period in question. *Id.* at 121.

temporarily helped to reduce unemployment and alleviate poverty. Rather than fostering import-replacing activities, however, subsidies merely provided additional funds for local people to import goods, services, and capital from outside the region.[177] As long as the region remains without significant import-replacing activities, it will need continued subsidies to maintain its current economic standard of living.

Jacobs' analysis and examples have important implications for the use of co-financing arrangements in the drive for urban revitalization. The use of public assistance or financing in redevelopment projects would seem to require, at the very least, a selection of projects consistent with the goals of achieving or enhancing a city's import-replacing ability. This means that the projects must do more than provide an influx of short-term jobs and outside capital infusion. They must stimulate a dynamic interaction between local suppliers and producers that will enhance the city's export economy. Only when the city earns its own importing funds and develops a diversified and versatile economy can it hope to achieve long-term economic success.

The current range of co-financing projects that some cities have undertaken hardly seems worthy of the task at hand. The subsidized development of downtown office buildings and hotels, or the desire to preserve historic structures by turning them into fast food and retail centers, is hardly the type of activity likely to bring forth long-term gains for a local city economy.[178] In the short run,

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177. *Id.* at 110-23.

178. *See generally* MacArthur, *Give Me Old-Time America Without The Gloss*, Wall St. J., Jan 14, 1986, at 32, col. 3. In this editorial MacArthur assaults the current trends in historic preservation and downtown redevelopment that focus on every city trying to become a tourist attraction or shopping and eating center. He starts by considering this process in Savannah, Georgia and then addresses the broader problem as he sees it sweeping across the United States.

> With the help of local bond issues and tax credits, politicians will claim victory in the fight against economic decline as they change the local landscape into a tourist attraction. The emphasis on essentially cosmetic improvements in this or that part of town results from a failure to imagine the future, as well as a false sense of American history. It also tends to mask the real economic problems we confront, and demeans our culture with artificial substitutes. Our commercially innovative culture has not resulted in beautiful cities: Detroit, Cleveland, Chicago and Los Angeles have been wonderfully productive, but they are not aesthetically pleasing in any European sense. With American ingenuity has come immense wealth, great tolerance for ethnic and cultural diversity and relatively widespread democracy and social mobility. Which brings me back to Savannah, a pretty but by no means beautiful city. Savannah's rise to importance had everything to do with its value as a port . . . . But what will become of Savannah if employment from its port, for example, is gradually supplanted by a tourist economy?

such projects will provide project-oriented jobs, as did the TVA, and will generate a series of minimum wage retail and service jobs. There also will be the new or renovated buildings for local politicians to point to as signs of progress, and an appearance of urban vitality will result from the short-term construction activity. Without a strong import-replacing economy, however, the new buildings merely may be shifting uses between different parts of the city or region, rather than fostering long-term economic growth. And while it may be a matter of pride to local residents to enhance the downtown skyline at the expense of the suburbs or other potential business locations, it becomes questionable whether such projects merit the use of public funds and resources.

For cities facing a decline in their industrial and commercial manufacturing bases, it hardly seems possible that economic prosperity will result from replacing skilled jobs and export capacity with a nonexport economy based on restaurants, shops, hotels, and numerous downtown attractions similar to those springing up like clones all across America.[179] Nonetheless, for political reasons it seems that co-financing activities have taken primarily this direction. These activities, when well orchestrated, can produce real and necessary changes for a local economy. As was illustrated by the Lockheed and TVA examples, however, the successful transplanting of specific industrial facilities to a city region or the use of government loans, grants, and subsidies cannot create a successful, import-replacing region. Without the import replacement prerequisite, a city region has no foundation for a lasting period of economic growth and prosperity.

## IV. The Philosophical Constraints on Co-Financing

Up to this point in the Article, discussion has focused on describing the nature of co-financing arrangements and the political and economic dynamics of co-financing activities. Beyond the realm of descriptive analysis, however, co-financing activity requires philosophical evaluation. A philosophical evaluation is important to this Article's discussion because the analysis of co-financing activities raises a fundamental philosophical question

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How can it survive aesthetically or commercially if no one can imagine anything other than businesses paying the minimum wage? How will social mobility be funded if the principal reason for Savannah's existance becomes the entertainment of pensioners on vacation from Akron and San Jose?

*Id.*

179. *See generally* J. Jacobs, *supra* note 150; MacArthur, *supra* note 178.

about the effect of these programs on traditional notions of individual liberty and the relationship between the state and private enterprise in a capitalist society.[180] This part of the Article will focus on philosophical constraints on co-financing activities. These constraints have two primary foundations that are useful in a philosophical evaluation. The first foundation reflects an understanding of the proper and limited role of government in a capitalist society, and the second involves the normative role of law in facilitating social order.

A capitalist society, in which private individuals own the means of production, provides a framework for the protection of individual liberty.[181] Individual liberty in this context refers to a view of social relationships that provides for a sphere of personal autonomy over one's own thoughts and actions free from outside coercive interference.[182] This sphere of personal autonomy is not limitless, however, and the concept of individual freedom in a market economy or laissez-faire social organization requires governmental restriction of antisocial behavior that, if left unchecked, would disintegrate social cooperation and civilization.[183] In the

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180. *See* Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976). Although Kennedy focuses on the difference between an individualist and an altruist view of law, his overriding theme stresses that all law is philosophy. Kennedy's discussion of individualism, however, is not a discussion of the classical liberal model of individual liberty. The classical liberal concern for individual liberty includes moral and natural law principles not fully shared by the Benthamite Utilitarians that Kennedy discusses. *See also* Lanversin, *Land Policy: Is There A Middle Way?*, 3 URB. L. & POL'Y 229 (1980). Lanversin argues that land policy varies with each country and is a function of political ideology because land rights or the lack thereof are defined by law and because government takes part in this process. Because land policy is universally political or ideological, one must consider these factors in evaluating given programs. *See also* Darin-Drabkin & Darin, *Let the State Control!*, 3 URB. L. & POL'Y 217 (1980) (presenting an example of Marxist philosophy applied to land policy).

181. *See* M. FRIEDMAN, *supra* note 17, at 1-36. Capitalism is a necessary but not sufficient condition for the existence and preservation of individual liberty. *Id.* at 10. "The kind of economic organization that provides economic freedom directly, namely, competitive capitalism, also promotes political freedom because it separates economic power from political power and in this way enables the one to offset the other." *Id.* at 9.

182. *See* F. HAYEK, *supra* note 16, at 13; *see also* M. ROTHBARD, THE ETHICS OF LIBERTY 35-43 (1983) (discussing the natural right to seek interpersonal relations and voluntary exchanges); M. FRIEDMAN, *supra* note 17, at 14-21. According to Friedman:

> The fundamental threat to freedom is power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power cannot be eliminated—a system of checks and balances.

*Id.* at 15.

183. *See* L. VON MISES, HUMAN ACTION, *supra* note 17, at 179-87; F. HAYEK, THE CON-

absence of a commitment to anarchy, the difficulty lies in determining the extent to which government properly can restrict an individual's behavior while still preserving a free society based on individual liberty. This issue, of course, has been debated extensively elsewhere.[184] The purpose of this Article, therefore, is not to attempt a restatement of the entire theoretical underpinnings of limited government, but rather to determine whether co-financing activities are beyond the bounds of legitimate state action.

From this philosophical perspective co-financing activities, as currently conceived, do run afoul of traditional classical liberal notions of government's legitimate role in a society based on the preservation of free enterprise and individual liberty. This is not to say that classical liberals would consider all governmental attempts to foster urban revitalization impermissible. To the contrary, there are ways in which co-financing arrangements could be made more acceptable to classical liberals, and these will be addressed in the recommendations section of this Article. Before addressing recommendations for structuring future co-financing programs, however, one must understand the philosophical problems with current activities.

The first philosophical problem is the substitution of the political means for the economic means. This process, as so aptly articulated by Albert Jay Nock in *Our Enemy, The State*, was illustrated in this Article's discussion of the politics and economics of co-financing.[185] The harm associated with this substitution is precisely that it removes the decisionmaking process of resource

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STITUTION OF LIBERTY 11-21 (1960). Within the confines of a free society, the state can be a legitimate collective vehicle for protecting the individual's liberty from the coercive interference of others. *Id. See also* F. HAYEK, *supra* note 17, at 82-83. The idea of government as a protector of individual freedom, however, does not mean that whatever the government does in the name of this protection is to be considered proper. Hitler may have gained power and acted in a strictly constitutional manner, but this would not make his rule "right." *Id.*

184. *See, e.g.*, R. EPSTEIN, *supra* note 69 (arguing for limited government and addressing the theory behind it); M. FRIEDMAN, *supra* note 17; M. FRIEDMAN & R. FRIEDMAN, *supra* note 17; F. HAYEK, *supra* note 17; D. HUME, ESSAYS—MORAL, POLITICAL, AND LITERARY 87-96 (2d ed. 1985); J. MILL, ON LIBERTY 53-106 (1975); R. NOZICK, ANARCHY, STATE, AND UTOPIA (1974) (defending individual liberty and seeking to define the proper role of the state in a society that values the individual as the basis of freedom); L. VON MISES, HUMAN ACTION, *supra* note 17; L. VON MISES, PLANNING FOR FREEDOM, *supra* note 17. *See also* A. SMITH, LECTURES ON JURISPRUDENCE 200-458 (1978). This part of Smith's book deals with justice and the forms of legal relationships between the individual and the state and considers different forms of government. This book, which is based on notes from Smith's lectures on jurisprudence at the University of Glasgow, also presents an interesting look at Adam Smith as legal philosopher.

185. *See* A. NOCK, *supra* note 117; *see also supra* text accompanying notes 117-79.

allocation from the marketplace, which reflects individual value determinations, and replaces marketplace decisionmaking with special interest groups' valuations effected by the groups' capturing the power of the state. In this way, the state becomes the means by which one group of people legally can exploit other members of society. The political means thus allows special interest groups to use government power to fulfill personal gains that individuals or groups cannot obtain in the marketplace.

Because classical liberalism prefers that resource allocations be made by individuals acting through the marketplace, attempts to circumvent the market process by government intervention are discouraged unless such intervention is required to assure individual human dignity and liberty.[186] While it may be true that government programs providing individuals with minimal levels of health care, shelter, and food are a legitimate basis for market intervention, it is hard to see how such a justification supports broadly based subsidies for one real estate developer, project, or city over another.

In short, classical liberals' first objection to co-financing reduces to a rather simple principle. If Indianapolis or any other city is really worth investing in, then private developers will make that investment without having taxpayers subsidize their cost and risk. To the extent that private investors are not willing to invest in Indianapolis or another city, they will invest in another location or project, which presumably will be more valuable because they are willing to invest without a subsidy. After all, hotels, shopping centers, office buildings, and restaurants are not like dams or airports. The former are the types of investments that private enterprise always has invested in. Thus, the primary objective of many current co-financing arrangements is not to encourage activities that otherwise would not occur, but rather to encourage these activities in locations apparently undesirable for the investment. Because these co-financing subsidies result in misallocations of resources—allocations contrary to those determined by individuals

186. *See* Malloy, *supra* note 13, at 163-77. In this article, I argue that the economic, political, and moral philosophy of Adam Smith and of recent economists such has Friedrich Hayek and Milton Friedman supports the conclusion that classical liberals' view of free market economics includes normative principles based on morality, natural law, and inalienable rights. Furthermore, I argue that the useful economist, in order to act consistently with classical liberalism, must use economics in a way that upholds individual human dignity and liberty. From this perspective, government is organized for the purpose of protecting individual human dignity and liberty. Government action, therefore, is justified in a limited capacity when such action is required to protect this liberty.

in the marketplace—they are objectionable.

Classical liberals' second objection to co-financing is that in a capitalist society, in which the means of production are owned by private individuals rather than by the state, promoting a program that results in governmental ownership, in one form or another, of many of a city's most prominent office, hotel, and retail properties is objectionable for two reasons. First, the result eliminates the impartial decisionmaking ability of local city officials, and second, it covertly reduces the ability of independent private capital to act as a check on government power.

Local city officials lose their ability to make impartial decisions regarding the direction of future growth when they already have staked millions of dollars in public funds and their own political futures on specific downtown projects. Having invested, for instance, in a particular shopping center or office building complex, the city has a vested interest in assuring some degree of financial success for the project, even if that means preventing future entry of more desirable, competitive private projects.[187] Likewise, assuring a project's success also may mean investing in additional subsidies to support already "sunk funds" if the market response to the project is less than was anticipated. An additional consequence of these subsidies, even when the city does not block market entry, is that the unsubsidized private developer may be unable to compete in the market as a direct result of the comparative advantage its competitors gain by their use of public funds. In any of these situations, the problem is clear. Allowing a city government to own profit-making enterprises that compete with similar existing or potential private enterprises and expecting impartiality is akin to putting Exxon Corporation in charge of the American oil industry and allowing it to oversee the activities of all its competitors, real or perceived.

The ability of private capital to act as a check on government power is a function of private capital's diversity and independence from the government. In a system of free enterprise, diverse individuals within the society are allowed to accumulate wealth and use this wealth to support individual challenges to the exercise of

187. *See* Gruen, *Public/Private Projects—A Better Way for Downtowns*, URB. LAND, Aug. 1986, at 4. This very action has been taken in St. Paul, Minnesota, where city officials used their influence with the regional planning agency to block approval of a suburban shopping mall that would compete with a downtown shopping facility in which the City had an economic interest.

government power.[188] In this way, private sources of wealth place resources that can serve as a check against the state beyond the state's reach.[189] To a certain extent, co-financing activities covertly reduce this private source of capital able to check the power of the state. This result occurs because co-financing can reduce diversity of wealth by subsidizing select developers and preventing market entry by others and because co-financing reduces the independence of private capital by linking the selected developer's interests to those of the city. For these reasons, co-financing activities again are objectionable.

A third classical liberal objection to co-financing is that a fundamental prerequisite to efficient resource allocation in a market oriented economy is the availability of good information concerning the relative costs of alternative actions. Philosophically, this availability is important because the expression of individual liberty through the marketplace is based in part on the premise that people are thinking, reasoning beings who will make rational economic choices based on the information available to them.[190] Thus, it is necessary to assess co-financing from the point of view of its current ability to provide the public with adequate information.

As this Article earlier discussed, co-financing activities benefit from the use of the political means, which allows funds to be raised from a much wider population than that likely to receive the primary benefit of a particular project. The very process of mixing the sources of public funds and playing local, state, and federal income sources one against the other makes it nearly impossible for the average urban resident to assess the value of a given project relative to its cost. This process is undesirable because it obscures market information and hinders individual decisionmaking and because the lack of good information against which to judge their

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188. *See* M. FRIEDMAN, CAPITALISM AND FREEDOM 7-21 (1962, reissued 1982); Malloy, *supra* note 13, at 168-71.

189. *See supra* note 188.

190. *See* L. VON MISES, HUMAN ACTION, *supra* note 17. Von Mises describes economics as the science of all human action and states that human action is necessarily always rational. *Id.* at 19. *See also* Kuttner, *The Poverty of Economics*, ATLANTIC MONTHLY, Feb. 1985, at 74. Although this article is critical of the trends that favor model building in economics, it provides a good analysis of basic economic approaches. It also argues that economics, of whatever branch, is basically an ideologically cbarged undertaking. *Id.* at 83. Relevant to the point at issue, the article refers to a position taken by Milton Friedman in his ESSAYS IN POSITIVE ECONOMICS. In that essay Friedman argues that the information and rationality assumptions underlying economics do not have to be empirically true so long as they lead to an internally consistent model that is not refuted by data. *Id.* at 79 (*citing* M. FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS (1953)).

performance makes government officials less accountable.

In addition to these objections to co-financing based primarily on considerations of the proper and limited role of government in a free society, there are grounds for objection based on the normative role of law in facilitating social order. The normative objection to co-financing relies on the notion that in a free society affirmative enforcement of all laws at all times is impractical, if not impossible, and that limited law enforcement resources require a legal system to depend substantially on voluntary compliance.[191] In order for this normative acceptance of laws to occur, a significant segment of the general populace must view the enforcing state and its operative legal system as legitimate.[192]

Professor Michael Hoeflich has considered this problem of normative acceptance of the law in conjunction with voluntary compliance under the federal tax laws.[193] His analysis reveals that it is possible for a set of legal rules, such as the tax code, to lose its normative value over time. As these rules lose their normative value, people no longer feel that they ought to pay their taxes, but rather treat the tax laws as a game in which they match wits against the government bureaucrats.[194] In part, Professor Hoeflich's observed decline in voluntary compliance under the tax laws can be attributed to a popular perception that the tax code, as structured, long has been merely a compilation of special interest benefits and burdens rather than a principled approach to sharing the costs of government.[195] As a result of this perception, the nor-

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191. *See* Malloy, *supra* note 13, at 166-68; *see also* Kornhauser, *The Great Image of Authority*, 36 STAN. L. REV. 349, 353-57 (1984) (arguing that law helps shape human conduct and thus serves a normative function); Michelman, *Norms and Normativity in the Economic Theory of Law*, 62 MINN. L. REV. 1015 (1978) (describing law as multi-dimensional with moral, social, political, and economic aspects); *see generally* L. FULLER, THE MORALITY OF LAW 33-94 (rev. ed. 1969) (arguing that governments' failure to observe certain guidelines in expecting people to obey the law would lead to reduced normative acceptance of the legal structure); H. HART, THE CONCEPT OF LAW 83-114, 133-37 (1961) (discussing the internal point of view and how law becomes an internalized standard for assessing conduct); J. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 190-91 (1950) (describing morality and one's sense of justice as important factors in the evaluation of the merits of a particular social or economic structure and therefore in the legitimization of that structure).

192. Malloy, *supra* note 13, at 166.

193. *See* Hoeflich, *Of Reason, Gamesmanship, and Taxes: A Jurisprudential and Theoretical Approach to the Problem of Voluntary Compliance*, 2 AM. J. TAX POL'Y 9 (1983) (viewing problems of tax compliance creatively and innovatively in relation to theories of gamesmanship and jurisprudence).

194. *Id.* at 37-65 (giving examples of "playing the game").

195. *Id.* at 9-88. "A recent English commentator on this problem of multipurpose tax systems has remarked that such a hodgepodge of conflicting interests and purposes cannot

mative acceptance of the tax laws is reduced, and this, of course, leads to reduction in the tendency towards law abidingness.[196] In the broader context of the law in general, this process ultimately can lead to disintegration of social order when the legal structure no longer is viewed as legitimate.

This analysis is equally applicable to considerations of co-financing activities. For instance, a typical response to objections to co-financing activities that use various public funds to encourage development in downtown Indianapolis is simply: "So what if Indianapolis gets a few dollars? Chicago, New York, Louisville, and innumerable other cities also get a few dollars, maybe even more than their fair share." In other words, the political and economic dynamics of co-financing appear to make co-financing activities subject to the same normative problems as the tax laws. To the extent that co-financing arrangements become perceived merely as commitments to satisfying special political interest groups rather than as principled approaches to genuine social problems, they will lose their normative acceptance. As these legal arrangements lose their normative acceptance, the legitimacy of co-financing activities and, ultimately, the legitimacy of the political structure that supports such interest-oriented legislation will be called into question.

Thus, it becomes clear, at least to the classical liberal, that co-financing activities raise important, fundamental, philosophical questions. The degree to which government should be involved in private market activities and the degree to which these activities affect normative principles necessary for social order are both called into question.

## V. Recommendations

Having described co-financing's nature and considered both its political and economic dynamics, together with its philosophical constraints, this Article now will consider recommendations for future action in this important area of real estate law and urban development. Classical liberal philosophy provides a useful approach to the need for recommendations because it provides a method of economic analysis that encompasses notions of natural

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possibly succeed in convincing those who must bear the tax burden of the tax system's inherent worth and fairness." *Id.* at 12 (*citing* H. Monroe, Intolerable Inquisition? Reflections on the Law of Tax (1981)).

196. Hoeflich, *supra* note 193, at 9-23.

law, inalienable rights, and the commitment of limited government to supplying and protecting the moral and normative imperatives of human dignity.[197] In an earlier article, I argued that classical liberalism is distinguishable from utilitarian analysis and cost-benefit economics because of classical liberalism's strong moral traditions rooted in the philosophy of Adam Smith.[198] It is not my objective to re-argue these points here, but it is important to understand that classical liberalism does not take an amoral approach to economic analysis like that used and advocated by many other economists; nor does it simply adhere to a principle of wealth maximization as the ultimate morality of the marketplace.[199] Class-

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197. Malloy, *supra* note 13.

198. *Id.* I contend that Smith's most famous book, THE WEALTH OF NATIONS, cannot he read in isolation from his earlier work, THE THEORY OF MORAL SENTIMENTS. Malloy, *supra* note 13, at 167. Together, these works reveal that Smith's theory of the marketplace was based on an underlying helief that self-interest and happiness within society depend upon high standards of moral conduct. *Id.* Smith believed in natural law rights and was a moral philosopher; he was not completely a cost and benefit utilitarian. *Id.* at 168 & n.22-24. Modern economists such as Hayek and Friedman raise these same concerns in their writing when they reflect on the normative role of law and the protection of individual liberty. *See* M. FRIEDMAN, *supra* note 17; F. HAYEK, LAW LEGISLATION AND LIBERTY, *supra* note 17. Hayek's three-volume work explores in detail many of the philosophical and moral issues first discussed in F. HAYEK, *supra* note 16.

199. Judge Richard Posner, while sharing some of classical liberalism's economic principles, is an example of a scholar who has done much to develop a combined theory of law and economics, yet has failed to retain a sense of moral judgment free of his simple utilitarian market theory. As a result, Posner's analysis has become too confined by amoral principles of wealth maximization and utilitarian cost-benefit analysis. He thus departs from the moral underpinnings of Adam Smith's theory and, therefore, is a philosopher of a different kind than the classical liberal, even though both employ similar economic methods. Posner's views on a wide range of subjects appear in his books, ECONOMIC ANALYSIS OF LAW (1986) and THE ECONOMICS GF JUSTICE (1983).

According to Posner, the development of an economic analysis of law emerged from two branches of eighteenth-century scholarship. *See* Posner, *Some Uses and Abuses of Economics in Law*, 40 U. CHI. L. REV. 281, 281-84 (1979). One branch originated with Adam Smith and focused on the laws regulating the "economic system." *Id.* at 281. The other branch of scholarship emerged from the work of Jeremy Bentham and focused on an economic analysis of nonmarket behavior such as accidents, crimes, marriage, pollution, and the legal and political processes themselves. *Id.* at 282. It seems that when Posner considered these two branches of thought, he selected Benthamite utilitarianism and lost track of Smith's moral and economic philosophy. A current restatement of Posner's belief in wealth maximization as the morality of the marketplace illustrates that, like utilitariansim, his approach does not recognize inalienable rights and is at least in part contrary to classical liberal notions of individual liberty. *See* Posner, *Wealth Maximization Revisited*, 2 NOTRE DAME J. L. ETHICS & PUB. POL'Y 85 (1985).

For additional criticism of Posner and his economic analysis of law, see Baker, *The Ideology of the Economic Analysis of Law*, 5 J. PHIL. & PUB. AFF. 3, 3-48 (1975) (identifying biases in the Posner approach); Kronman, *Wealth Maximization As Normative Principal*, 9 J. LEGAL STUD. 227 (1980) (discussing Posner's normative principle of wealth maximization); Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451

ical liberalism requires a constant and continuous dialogue on the subject of human dignity, which dialogue may lead to the determination of limited government's proper role in the protection of individual liberty within the context of an organized social structure.[200]

Classical liberalism, therefore, does not dictate the complete impermissibility of co-financing activities. To the contrary, classical liberalism provides a framework for taking all the factors discussed in this Article and using them to formulate a perspective or approach to co-financing that is consistent with the essential requirements of a free market economy. A free market economy, in the classical liberal sense, is concerned both with market efficiency and with the preservation of individual liberty through a moral and limited approach to government. What follows, then, are recommendations for future co-financing activity that are consistent with classical liberal views on the relationship between law and economics.

For classical liberals, government's proper and legitimate role is limited to engaging in those activities necessary to correct instances of market failure and to protect fundamental human rights essential to the concept of individual liberty.[201] In this context, government arguably has a proper role in co-financing activities. Permissible co-financing activities, however, must comply with two essential requirements. First, the projects selected for co-financing assistance must be of a type not typically produced in the private marketplace. That is to say, market failure exists because natural market forces do not provide for adequate invest-

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(1974); Michelman, *A Comment on Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 307 (1979) (describing wealtb maximization as a principle biased in favor of the wealthy).

200. It is important to understand that moral principles do not bave to be based on any given religion or source. Moral principles for classical liberal thought can be found in notions of natural law and involve concepts of right and wrong sanctioned by theological, logical, and biological theories. *See* H. MENCKEN, TREATISE ON RIGHT AND WRONG 14 (1977). Mencken asserts that morality has existed among all peoples in one form or another. *Id.* at 5. Additionally, people fundamentally agree that murder, theft, trespass, adultery, and false witness are examples of antisocial and immoral behavior. *Id.* at 6-8. Despite this general agreement on certain basic moral norms, the authority for individuals' moral beliefs can differ considerably over time and place. *Id.* at 8-62. Mencken described the three theories of morality as follows: (1) theological, which is based in religious doctrine; (2) logical, which stems from philosophical inquiries and seeks to justify human conduct on purely logical grounds, rather than on the will of the gods; and (3) biological, which originates in Darwin's work on THE DESCENT OF MAN, wherein man's moral passions are linked to instinct and are alleged to be observable in many lower animals. *Id.* at 1-62.

201. *See generally* Malloy, *supra* note 13.

ment in the desired type of project. Second, the projects selected must serve a function essential to preserving the human dignity of individuals within the society. All of this must be accomplished within a context that nonetheless supports the continued functioning of the private market while assuring the potential for the growth of more dynamic, import-replacing city regions.

On the basis of these general criteria, many current co-financing activities seem impermissible. This conclusion is true even though a legitimate role exists for government to play in promoting urban redevelopment. Subsidizing shopping centers, hotels, office buildings, and restaurants, for instance, hardly is compatible with limiting government co-financing activities to the types of projects that are the subject of inadequate investment in the private market. Private enterprise always has invested in shopping centers, hotels, office buildings, and restaurants, and these projects continue to be the focus of substantial private investment. Likewise, it seems difficult to contend seriously that subsidizing these particular types of projects is necessary to assure the protection of human dignity and individual liberty. To the contrary, people living in the street without food, shelter, or minimal medical care hardly are in need of room space at a luxury hotel or of additional high-priced clothing boutiques.[202]

Supporters of co-financing for shopping centers, hotels, office buildings, and restaurants typically respond with counterarguments to these challenges. First, they argue that despite continued private investment in these types of real estate projects, the private marketplace is unable to assure that these projects are located properly. Co-financing proponents assert that underinvestment in the downtown urban center is an indication of market failure. This lack of investment, however, is not market failure. The private

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202. Depending on the source of data used, 250,000 to 4,000,000 homeless people live in America. *See Homelessness: Demographics, Causes, and Cures In A Nutshell*, URB. LAND, May 1986, at 32. Despite the increasing problem of the homeless, under the Reagan administration the federal government is providing little help. The Administration prefers to identify the problem as a local problem in need of local answers. *Id.* at 33. *See also* Karlen, Agrest, Robins & Greenberg, *Homeless Kids: 'Forgotten Faces'*, NEWSWEEK, Jan. 6, 1986, at 20; Morganthau, Agrest, Greenberg, Doherty & Raine, *Abandoned*, NEWSWEEK, Jan. 6, 1986, at 14; Alter, Greenberg & Doherty, *The Homeless: Out in the Code*, NEWSWEEK, Dec. 16, 1985, at 22; Caleca, *Indy's Homeless*, Indianapolis Star, March 16, 1985, at F1, C1. The estimate is that Indianapolis has between 700 and 3000 homeless. *Id.* at F-4 col. 1. These homeless are made up of a variety of people including the traditional image of the old wino or bag lady, former mental patients, and the new homeless: former factory workers, farmers, and college educated professionals who have been left behind in the economic recovery. *Id.* at F-1, col. 2-3.

marketplace is allocating resources to the production of the very types of projects the city seeks to subsidize. The location question is merely a disagreement as to where private capital should be invested. Investors using their own resources are bound to seek the best return for their investment. Their choice of location, therefore, should be at least as good as, if not better than, the location choices of politicians seeking to spend someone else's money.

A city confronting a decline in its downtown urban center should examine the political and economic reasons for this decline. It may be due to excessive taxation or zoning restrictions or to a decline in police efforts to control crime and provide for safety on the streets. These reasons for decline, however, require political attention to addressing these particular problems. Co-financing as a mechanism for subsidizing particular special interests and selected real estate projects cannot lead to the creation of a sustained and vibrant urban economy because it does little or nothing to enhance the city's import-replacing capacity.

A second challenge to criticism of current co-financing strategies is based on the asserted value of "trickle down" job creation. Investing in downtown shopping centers, hotels, office buildings, and restaurants is supposed to create job opportunities for the unskilled and difficult to employ. The development of such projects undoubtedly generates a number of unskilled and low paying jobs, but there are several problems with the asserted value of subsidizing such efforts. First and foremost is that these subsidies suffer from all the problems associated with Jane Jacobs' analysis of transplant industries and government subsidies.[203] As previously discussed, transplant industries and government subsidies may be able to provide temporary relief for the unemployed or the impoverished, but they can neither develop nor sustain an import-replacing city. Thus, they fail to create the dynamic urban economy that is necessary for true long-term economic growth and prosperity.[204] Without the ultimate development of an enhanced import-replacing city economy, trickle down job creation is of nominal value. The subsidized urban economy lacks the true economic foundations of an integrated city region and therefore is unable to develop the necessary economic opportunities that will allow the unskilled workers to advance within the market structure.[205] This

203. *See* J. JACOBS, *supra* note 150; *supra* text accompanying notes 150-790.

204. *See supra* notes 150-79 and accompanying text.

205. *Id.*

is not to say that no actual benefit accrues to the unemployed from these projects, but it does suggest that policies that encourage import-replacing activities rather than those that subsidize the current array of selected projects can better provide trickle down job opportunities.

The second problem with the trickle down assertion of those supporting current co-financing activities is that current projects result in urban gentrification, which can have negative effects equal to or greater than any asserted benefits to the unskilled and unemployed people living in or near the downtown center.[206] Gentrification results when middle-class and upper-income people are attracted to the downtown area because of the increase in upscale shopping, eating, and working opportunities.[207] In the process low-income people are displaced either by the acquisition of their property for the selected real estate projects or by rising rents and land costs that make downtown living less affordable.[208] The disruption of established neighborhoods and the dislocation of the urban poor represent a social cost that classical liberals must consider in evaluating current co-financing programs even if trickle down theorists do not. As a consequence, the alleged value of trickle down is offset at least in part by the problem of gentrification.

The third problem with the trickle down assertion is that it ignores simple economic realities about job creation. As long as money is not stuffed in a mattress, it will be employed in some capacity in the economy.[209] The result is that jobs will be created with that money. For instance, a city's using one million dollars in tax revenues to subsidize a business that employs a number of people only means that the one million dollars that would have been available for individuals to invest in the marketplace has been invested for them by the city.[210] Individuals in possession of the

206. *See* Bryant & McGee, *Gentrification and The Law: Combatting Urban Displacement*, 25 W.U. J. URB & C. L. 43 (1983); McDougall, *Gentrification: The Class Conflict Over Urban Space Moves Into The Courts*, 10 FORDHAM URB. L. J. 177 (1982); LeGates & Hartman, *Gentrification—Caused Displacement*, 14 URB. LAW. 31 (1982); Note, *Gentrification, Tipping And The National Housing Policy*, 11 N.Y.U. REV. L. & SOC. CHANGE 255 (1982).

207. *See supra* note 206.

208. *See id.*; *see also, e.g.*, INDIANAPOLIS: DOWNTOWN DEVELOPMENT FOR WHOM?, *supra* note 129, at 12-18 (noting the dislocation of residents and destruction of many low-income neighborhoods in order to make way for co-financed redevelopment projects).

209. The money will be spent on goods and services or donated to charity, which will use it for goods and services. If the money is invested or saved, then the recipients of the investment or deposit will use it on loans to others. *See generally* H. HAZLITT, *supra* note 123, at 177-90.

210. *Id.* at 31-36.

money would have purchased more goods and services than they otherwise were able to and thereby would have increased job opportunities in the activities most valued by community members. Thus, the one million dollars is still only one million dollars no matter who is spending it, and the jobs created by one project merely mean the loss of potential jobs elsewhere. The simple economic reality relates back to the very first problem discussed in connection with this trickle down assertion and supports the conclusion that trickle down benefits resulting from policies that favor import-replacing activities would be greater than the benefits generated by current practices of co-financing specific real estate projects.

Ultimately, the arguments in favor of subsidizing the construction of shopping centers, hotels, office buildings, and restaurants through the process of co-financing must be viewed as special interest arguments asserted as justification for the use of the political means. The assertion that the location problem for these types of real estate projects in itself is evidence of market failure is an unsupported argument that covers special interests' preference for a different location for resource employment from the location dictated by individual preferences effected through the private market. Likewise, the actual benefits from trickle down job creation, at best, are much less valuable than those proclaimed by the special interests that will benefit from construction of the subsidized real estate project. Thus the supporters of many current co-financing activities demonstrate the typical attitudes and practices analyzed in the section of this Article dealing with the political and economic dynamics of co-financing.

Given this classical liberal perspective on many current co-financing activities, it is now possible to discuss specific recommendations. The discussion of recommendations will follow in three parts. First, the permissible types of projects for co-financing will be outlined. Second, guidelines for co-financing participation will be established. Third, recommendations will be made concerning alternatives to co-financing that would improve the urban economic environment in ways consistent with facilitating import-replacing activities.

Permissible projects for co-financing activities must satisfy a two part test of being the type of project the private market fails to provide for and serving a function essential to preserving individual human dignity. On these grounds, this Article rejected co-financing of shopping centers, hotels, office buildings, and restaurants. In order to meet this two part test, a completely different list of projects must be developed. An outline of acceptable projects would include the following: low-income housing to provide basic shelter for the poor, day care facilities for low-income people and the underemployed to allow them to engage more fully in the marketplace, and job training and retraining facilities to develop the working potential of the poor and retrain workers displaced by the dynamics of the local employment market as changes in technology and market forces affect the continued or future employability of specific job skills.

All the acceptable projects outlined above focus on the types of projects that the private market is unlikely to invest in because the poor, unemployed, and underemployed lack the purchasing power to make such investments profitable. These are not merely projects in which substantial investment is occurring elsewhere. Rather, they are projects that would receive no substantial private investment but for the assistance of government subsidies. Because the market truly fails to produce these projects, co-financing activities could be justified as one method of assisting in these projects' development.

As to the second part of the two part test of acceptability, each of the co-financing projects outlined above is designed to address the basic and fundamental rights of individuals. In essence, these projects raise the issue of whether the government should subsidize the needs of a certain class of people when the private market fails to allocate resources for their use. This is fundamentally a moral question that cannot be resolved by simple utilitarian cost-benefit analysis.[211] As I have argued in an earlier article, economic analysis that fails to incorporate an understanding of moral philosophy and inalienable rights fails to serve a valuable purpose in resolving many of our nation's most pressing social problems.[212] This focus on morality in economic analysis is consistent with the classical liberal philosophy of Adam Smith, Friedrich Hayek, and Milton Friedman.[213] Access to both basic shelter and job training opportunities are within the confines of reasonable expectations for individual liberty and human dignity in a free soci-

211. *See* Malloy, *supra* note 13, at 176-77; *see also* Krietmeyer, *Toward A Consensus On Economic Rights: The Pastoral Letter of the Catholic Bishops*, 9 HARV. J.L. & PUB. POL'Y 117 (1986); Scalia, *Morality, Pragmatism And The Legal Order*, 9 HARV. J.L. & PUB. POL'Y 123 (1986).

212. *See* Malloy, *supra* note 13, at 177.

213. *See supra* note 198.

ety. Thus, projects that aid the poor in the way the projects outlined above do are acceptable for co-financing subsidies. Even if one were to disagree with this proposition, however, it would be incumbent upon the dissenter to demonstrate that no moral basis supports providing such minimal services to the poor. Finally, even if that demonstration were made, it would in no way justify the co-financing of shopping centers, hotels, office buildings, and restaurants.

All in all, the change in the direction of co-financing activities suggested by this outline of acceptable projects is essential to preserving the proper and limited role of government in a free society. By requiring that government limit its activities to those cases in which there is true market failure and in which there is a moral basis for acting to protect an individual's liberty, the role of limited government is preserved. Government action in these situations is no different from government action in providing for public roads and other infrastructure and service needs. When private individuals cannot profitably provide infrastructure and services that nonetheless are important to the concept of social order, economists generally have accepted a governmental role. The reordering of co-financing activities recommended in this Article, therefore, would make such activities consistent with the traditionally accepted principles of limited government.

Presuming an acceptable type of project is presented, government co-financing activities need to be restricted by certain guidelines. These guidelines must focus on three requirements. First, guidelines must identify the scope of liability that should attach to a city acting in a co-financing capacity to complete an acceptable project with a private developer. Second, in order to preserve the largest possible sphere of individual liberty in a capitalist society, meaningful constitutional limitations must be placed on justifications for government co-financing activities. Third, adequate information must be available for assessing the costs and benefits of co-financing projects and for serving as a basis for making government more accountable for its conduct.

As this Article argued earlier, local governments engaged in co-financing activities ought to be held to the same standards of liability and obligation as is a private developer or lender.[214] Governmental activities in this area are similar to their private market counterparts, and local governments, therefore, should not enjoy

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214. *See supra* notes 51-56 and accompanying text.

any lower standards of care or commercially reasonable conduct. Making local government stand on equal footing with the private developers chosen for co-financing activities also encourages a more business-like approach to the construction and completion of projects. It also should make the full cost of engaging in co-financing activities more apparent to local government officials and their constituents and thereby will make for a more fully informed decisionmaking process.

Constitutional limitations on government co-financing activities must be limitations of substance, rather than of mere form. A free society based on a limited governmental role must require sound justifications for employing the government's power in the pursuit of economic development. As this Article demonstrated, constitutional limitations on government activities that restrict competition in the private sector and employ both public funds and the power of eminent domain are circumvented easily.[215] Current trends indicate a growing acceptance of broadly defined public welfare justifications that can permit a complete array of government activity in the private real estate development sector of the economy.[216] In order to prevent the eventual full scale governmental intrusion into the traditional activities of the private marketplace, government assistance to private developers must be limited to only those projects acceptable for co-financing. This means that constitutional restrictions ought to prevent co-financing of shopping centers, hotels, office buildings, and restaurants because these projects do not involve the traditional grounds for government activity. Justifications in support of using governmental powers, such as condemnation, ought to be limited to those few cases in which a market failure exists and the project is essential to protecting individual human dignity. This limitation, of course, would restrict drastically the type of activities government could support through co-financing, but in a free society based on a capitalist economic structure, the role of government should be limited.

Adequate information is essential for assessing the costs and benefits of a co-financing project and for making government more accountable for its conduct.[217] Providing information in this context, however, means more than simply publishing expected budget and return items in the local newspaper. This, of course, is not to

215. *See supra* notes 57-80 and accompanying text.
216. *Id.*
217. *See supra* text accompanying note 190.

say that such publication is without merit, but only that such publication does not provide full information, nor does it demonstrate the significance of cost items in the budget. In order to insure better information for the decisionmaking process, two requirements must be met. First, to the extent possible, the city to receive the primary benefits of the completed project should internalize the entire cost of a co-financing project. Second, to the extent that nonlocal funds are used in an acceptable co-financing project, access to the outside funds should be linked to a local commitment to facilitate import-replacing activity.

Internalizing the cost of a co-financing project would require a city to finance its own activities just as an unsubsidized private individual must do in buying goods or services in the private marketplace. Local politicians would have to engage in a convincing dialogue in order to get sufficient local support for their proposed projects. Without a source of nonlocal funds or cross-subsidies on which to draw, local residents would carry the full cost of the city project. In this way, co-financing arrangements would be subject to close scrutiny because local taxpayers would see the exact result of the government's use of their money. Each individual would be able to see exactly what other projects or investments were given up in order to pursue the project selected. This would allow for a more informed decisionmaking process and would give substance to the notion that as the potential recipients of an improved urban environment, the local residents should be willing to pay the full cost of the benefits they hope to enjoy.

In a less than ideal world, it may be impossible to avoid the politics that make nonlocal funds available to cities seeking to engage in co-financing projects. Quite frankly, it may be appropriate to have outside funds made available to a city in certain circumstances. A particular city may be extremely poor or may be experiencing dramatic changes in its local economy that place many residents on unemployment and welfare. Such a city would be unable to afford co-financing projects. As long as co-financing activities are limited to projects that benefit low-income people, the use of nonlocal funds can be justified provided those funds are linked to the encouragement of import-replacing activity. Linkage is important because, ultimately, subsidies for co-financing projects remain just that, regardless of their origin, and in order to foster real long-term economic growth and opportunity, a city must escape its need for subsidies and develop a strong and dynamic local economy. Thus, for instance, the receipt of federal funds may be conditioned on requirements that the city eliminate or reduce negative business restrictions such as rent controls or excessive zoning requirements that discourage investment. In this way, nonlocal funds are made available at the expense of eliminating bad local economic policy, rather than as a way to use outside funds to offset the undesirable effects of local special interest legislation.[218]

Given this Article's recommendations for the limited types of projects acceptable for co-financing and the guidelines for their implementation, a city still has ways by which to encourage commercial economic development. The methods employed to encourage development or revitalization must be compatible with the need to facilitate import-replacing activities within the city region. Furthermore, the steps taken to encourage economic activity should be of a general rather than outcome specific nature. In other words, government policy should be expressed by general rules applicable to all people, rather than by specific rules designed to create incentives for specific enterprises or special interest groups.[219]

Instead of local politicians trying to second guess the marketplace or trying to create specific incentives for select special interest groups, the process of general rules would be aimed at enhanc-

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218. *See* Hoeflich & Malloy, *supra* note 123. This article discusses many bad effects of local special-interest legislation in the housing area. In addition, it recommends limiting or eliminating federal funds for states that employ undesirable local housing regulations, such as rent controls. *Id.* at 683-89.

219. *See* F. HAYEK, *supra* note 16, at 220-28.

> The classical argument for freedom in economic affairs rests on the tacit postulate that the rule of law should govern policy in this as in all other spheres. We cannot understand the nature of the opposition of men like Adam Smith or John Stuart Mill to government "intervention" unless we see it against this background. Their position was therefore often misunderstood by those who were not familiar with that basic conception; and confusion arose in England and America as soon as the conception of the rule of law ceased to be assumed by every reader. Freedom of economic activity had meant freedom under the law, not the absence of all government action. The "interference" or "intervention" of government which those writers opposed as a matter of principle therefore meant only the infringement of that private sphere which the general rules of law were intended to protect. They did not mean that government should never concern itself with any economic matters . . . . To Adam Smith and his immediate successors, the enforcement of the ordinary rules of common law would certainly not have appeared as government interference; nor would they ordinarily have applied this term to an alteration of these rules or the passing of a new rule by the legislature so long as it was intended to apply equally to all people for an indefinite period of time . . . . There is perhaps no aim which they would not have regarded as legitimate if it was clear that the people wanted it; but they excluded as generally inadmissible in a free society the method of specific orders and prohibitions.

*Id.* at 220-21.

ing the economic environment of the entire city region. Examples of this type of program would include across the board reductions in local taxes, streamlining planning and zoning regulations, and expending city revenue on traditional infrastructure and services, such as roads, that enhance all types of economic activity. A city also might seek to enhance its economic environment by actively promoting competitive reductions in state-wide income taxes, promoting right to work laws, or reducing unnecessary economic regulation of business. Finally, a city properly might engage in a study of its strengths and weaknesses and expend revenue in promoting its economic advantage as a means of furnishing information to the private marketplace.[220] Such urban policies would promote an environment conducive to import-replacing activities necessary for achieving economic growth and at the same time protect the free flow of capital, technology, labor, and ideas.

All these recommendations, from the types of projects acceptable for co-financing and the guidelines for their implementation to the suggested alternative methods of seeking economic development, are consistent with the classical liberal view on the proper relationship between government and the individual in a free society. First, acceptable projects for co-financing are limited and can be justified only when there is true market failure and the government's involvement in correcting the market failure is within the traditional, limited confines of activity necessary to insure individual liberty.[221] These requirements dramatically reduce the problems associated with use of the political means. When properly implemented, these requirements reduce governmental intrusion into the marketplace and allow individual preferences, as expressed in the marketplace, to enjoy the largest possible sphere of expression consistent with the needs of society and individual liberty. When properly restricted, government can protect individual liberty and human dignity while avoiding complete capture by special interest groups bent on employing the power of the state in an effort to exploit others in ways not possible in the competitive

220. For example, a city may find that it is ideally situated for the needs of the high-tech electronics industry and may he ahle to encourage private investment by providing the market with better information about the city's particular location. For factors to consider with a high-tech strategy, see Gorlow, *High-Tech Location Decisions and Corporate Dynamics*, URB. LAND, Dec. 1984, at 14; Porter, *Research Parks: An Emerging Phenomenon*, URB. LAND, Sept. 1984, at 6; Loughlin, *High Tech and Real Estate: Basic Realities*, URB. LAND, June 1984, at 32.

221. *See supra* text accompanying notes 197-202, 210-15 (concerning the type of projects acceptable for co-financing).

marketplace.

Second, these recommendations dramatically reduce the philosophical problems with promoting government ownership in a society otherwise committed to a capitalistic structure in which the means of production are owned by private individuals.[222] As long as government co-financing arrangements are limited to the types of projects recommended in this Article, the government will not intrude on significant private market activity and, therefore, should avoid losing its ability to make impartial decisions concerning urban planning and future development. At the same time, people engaged in private market activities will be forced to continue to compete in the marketplace without linking the financial success of their commercial projects to the city's ownership interest, and this should preserve a basis for greater independence and diversity in the debate over urban policy.

Third, these recommendations are designed to provide people with more information than currently is available concerning the nature of government co-financing activities.[223] To the extent that these recommendations allow individuals to appreciate more clearly the costs and benefits of a given project and the implications of governmental intrusion into the market, they provide a basis for more informed decisionmaking and for increased governmental accountability.

Finally, to the extent that these recommendations preserve the limited function of government and to the extent that they provide a moral and philosophical framework for addressing urban policy, they are less likely to lose their normative value.[224] These recommendations represent a reasoned and principled approach to urban revitalization and are not merely an attempt to expand the "grab bag" of subsidies available for special interest groups. Additionally, they are based on traditionally accepted American values of individual liberty, free enterprise, and a government role limited to instances of market failure and protection of fundamental moral values concerning individual human dignity. As a consequence, this Article's recommendations are normatively more desirable in the long run than many current co-financing practices.

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222. *See supra* text accompanying notes 187-90 (concerning the philosophical problems of government ownership in a capitalist society based on private ownership).

223. *See supra* text accompanying notes 188-93 (concerning the need for better information).

224. *See supra* text accompanying notes 191-96 (concerning normative values and the law).

In addition to being consistent with classical liberal philosophy, these recommendations also are consistent with Jane Jacobs' observations about the necessary path to long-term economic growth, prosperity, and opportunity.[225] These recommendations focus on creating an environment conducive to the economic dynamics essential to facilitating import-replacing activity while they reduce the role of government loans, grants, and subsidies. Only through enhanced import-replacing activity can true economic progress continue, for government loans, grants, and subsidies can provide only short-term relief for urban problems without correcting the structural difficulties underlying these problems.

## VI. Conclusion

In a sense, America's urban centers are experiencing a renaissance of sorts that reflects the vitality of a renewed interest in the city. Observations of this activity reveal an impressive array of new downtown real estate projects being constructed and the reemergence of more affluent people working, living, shopping, and entertaining in America's downtowns. Beneath the glossy first impressions, however, is a complicated product of political and economic dynamics that, when analyzed, reveals that the renaissance may be something less than meets the eye.

The focus of this Article has been on analyzing the political and economic dynamics of co-financing arrangements in the manner of a traditional political economist using a classical liberal perspective. This analysis revealed that many current co-financing activities are merely the product of special interest group politics. These special interest groups successfully are circumventing private market allocations of resources by using the political means in support of their own profits. Significantly, they use the political means to support projects not justified by market failure conditions or by their fundamental contribution to the preservation of individual liberty and human dignity.

The proper method of engaging in co-financing arrangements is to pursue projects in which the limited and legitimate role of government is preserved. This means restricting government co-financing activities to limited types of projects: projects that serve low-income people and that otherwise would go unsupplied because the private market will not address these needs in the

225. *See supra* text accompanying notes 150-79 (concerning the needs of the urban economy).

absence of significant purchasing power. In fulfilling this governmental function through real estate co-financing, a city must be restricted by certain guidelines, but a city is free to use certain limited alternatives to co-financing that would support and encourage local economic development.

The guidelines and recommendations suggested by this Article are designed to promote co-financing activities and urban revitalization by means consistent with classical liberal philosophy. The resulting recommendations also are consistent with the process of assuring long-term economic growth, prosperity, and opportunity in America's city regions. Such economic development cannot occur solely through government loans, grants, and subsidies. These governmental responses provide short-term relief for the economically strapped, but do little if anything to bring about the necessary structural change and development needed to assure the personal and societal benefits resulting from a strong urban economy.

In this context, it is clear that the current urban renaissance may fall short of expectations. In fact, to the extent it is based on the short-term effects of government loans, grants, and subsidies, current activity may represent merely an interim stage of economic activity that will be followed by a less healthy and less dynamic urban economy than that existing before the so-called renaissance. In order to avoid this consequence and in order to reestablish the proper and limited role of government in a free society, it is essential to expand the scope of the current dialogue on urban policy. Ultimately, this Article's goal has been to give new direction to this dialogue and to suggest the classical liberal alternative to current approaches to urban revitalization.