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Cities, Property, and Positive Externalities

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CITIES, PROPERTY, AND POSITIVE EXTERNALITIES

GIDEON PARCHOMOVSKY* & PETER SIEGELMAN**

ABSTRACT

Cities are the locales of numerous interactions that generate externalities—both negative and positive. Although the common law provides a vast array of mechanisms for limiting negative externalities, there is a striking absence of provisions for stimulating the production of positive ones. As a consequence, activities whose social benefits are greater than their private costs are not undertaken, with a resulting efficiency loss.

In this Article, we demonstrate how cities can develop commercial districts that allow for the capture of positive externalities by following the example of suburban malls. In malls, anchor stores provide positive externalities—additional customers—to neighboring stores. Anchors capture these externalities through the subsidized rents they pay to mall owners, who in turn charge higher rents to the smaller businesses who benefit from the additional traffic. This private law mechanism provides a strong reason for large stores to locate in suburban malls—where they can recoup some or all of the spillover benefits they provide—as opposed to urban centers, where they are unable to recover the benefits they provide to neighboring stores.

Businesses in cities may generate similar positive externalities, but the law offers virtually no mechanisms by which they can recover any of the value of the benefits they provide. We argue that cities should use public law to create planned commercial districts, analogous to suburban malls, which would allow for the capture of positive

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externalities among commercial establishments. We also discuss how cities can use the legal powers at their disposal to achieve this goal. We submit that the reconfiguration of downtown areas will not only result in the production of new positive externalities but will also reduce the negative externalities associated with urban sprawl.

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INTRODUCTION

Viewed from an economic perspective, cities are all about positive¹ and negative externalities.² Cities that minimize the scope and magnitude of negative externalities and are able to produce positive externalities will have an inherent edge over localities that fail at these twin tasks.³ From a legal standpoint, therefore, successful urban planning requires cities to adopt legal policies that minimize harmful third-party effects—that is, negative externalities, and encourage uses with salutary spillovers—that is, positive externalities. Both types of externalities are of great significance to the economic performance of cities. Yet, the two types have been treated very differently by scholars and lawmakers.⁴

With a few notable exceptions, property and land use laws are largely concerned with the problem of negative externalities—acts that impose unaccounted-for costs on others. Ownership structures, as well as the laws of nuisance, servitudes, and zoning, are commonly understood as means for internalizing negative externalities,⁵ which have also been a focal point in property and tort theory.

1. See N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 199 (6th ed. 2012) (defining positive externalities as arising from activities that yield benefits to parties who do not pay to receive them); Edward L. Glaeser et al., *Growth in Cities*, 100 J. POL. ECON. 1126, 1127-28 (1992); see also Richard Florida, *Cities, Bikes, Diabetes, Flu Shots and Positive Externalities*, CREATIVE CLASS (Nov. 14, 2007, 9:33 PM), http://www.creativeclass.com/_v3/creative_class/2007/11/14/cities-bikes-diabetes-flu-shots-and-positive-externalities/ (“Cities are vast reservoirs of positive externalities in employment, transportation, education, recreation and services. People migrate to cities hoping for all those happy spillovers to land on them.”).

2. See MANKIW, *supra* note 1, at 196 (defining a negative externality as arising from an actor’s behavior that imposes a cost on someone else, for which the actor does not pay).

3. As David Schleicher put it, “[c]ities develop because they provide these ‘agglomeration’ gains, that is, they provide residents with the advantages of big, diverse, and productive markets and creative ferment. Because of this, cities will draw residents and businesses even if all local governments provide identical local policies.” David Schleicher, *The City as a Law and Economic Subject*, 2010 U. ILL. L. REV. 1507, 1510 (2010).

4. See *infra* Part I.A.

5. See, e.g., Dean Lueck, Co-Dir., Program on Econ., Law & the Env’t, Univ. of Ariz., Lecture at the European School on New Institutional Economics: Economics of Property Law (May 18, 2011), available at http://esnie.org/pdf/textes_2011/Lueck.pdf (observing that property rights give rise to a myriad of externalities and explaining that property law addresses externalities through the doctrines of trespass, nuisance, and servitudes, and through regulatory zoning).

All the while, however, scholars have paid scant attention to the mirror-image phenomenon of *positive* externalities—acts that confer unaccounted-for benefits on others. Property theorists have long recognized the existence of positive externalities, but the literature has largely ignored them.⁶ Even worse, in the few cases in which urban planners have touted positive spillovers from various development projects such as sports stadiums, these promised benefits have typically failed to materialize.⁷

In this Article, we propose a legal policy that would enable cities to better manage positive externalities, increasing their odds of success. One aspect of urban life that is rife with positive externalities is commerce.⁸ Not all businesses are created equal, however. Famous brand name stores and large commercial establishments create a plethora of positive externalities for their smaller neighbors.⁹ To illustrate, consider the effect of a downtown Apple store on neighboring business. Many of the customers attracted by the Apple store are likely to purchase a coffee at a neighboring café or a meal at a nearby restaurant. Some may even use this opportunity to shop for clothes or furniture. Importantly, there is no reciprocity in the relationship: most smaller businesses simply do not have the gravitational pull to attract masses of customers independently, and

6. See *infra* Part I.A. One significant exception is Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 257-58 (2007), which offers a theory of why uncompensated positive externalities, or spillovers, are sometimes desirable, especially in the context of intellectual property, where spillovers may lead to further innovation. Another is Scott Hershovitz, *Two Models of Tort (and Takings)*, 92 VA. L. REV. 1147 (2006). Hershovitz's argument is that if the basis of tort law is really to promote efficiency, the law should be as concerned with rewarding positive externalities as it is with punishing negative ones. *Id.* at 1186-88. We take no position in this philosophical dispute between correct justice and efficiency theories, but we do present an example where the failure to account for positive externalities has significant efficiency consequences.

7. See Robert A. Baade & Richard F. Dye, *The Impact of Stadium and Professional Sports on Metropolitan Area Development*, GROWTH & CHANGE, Apr. 1990, at 1 (analyzing stadium investment and questioning its positive economic impact); Dennis Coates & Brad R. Humphreys, *Professional Sports Facilities, Franchises and Urban Economic Development*, 3 PUB. FIN. & MGMT. 335, 335 (2003) (“[E]conomists have found no evidence of positive economic impact of professional sports teams and facilities on urban economies.”).

8. See Schleicher, *supra* note 3, at 1509-10 (explaining that by selecting the right location, a business can “capture information spillovers, and participate in larger and more specialized labor and consumption markets”).

9. See *infra* Part II.B.

thus do not bestow a similar benefit on brand name stores.¹⁰ The positive effect of larger businesses on smaller ones can best be seen when an anchor business shuts down or relocates to another area. Closings or relocations of anchor stores are often the kiss of death to many small businesses and may portend the economic decline of entire downtown areas.¹¹ The opposite is also true: the arrival of an anchor store may revive a commercial district, and a critical mass of branded stores can do much to secure the viability of a downtown area.¹²

Cities' failure to take account of the positive externalities generated by anchor stores may have played an important part in the much-lamented hollowing-out of central city business districts and the flight by retail commerce, and its customers, to the suburbs.¹³ Because—as we demonstrate below—large retail stores are able to capture the positive spillovers they generate when they locate in malls, but not when they locate in central cities, suburban malls have a built-in competitive advantage over urban centers when it comes to attracting such enterprises.¹⁴

Cities can attract branded stores in many ways. One obvious way is to subsidize them. We believe, however, that the subsidy solution is misguided. Subsidies impose a cost on the public and raise the specter of political corruption.¹⁵ Instead, we suggest that local planners should adopt policies that can unlock the value inherent in positive externalities by attracting businesses and establishments that create positive spillovers for neighboring businesses, and by allowing the former to internalize those benefits.¹⁶

10. See *infra* Part II.B.

11. See Interview by Jacky Lyden with Chris Leinberger, Professor of Practice in Urban and Reg'l Planning, Univ. of Mich. Taubman Coll. of Architecture & Urban Planning, on NPR (Aug. 20, 2011), available at <http://www.npr.org/2011/08/20/139815836/without-an-anchor-store-does-a-neighborhood-float-away>; see also MICHAEL D. BEYARD ET AL., URBAN LAND INST., TEN PRINCIPLES FOR REBUILDING NEIGHBORHOOD RETAIL, at iv (2003), available at http://www.uli.org/wp-content/uploads/ULI-Documents/TP_NeighborhoodRetail.ashx_.pdf.

12. See BEYARD ET AL., *supra* note 11, at 6-7.

13. See *id.* at iv.

14. Compare *infra* Part II.B (noting techniques used by malls to capture anchor stores' positive spillovers), with *infra* Part III (outlining the challenges cities face in taking advantage of anchor stores).

15. See *infra* notes 158-68 and accompanying text.

16. See *infra* Part III.

To get a handle on how to achieve this result, it is useful to think about the problem from the perspective of a single owner. In his seminal article, *Toward a Theory of Property Rights*, Harold Demsetz demonstrated that it is possible to internalize the externalities resulting from the usage of land by consolidating all the rights in the hands of a single owner.¹⁷ Adopting the Demsetzian perspective, we imagine a world in which a single entity owns all commercial properties and ask how she would manage the properties to take account of the spillover benefits that large stores create for smaller ones. In fact, this problem is less hypothetical than it may appear at first glance: owners of private shopping malls encounter this problem on a regular basis and have come up with an effective solution: differential rents.¹⁸

Most people know that a key to the success of many shopping malls is the inclusion of one or more major anchor stores that have an independent ability to draw clientele.¹⁹ What is less well known is that such anchors pay a highly reduced rent relative to other stores.²⁰ Empirical studies establish that anchor stores average 14 percent of the rent per square foot charged to smaller retailers, and in some cases pay no rent at all.²¹ The lower rent reflects the beneficial effect such stores generate for neighboring smaller retailers via the additional customers that the anchor stores bring to their smaller cotenants.²² The differential rent collected by mall owners is effectively an internalization mechanism that takes account of the relative contributions of store owners to each other's business. Indeed, one of the important functions of mall management is to design and implement an appropriate pricing scheme that allows the anchor stores to capture a significant share of the spillover benefits they create.²³

We show that a variant of this scheme can be used to help revive urban commercial districts. To implement it, cities should take two

17. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 355-56 (1967).

18. *See infra* Part II.B.

19. *See infra* Part II.B.

20. *See infra* Part II.B.

21. *See infra* Table 1.

22. *See infra* Part II.B.

23. *See infra* Part II.B.

steps. First, they should use their planning and zoning powers to designate optimal locations for commercial districts.²⁴ Once this task has been accomplished, cities should use their eminent domain power to consolidate all the rights in the relevant lots.²⁵ At the end of this process, all lots will be under single ownership—that of the city. At this point, a city faces a choice of developing the shopping district by itself, or of auctioning it off to mall developers. We discuss the pluses and minuses of each approach.²⁶

Implementation of our scheme may not only revive commercial areas in cities and guarantee their economic sustainability, but will also have an underappreciated yet highly desirable effect: it will tend to reduce the negative externalities stemming from urban sprawl.²⁷ Surprisingly, the internalization of positive externalities in commercial districts would simultaneously result in the reduction of many negative third-party effects and a substantial enhancement of overall efficiency.²⁸

The remainder of this Article proceeds as follows. In Part I, we discuss the theoretical literature on externalities and its influences on legal doctrines. We show that whereas concern with negative externalities has shaped multiple doctrines in various legal areas, positive externalities have received almost no attention from lawmakers and legal scholars. Notwithstanding the lopsided treatment of negative and positive externalities in the theoretical literature and in practice—or perhaps because of it—we conclude that the internalization of positive externalities is a laudable goal for legal policy if it can be attained at a reasonable cost. The discussion in Part II builds on the theoretical exploration in Part I by extending and applying the theory in the contexts of urban development and

24. See *infra* notes 169-78 and accompanying text.

25. See *infra* notes 182-88 and accompanying text.

26. See *infra* Part III.B.

27. See, e.g., MATTHEW E. KAHN, GREEN CITIES: URBAN GROWTH AND THE ENVIRONMENT 3, 98 (2006) (arguing that increasing density via urbanism is a way to avoid the conflict between growth in output and environmental degradation); Ryan Avent, *One Path to Better Jobs: More Density in Cities*, N.Y. TIMES, Sept. 3, 2011, <http://www.nytimes.com/2011/09/04/opinion/sunday/one-path-to-better-jobs-more-density-in-cities.html?pagewanted=all> (summarizing theoretical arguments and empirical evidence showing that concentrating economic activity in cities creates more jobs and leads to technological dynamism because of spillover effects—positive externalities).

28. See Avent, *supra* note 27.

shopping mall configuration. By juxtaposing the two contexts, we draw potential recommendations for redesigning downtown commercial districts. In Part III, we advance a blueprint for implementing our proposal and address possible challenges and objections. Finally, in Part IV, we assess the broader economic benefits to cities from adopting our proposal.

I. EXTERNALITIES AND THE LAW

In this Part, we introduce the concepts of negative and positive externalities and discuss their treatment in economics and law. As we show, concern about negative externalities has played a key role in the development of property, as well as tort doctrine. Surprisingly, the twin concept of positive externalities has been shunted to the side by theorists and virtually ignored by common law courts. Under common law rules, actors who create positive externalities for others have only very limited scope to recover for any of the benefits they have conferred.²⁹

In an attempt to address this anomaly, we discuss the limited scholarly justifications for ignoring positive externalities. We find fault with most of these justifications, but even if efficiency-minded common law courts would do best to ignore positive externalities, this in no way means that such spillovers should be ignored altogether. Indeed, much of urban development policy can be characterized as attempts—often misguided—to create or foster positive externalities via the exercise of regulatory authority. For example, city governments often agree to subsidize the building of stadiums for sports teams in the unwarranted hope that doing so will create spillover benefits for the community at large that the team or stadium owner cannot recover on their own.³⁰ In fact, it seems likely

29. See *infra* Part I.A.

30. See Roger G. Noll & Andrew Zimbalist, *Sports, Jobs, Taxes: Are New Stadiums Worth the Cost?*, BROOKINGS REV., Summer 1997, at 36 (“[W]e ... examine the local economic development argument from all angles: case studies of the effect of specific facilities, as well as comparisons among cities and even neighborhoods that have and have not sunk hundreds of millions of dollars into sports development. In every case, the conclusions are the same. A new sports facility has an extremely small (perhaps even negative) effect on overall economic activity and employment. No recent facility appears to have earned anything approaching a reasonable return on investment.... Regardless of ... the unit of analysis[,] ... the economic

that the common law's failure to recognize positive externalities has led urban planners to emphasize them in attempts to regulate development.

We conclude that the presence of positive externalities—when they are correctly identified, rather than merely hypothesized to exist—constitutes a legitimate basis for policy. Regulations should strive to internalize both negative and positive externalities when there is a cost-effective way to do so. We suggest that such a mechanism does indeed exist in the case of shopping malls, which are designed so as to capture the positive externalities created by anchor stores on other nearby stores.

A. Of Negative and Positive Externalities

As any law student knows, externalities come in two forms: negative and positive. A negative externality refers to the adverse effect of one's activity on others that is not reflected in market prices.³¹ Accordingly, if Amy operates a cement factory next to Beth's home, the smoke, noise, and soot emanating from the factory constitute negative externalities imposed on Beth.³² Positive externalities are the uncompensated *beneficial* effects of one's activities enjoyed by third parties.³³ Hence, if Carol tends a beautiful, unfenced garden that Deborah passes every day on her way to work, Deborah enjoys a benefit from Carol's action, for which Deborah need not pay.

Although negative and positive externalities may be thought of as two sides of the same coin, or two manifestations of the same problem, the former has received endless attention, whereas the latter has largely remained an academic curiosity. It is no exaggeration to say that negative externalities were the key impetus for the

benefits of sports facilities are de minimus.”).

31. *See supra* note 2.

32. *See* *Boomer v. Atl. Cement Co.*, 257 N.E.2d 870, 875 (N.Y. 1970) (conditioning an injunction on the nonpayment of permanent damages); *see also* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1115-16 (1972) (stating that internalizing externalities created by pollution is a frequent goal of nuisance law).

33. *See supra* note 1.

development of the law and economics movement,³⁴ and they are frequently invoked as the justification for much of our property, tort, and regulatory law.³⁵ One can easily trace the impact of negative externalities on both law and economics, and legal doctrine by focusing on a single problem: pollution.

The first theorist to address the problem of pollution was the British economist Arthur Pigou.³⁶ Perturbed by the fact that factories could pollute with impunity, Pigou proposed imposing a tax on polluters in order to force them to take account of the harm they inflicted on the rest of society. The amount of the tax was to be equal to the harm society suffered as a result of the pollution.³⁷ This mechanism, which later became known as a “Pigouvian tax,” was the first attempt to internalize the harms of pollution, and thereby to align the narrow economic self-interest of polluters with the broader societal interest.³⁸ As should be apparent, Pigou’s solution was regulatory in nature.

The next attempt to tackle the pollution problem was also the definitive moment in modern law and economics. In his seminal work, *The Problem of Social Cost*, Ronald Coase demonstrated that when transaction costs are sufficiently low—nonexistent in his original analysis—private bargaining will solve the problem of negative externalities.³⁹ Revisiting the problem of pollution, Coase showed that in a world with no transaction costs and perfect information, bargaining between the parties would lead to one of two outcomes. Either the polluter would compensate the victim—if the benefit the polluter derived from the underlying activity

34. See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 1-16 (1960) (examining legal frameworks and concluding that in the absence of transaction costs, each is equally efficient at internalizing externalities).

35. See *infra* notes 48-71 and accompanying text.

36. See, e.g., E.C. Pasour, Jr., *Pigou, Coase, Common Law, and Environmental Policy: Implications of the Calculation Debate*, 87 PUB. CHOICE 243, 243 (1996) (“The modern theory of neighborhood effects is rooted in A.C. Pigou’s *Economics of Welfare*.”).

37. More precisely, efficiency requires that the marginal tax rate be set equal to the marginal social harm. See, e.g., *id.* at 244-45 (“A per-unit tax (T) levied on the [polluter] equal to the difference between marginal private cost and marginal social cost will internalize the externality.”).

38. See *id.* at 248.

39. See Coase, *supra* note 34, at 9-11 (explaining that in a transaction cost-free world, the allocation of legal liability will not affect the final allocation of resources because of private bargaining).

exceeded the harm to the victim—or abate the pollution, in the extreme case, by shutting down her plant—if the harm to the victim exceeded the benefits to the polluter from continuing operation.⁴⁰ In either case, the efficient solution would be reached. And, astonishingly, the efficient result would be obtained *regardless* of whether the factory held the legal entitlement to pollute or the victim had the legal entitlement to be free from pollution.⁴¹ Coase, therefore, proposed a contractual solution to the problem of negative externalities.

Harold Demsetz, who espoused a property-centered perspective, advanced a different approach to the problem of negative externalities. Demsetz's *Toward a Theory of Property* deviated from prior contributions in another sense: it did not focus on pollution per se but rather on the exploitation of natural resources.⁴² Demsetz observed that open access and common property regimes invariably generate negative externalities in asset use. In both regime types, actors receive the full marginal benefit of their use of common resources but incur only a fraction of the marginal cost represented by the small diminution in their future consumption opportunities, with the lion's share of the cost distributed over all the other owners or group members.⁴³ Accordingly, Demsetz predicted that resources held in common will be over-exploited⁴⁴—a phenomenon that was subsequently dubbed the “tragedy of the commons” by Garrett Hardin.⁴⁵

Importantly, Demsetz did not just settle for pointing out the problem; he also proposed a solution. He noted that the externality problem can be solved by consolidating all relevant rights in resources in the hands of a single private owner. Once an asset is

40. *See id.* at 11.

41. *See id.*

42. *See* Demsetz, *supra* note 17, at 356 (“The resulting private ownership of land will internalize many of the external costs associated with communal ownership This concentration of benefits and costs on owners creates incentives to utilize resources more efficiently.”).

43. *See id.* at 354-55, 358-59.

44. *Id.* at 354-55.

45. Garrett Hardin, *The Tragedy of the Commons*, 162 *SCIENCE* 1243, 1244-45 (1968).

owned by a single owner, most consumption externalities disappear.⁴⁶

It is precisely for this reason that actors litter in public streets, but hardly ever in the privacy of their homes. When an individual disposes of her cigarette in a public street, she gets the full, albeit small, benefit of her act, whereas the larger cost is spread out over the entire population. If she were to do so in her own home, she would get the same benefit, but since she herself would have to clean it up eventually, she would also pay the full cost of doing so. When the same individual both receives the benefit and has to pay the full costs of an act, the individual will refrain from acts such as littering that generate low benefits and high costs. The concentration of all rights in the hands of a single individual greatly reduces the owner's ability to pass the costs of her behavior with respect to the asset onto third parties.⁴⁷

The impact of negative externalities on our tort law is even greater than their effect on property theory. Indeed, concern about negative externalities lies at the heart of the law of negligence, the centerpiece of our tort system. Negligence law is aimed at encouraging actors to take the costs they impose on others into account by entitling harmed parties to seek redress against tortfeasors.⁴⁸ Accordingly, if Eric drives negligently in a school zone and hits Fay, he will have to compensate Fay for the harm she suffered. Of course, the duty to compensate may be justified on corrective justice grounds,⁴⁹ but it also forces actors to consider the effect of their actions on third parties. Realizing this, actors will deviate from the socially acceptable standard of behavior only if the benefit they derive from such deviation exceeds the expected harm they may cause to third parties.⁵⁰

In the case of accidents—and more generally, most instances that come under the law of negligence—transaction costs are typically

46. Demsetz, *supra* note 17, at 356-57.

47. *Id.*

48. See, e.g., Steven Shavell, *On Liability and Insurance*, 13 BELL J. ECON. 120, 121 (1982).

49. See, e.g., Stephen R. Perry, *The Moral Foundations of Tort Law*, 77 IOWA L. REV. 449, 513 (1992).

50. See, e.g., Gideon Parchomovsky & Alex Stein, *Reconceptualizing Trespass*, 103 NW. U. L. REV. 1823, 1833 (2009).

high.⁵¹ Consequently, Coase's model of internalization-by-contract is not an ideal solution. A pedestrian cannot be expected to contract with all potential drivers who pose a threat to her. Nor is it practical to achieve internalization using Demsetz's single owner standard. Surely, a driver cares about damage to her automobile. But absent a duty to compensate, she may not pay sufficiently careful heed to the potential harm her driving poses to pedestrians and other third parties. The duty to compensate ameliorates drivers' incentives to focus narrowly on their own self-interest.⁵²

Conversion is another example of a tort that is concerned with negative externalities.⁵³ In a world without conversion, people would help themselves to others' assets whenever they derived some positive value from doing so. For example, Jill would appropriate Harry's laptop, even if she only needed it to update her Facebook page. The tort of conversion causes potential takers of private property to think not only about the benefits they can derive from an asset, but also about the cost the owner would suffer as a result of the deprivation.

Turning to property law, we can see many of the same design features. Property rights are rights in rem, meaning that they prevail against "the rest of the world."⁵⁴ This is significant because many assets provide abundant consumption externalities for third parties. Consider an unfenced apple orchard situated next to a high school. As in the context of torts, the cost of establishing contractual arrangements with respect to property is prohibitive in the real

51. Cf. Demsetz, *supra* note 17, at 356 (making the same argument in a communal property context).

52. Notice we use the term "ameliorate" and not "eliminate." This is because driving gives rise to a host of other externalities, foremost among which are pollution, congestion, and other environmental effects. Indeed, many economists attribute the excessively high number of large sports utility vehicles on American roads to the fact that neither the legal system nor any extralegal mechanism achieves full internalization in this context. See, e.g., William S. Vickrey, *Congestion Theory and Transport Investment*, AM. ECON. REV., May 1969, at 251, 251; Michelle J. White, *The "Arms Race" on American Roads: The Effect of Sport Utility Vehicles and Pickup Trucks on Traffic Safety*, 47 J.L. & ECON. 333, 334-36 (2004); Michael Anderson & Maximilian Auffhammer, *Pounds That Kill: The External Costs of Vehicle Weight* 3-4 (Nat'l Bureau of Econ. Research, Working Paper No. 17170, 2011).

53. See, e.g., Perry, *supra* note 49, at 457-58 (noting that the "nonconsensual transfer of possession" gives rise to the tort of conversion, and the justification "seems clear enough").

54. E.g., Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 777 (2001).

world—the owner cannot be expected to negotiate a price with each student who might want to take an apple.

But what about Demsetz’s single owner principle? Many assets, although not all of them, are indeed owned by a single owner. However, the formalization of a single owner only takes care of intra-asset externalities that arise when an asset has multiple owners.⁵⁵ Unfortunately, the single owner principle does nothing to ameliorate *interasset* externalities, namely those that are imposed on other asset owners by one’s use of one’s own asset. To illustrate, consider an owner who loves hosting loud parties every weekend. The parties delight the particular owner. In fact, in terms of her personal preferences, she sees no downside to hosting them. Her neighbors, who have different preferences, may see the situation rather differently.

Hence, property law contains various doctrines that diminish the exposure of property owners to negative externalities.⁵⁶ Think first about the doctrines of trespass and nuisance.⁵⁷ Both doctrines apply to noncontractual interactions involving property owners and third parties. Nuisance law is crafted to prevent property owners from using their land in ways that cause unreasonable interference to neighboring property owners.⁵⁸ Without nuisance law, property

55. See Demsetz, *supra* note 17, at 355 (describing the single property owner’s sole focus on the particularly owned property in light of future individuals’ prospective ownership of the same).

56. See, e.g., Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315, 1333 (1993) (“External institutions designed to deter negative spillover effects of land activities include, for example, norms of neighborliness, common-law nuisance rules, and government land-use regulations.”); Yonatan Even, *Appropriability and Property*, 58 AM. U. L. REV. 1417, 1424 n.10 (2009) (“Some negative externalities—most notably, those that have an adverse effect on neighboring privately held property—are dealt with by tort law doctrines such as trespass and nuisance. Others—especially those that affect resources that are held in common—are dealt with through governmental regulation in the form of environmental laws, zoning laws, etc.”); Bradley C. Karkkainen, *Zoning: A Reply to the Critics*, 10 J. LAND USE & ENVTL. L. 45, 47 (1994) (reporting that zoning advocates maintain that “zoning serves principally to protect property owners from the negative externalities of new developments”).

57. Indeed, as Thomas Miceli suggests, the laws of trespass and nuisance are “[t]he principal common law remedies for externalities.” See Thomas J. Miceli, *Property*, in THE ELGAR COMPANION TO LAW AND ECONOMICS 246, 250 (Jürgen G. Backhaus ed., 2d ed. 2005).

58. See, e.g., RESTATEMENT (SECOND) OF TORTS § 822 (1979) (“One is subject to liability for a private nuisance if, but only if, his conduct is a legal cause of an invasion of another’s interest in the private use and enjoyment of land, and the invasion is either (a) intentional and unreasonable, or (b) unintentional and otherwise actionable under the rules controlling

owners would be tempted to use their property in a myriad of ways that give them pleasure, while causing suffering to their close, and maybe not so close, neighbors. Nuisance law is a corrective mechanism that forces each owner to take account of the negative effects of her actions on other owners and engage only in those activities that do not unduly interfere with the interests of proximate property owners.⁵⁹

Trespass law has the same effect as nuisance law, except it applies to owners and nonowners alike.⁶⁰ Trespass law discourages the general public from taking liberty with others' property.⁶¹ It discourages passersby from availing themselves of private and public land without permission from the owner. If third parties were at liberty to enter land whenever they wanted, they would take advantage of this privilege without regard to the interference they cause to the owner's use or the psychological harm they inflict upon her.⁶²

It should be borne in mind that not all property forms feature a single owner. Much property, if not most, is owned by multiple parties. These cases are governed by the law of cotenancies. A cornerstone of the law of cotenancies is the duty not to commit waste. A cotenant who commits waste—represented by actively compromising the asset or by allowing it to fall into disrepair—ought to compensate the other cotenants for the loss they suffer.⁶³ The logic should be clear by now. Cotenancy regimes create an incentive for the cotenant-in-possession to overuse the asset because she gets the full marginal benefit of the use, whereas the marginal cost is spread out among all cotenants.

Law's campaign against negative externalities is not restricted to private law. In fact, private law is strikingly ill-suited to deal with

liability for negligent or reckless conduct, or for abnormally dangerous conditions or activities.”).

59. See Abraham Bell & Gideon Parchomovsky, *Reconfiguring Property in Three Dimensions*, 75 U. CHI. L. REV. 1015, 1040 (2008) (“Nuisance law is designed to deal with the problem of externalities.”).

60. See Parchomovsky & Stein, *supra* note 50, at 1828-37 (discussing both ex ante and ex post rationalizations for trespass liability and remedy).

61. See *id.* at 1828-29 (“[Trespass law] empowers the owner to prevent others from using, occupying, or taking her property.”).

62. See *id.* at 1834.

63. See 20 AM. JUR. 2D *Cotenancy and Joint Ownership* § 90 (2012).

negative externalities that exceed a certain scale.⁶⁴ Think about industrial pollution. Our tort and property laws that rely on private enforcement often cannot cope with the full magnitude of the problems they confront. For example, industrial pollution often affects multiple people in different jurisdictions and even nations.⁶⁵ The massive scale of the problem creates multiple enforcement problems.⁶⁶ First, it may be costly to track the pollution to its source. Second, there may be various problems of causation when there are multiple polluters. Third, collective action problems may undermine enforcement efforts; each of the victims would love to receive compensation but prefers to see someone else spearhead the litigation efforts. These challenges call for larger-scale regulatory intervention, and recognizing this logic, Congress has enacted various laws that set up special agencies to specify the permissible levels of pollution and to enforce these restrictions. Environmental legislation, such as the Clean Air Act⁶⁷ and the Clean Water Act,⁶⁸ are prime examples of this approach. But, of course, myriad other forms

64. See Ellickson, *supra* note 56, at 1332-35 (arguing that group ownership is best to address issues of ownership boundaries and large-scale issues).

65. See Carl B. Meyer, *The Environmental Fate of Toxic Wastes, the Certainty of Harm, Toxic Torts, and Toxic Regulation*, 19 ENVTL. L. 321, 328-30 (1988) (discussing the growth of toxic waste's scope).

66. See generally Linda S. Mullenix, *Problems in Complex Litigation*, 10 REV. LITIG. 213, 218-19 (1991) (outlining six problem "themes" associated with litigating "contemporary mass tort complex litigation").

67. 42 U.S.C. §§ 7401-7671(q) (2006); see also R. SHEP MELNICK, REGULATION AND THE COURTS: THE CASE OF THE CLEAN AIR ACT 25-31 (1983) (detailing the 1970 "policy breakthrough" and the resulting Clean Air Act).

68. 33 U.S.C. §§ 1251-1387 (2006). *But see* Henry N. Butler & Jonathan R. Macey, *Externalities and the Matching Principle: The Case for Reallocating Environmental Regulatory Authority*, 14 YALE L. & POL'Y REV. 23, 58-61 (1996) (discussing several methods of internalizing costs on polluters through state and local government regulation).

of regulation,⁶⁹ ranging from antitrust,⁷⁰ to criminal law,⁷¹ to securities regulation,⁷² are tailored to curb self-interested behaviors whose costs are borne, at least in part, by others.

The contrast between the legal system's extensive mechanisms for dealing with negative externalities and its meager resources for coping with positive spillovers is striking. The chief body of law that deals with positive externalities is unjust enrichment. The law of unjust enrichment, or restitution, is based on the principle that individuals who receive a benefit to which they are not entitled must return the benefit—in kind or in cash—to the benefactor.⁷³ As a rule, unjust enrichment entitles an aggrieved party to restitution only in cases of ill-gotten gains, when the benefactor did not intend to confer the benefit on the recipient.⁷⁴ Examples of such unintentionally conferred benefits include benefits secured through fraud, misrepresentation, or mistake.⁷⁵

In instances involving *intended* benefits, restitution will be awarded only in rescue cases, when multiple parties are jointly and severally liable under the law and one of them performs the underlying obligation for which they are all responsible, or, conversely, when a party secures through legal proceedings payment that

69. See, e.g., Paul L. Joskow, *Weighing Environmental Externalities: Let's Do It Right!*, ELECTRICITY J., May 1992, at 53, 56-57 (discussing emissions regulation); Jules Pretty et al., *Policy Challenges and Priorities for Internalizing the Externalities of Modern Agriculture*, 44 J. ENVTL. PLAN. & MGMT. 263, 270-78 (2001) (discussing agriculture regulation); Paul Thorsnes, *Internalizing Neighborhood Externalities: The Effect of Subdivision Size and Zoning on Residential Lot Prices*, 48 J. URB. ECON. 397, 399-402 (2000) (discussing land development regulation).

70. See Richard A. Posner, *Federalism and the Enforcement of Antitrust Laws by State Attorneys General*, 2 GEO. J.L. & PUB. POL'Y 5, 5 (2004) (discussing the internalization of monopoly costs imposed on society).

71. See Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, 1990 DUKE L.J. 1, 8-10 (discussing the internalization of the negative externalities created by crime).

72. See George Foster, *Externalities and Financial Reporting*, 35 J. FIN. 521, 525-32 (1980) (analyzing the myriad means by which financial reporting accounts for externalities).

73. See Ariel Porat, *Private Production of Public Goods: Liability for Unrequested Benefits*, 108 MICH. L. REV. 189, 190, 195, 197 (2009) (discussing unjust enrichment in positive externality terms). Also relevant is Saul Levmore's treatment of these issues. See generally Saul Levmore, *Explaining Restitution*, 71 VA. L. REV. 65 (1985).

74. Porat, *supra* note 73, at 195.

75. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §§ 5, 13 (2011).

multiple parties are entitled to share.⁷⁶ In reviewing the law of restitution, Ariel Porat refers to these cases as exceptions to the general legal rule that unrequested benefits do not give rise to restitution.⁷⁷

Copyright and patent law may be thought of as two other legal areas designed to deal with positive externalities.⁷⁸ Both bodies of law entitle actors—authors in the case of copyright law and inventors in the case of patent law—to collect from others the value of the benefits the actors have bestowed upon others.⁷⁹ Patent law empowers inventors to collect the value of unrequested benefits from follow-on innovators.⁸⁰ Copyright law confers upon authors a broad right to control adaptations of their original works.⁸¹ In effect, the exclusivity granted to inventors and authors allows them to demand payment from third parties who benefit from their creations, even though the recipient of the benefit did not request it.

Yet we have nothing resembling a full-blown jurisprudence of benefits. An owner of a beautiful home cannot demand payment from passersby for the visual enjoyment they derive. Residents who clean and maintain a public park cannot collect the value of the benefit they create for other users of the park. Likewise, individuals who voluntarily provide various community services cannot collect payment from actual or potential beneficiaries, nor are those who instruct others how to perform certain tasks or dispense valuable

76. Porat, *supra* note 73, at 195-97; *see also* Levmore, *supra* note 73, at 65 (“The rule is, of course, that ‘volunteers’ or ‘officious intermeddlers’ do not recover in restitution even if they can prove their expenses or the value of their provisions.”).

77. Porat, *supra* note 73, at 195-98 (“[W]hen benefits are *voluntarily* conferred but *not at the recipient’s request*, the law [generally] does not impose any duty of restitution on the recipient, and she is allowed to keep the benefits at no cost to her.”).

78. Wendy J. Gordon, *Toward a Jurisprudence of Benefits: The Norms of Copyright and the Problem of Private Censorship*, 57 U. CHI. L. REV. 1009, 1048 (1990) (“[C]opyright ... serve[s] a particular incentive function: [it seeks] to ‘internalize externalities.’”); Rolf Weder & Herbert G. Grubel, *The New Growth Theory and Coasean Economics: Institutions to Capture Externalities*, 129 REV. WORLD ECON. 488, 490 (1993) (discussing the positive knowledge spillovers created by the patent system).

79. *See* Ted Sichelman, *Commercializing Patents*, 62 STAN. L. REV. 341, 357-58 (2010) (describing this as the “reward theory” of patent law); Lloyd L. Weinreb, *Copyright for Functional Expression*, 111 HARV. L. REV. 1149, 1231-32 (1998) (“The benefit to the copyright owner is thus obtained at the expense of those who would have acquired the work at the lower price were there no copyright.”).

80. *See* Sichelman, *supra* note 79, at 357-58.

81. 2 NIMMER ON COPYRIGHT § 8.09 (2011).

information to third parties entitled to collect any rewards. Finally, individuals who compliment a peer are not eligible to receive anything from her.

B. Theoretical Justifications and Their Limitations

In recent contributions, several leading law and economics scholars have sought to justify the law's disparate treatment of negative and positive externalities. Saul Levmore, for example, raised, and rejected, the theory that the law generally does not take account of positive externalities on account of various valuation difficulties.⁸² In a nutshell, the argument runs as follows: to award restitution for benefits received, courts must be able to evaluate the benefit to the recipient. Unfortunately, the value of the benefit to the recipient is private information unobservable and unverifiable by the courts. Levmore finds this explanation unpersuasive. He notes that despite the evaluation difficulties, the law recognizes restitution for benefits in some cases.⁸³ Furthermore, if valuation difficulties are the reason for denying restitution, then restitution should be recognized whenever valuation does not present a serious problem. Moreover, Levmore points out that the evaluation difficulties that attend tort disputes are no less acute, yet that did not stop us from developing a full-fledged torts jurisprudence.⁸⁴

Ariel Porat advances a different explanation. Porat begins by pointing out an essential asymmetry between positive and negative externalities.⁸⁵ In the case of negative externalities, tortfeasors have no upper bound to the level of harm they can inflict on potential victims.⁸⁶ Absent laws forbidding such activities, self-interested actors may pollute massively, drive hyper-recklessly, and create extreme health and safety risks for others. Hence, it is essential to

82. See Levmore, *supra* note 73, at 69-72.

83. *Id.* at 71.

84. *Id.* at 71-72. It should be noted that Levmore discusses three additional explanations for the law's disparate treatment of costs and benefits. He ultimately rejects them all. See *id.* at 72-82. For an excellent summary, see Hershovitz, *supra* note 6, at 1151-60.

85. See Porat, *supra* note 73, at 190.

86. See *id.* at 199 ("[W]ithout regulation or internalization, there would be no restriction whatsoever on injurers' harmful activities.... [And consequently] injurers would be completely indifferent to causing harms; even a small expected benefit would induce them to create huge losses for others.").

impose legal limits that cap the level of injurious activities actors can carry out. However, no similar concern exists in the case of positive externalities.⁸⁷ The worst possible outcome is simply that an actor will choose not to make any contribution that creates positive spillovers. In other words, Porat argues that whereas the harm from negative externalities is potentially unbounded, the harm from someone's failure to undertake activities that generate positive externalities is capped at zero.⁸⁸

Porat's explanation is powerful, and it certainly captures an important difference between negative and positive externalities. But, of course, the real question is whether society should encourage individuals to undertake activities that generate positive externalities, or whether it should tolerate the underprovision of such activities. Porat admits that the absence of a duty on beneficiaries to compensate their benefactors creates a disincentive for actors to engage in activities that benefit others.⁸⁹ More generally, the law's stance on positive externalities leads to underproduction of activities that benefit others. Hence, Porat calls for an "Expanded Duty of Restitution,"⁹⁰ under which, when certain conditions are met, recipients would be legally obliged to "compensate benefactors for unrequested benefits" in order to "promote efficiency and provide incentives for private production of public goods."⁹¹

Giuseppe Dari-Mattiacci proffers a different solution to the negative/positive externalities puzzle. Dari-Mattiacci points to several key differences between the two types of externalities.⁹² First, he distinguishes negative and positive externalities on the basis of

87. *See id.* (concluding, after explaining the need for legal intervention in the case of negative externalities, that "[n]o parallel risk exists in the case of benefits" because society has no reason to be worried about actors enhancing the level of benefit-conferring activities). On the other hand, one might question Porat's assertion that the maximum loss from the failure to provide a positive benefit is zero. An opportunity cost measure would count the nonprovision of a benefit as a loss, and this loss could be of any size. Porat correctly notes that *A*'s failure to provide a benefit does not necessarily preclude *B* or *C* from doing so; but there would seem to be many circumstances in which *A* is the only party likely to provide the benefit, and if she fails to provide it, nobody else will. *See, e.g., id.* at 195 (discussing rescue cases).

88. *See id.* at 199.

89. *See id.* at 191.

90. *Id.* at 190.

91. *Id.* at 190-91.

92. *See* Giuseppe Dari-Mattiacci, *Negative Liability*, 38 J. LEGAL STUD. 21, 22-26 (2009).

intent.⁹³ Specifically, he argues that although the law should impose liability for both intentional and unintentional inflictions of harm, it should concern itself with only *unintentional* conferral of benefit; intentional bestowals of benefits should not give rise to restitution.⁹⁴ Following the credo of law and economics, Dari-Mattiacci accepts the premise that the law should impose liability in order to deter parties from bypassing voluntary market transactions—or, in more common parlance, contracts.⁹⁵ The imposition of liability for negative externalities does exactly that: it forces potential harm-doers to reach out to potential victims and negotiate consensual transactions with them. The imposition of a duty of restitution for intentionally conferred benefits would induce some potential “do-gooders” to bypass the market, perform unrequested “acts of kindness,” and then seek to collect for them. Hence, the law should not recognize a duty to collect in cases of intentional positive externalities.

A second distinction between negative and positive externalities focuses on evidence. Here, Dari-Mattiacci argues that the legal system can more easily handle cases of negative externalities because victims who sue to recover for harms they have suffered from negative externalities, such as torts, have an inherent incentive to adduce evidence relating to their harm.⁹⁶ In cases of positive externalities, by contrast, beneficiaries have an inherent incentive to conceal evidence pertaining to the actual receipt of a benefit and its magnitude.⁹⁷

A third, and final, distinction Dari-Mattiacci proposes concerns the cost to the adjudicative system.⁹⁸ In the case of negative externalities, the legal system can simply set a behavior standard—for example, negligence—and thereafter do nothing.⁹⁹ This is because Dari-Mattiacci assumes—following the standard tort model of John Brown¹⁰⁰ and Steven Shavell¹⁰¹—that the standard of care will never

93. *Id.* at 31-33.

94. *Id.* at 32-33.

95. *See id.* at 32.

96. *See id.* at 41.

97. *See id.*

98. *See id.* at 46-49.

99. *See id.* at 25.

100. *See generally* John Prather Brown, *Toward an Economic Theory of Liability*, 2 J. LEGAL STUD. 323 (1973).

101. *See generally* Shavell, *supra* note 48.

be violated. That is, injurers, being rational, will adjust their behavior to the standard and will never act in a negligent fashion.¹⁰² Accordingly, the need to enforce the standard will never arise. The cost of dealing with positive externalities is much higher. If the law were to award a subsidy to benefactors in cases of positive externalities, the subsidy would be paid repeatedly—each time a benefactor could prove that she met the legal standard for receiving it.

Dari-Mattiacci's framework is cogent and illuminating, yet there are several problems with it. We begin with his distinction between intentional and unintentional conferrals of benefits. From an economic standpoint, intent should not be the decisive criterion for awarding restitution. Rather, the level of transaction costs should be the measure. This point can be traced back to Guido Calabresi and Douglas Melamed's classic article on which Dari-Mattiacci relies.¹⁰³ As Calabresi and Melamed famously observed, when transaction costs are sufficiently low, actors ought to rely on voluntary market transactions, and lawmakers should deter attempts to circumvent the market.¹⁰⁴ When transaction costs are prohibitively high, it is no longer possible to channel transactions through the market, and it makes sense to allow people to act and compensate affected parties after the fact.¹⁰⁵ In Calabresi-Melamedian terms, this is a switch from property rule protection—under which the entitlement holder sets the price of any use or taking of her entitlement¹⁰⁶—to liability rule protection—a legal regime that empowers a third party, such as a court or a regulator, to determine the price for using others' entitlements after the fact.¹⁰⁷ Hence, in high transaction cost environments, benefactors should be entitled, in principle, to restitution even in the case of intentional benefits.

Another problem with intent-based rules is that they can be easily manipulated. Potential benefactors, aware of the legal rules that entitle them to compensation only in cases of unintentional

102. For an explanation of why rational actors will almost always find it cheaper to comply with the standard of care in a negligence regime, see, for example, STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 177-206 (2004).

103. See Dari-Mattiacci, *supra* note 92, at 32-33.

104. See Calabresi & Melamed, *supra* note 32, at 1092 & n.7.

105. See *id.* at 1106-10.

106. *Id.* at 1092.

107. See *id.*

conferral of benefits, will invariably try to argue that their actions were unintentional. Relatedly, the proposed distinction will be difficult to operationalize in practice. There may be cases of mixed motives, as well as cases in which a benefactor intended to confer a benefit on some recipients but not on others. At the end of the day, therefore, adoption of the proposed distinction may lead to prolonged litigation.

As for Dari-Mattiacci's evidence-based distinction between negative and positive externalities, it proves too much and too little at the same time. Actually, both negative and positive externalities raise evidentiary challenges, and these challenges are more symmetrical than Dari-Mattiacci's analysis suggests. Consider first the challenge of identifying the target group—victims in the case of negative externalities and beneficiaries in the case of positive ones. Dari-Mattiacci is absolutely correct that direct victims of negative externalities have an inherent incentive to identify themselves and seek recovery.¹⁰⁸ No such incentive exists for beneficiaries of positive externalities. Yet, it is not too difficult to identify the direct beneficiaries of positive externalities. Objective measures such as increase in property values can aid us in this quest. As for indirect beneficiaries, admittedly, they will be difficult to identify. But the same is true of indirect, or nonimmediate victims of negative externalities, especially large-scale ones. Industrial pollution is a case in point. Many of the victims of industrial pollution are not readily discernible, and often they do not even know that they have been victimized, let alone by whom.

The difficulty of assessing the harm or benefit remains. Dari-Mattiacci suggests that in the case of negative externalities, victims can be relied on to adduce reliable evidence concerning the magnitude of their harm, whereas in the case of positive externalities, beneficiaries have no such incentive.¹⁰⁹ We beg to differ. In both cases, litigants—both plaintiffs and defendants—have an incentive to misrepresent the evidence. Plaintiffs who incurred a harm resulting from a negative externality have a built-in incentive to overstate their harm in order to recover a greater amount. Beneficiaries

108. See Dari-Mattiacci, *supra* note 92, at 25.

109. *Id.*

from positive externalities have an incentive to understate the benefit they received in order to pay less. The legal process deals with both challenges by relying on experts and other objective criteria such as market prices and other indexes. In the final analysis, therefore, Dari-Mattiacci's evidence-based account, although relevant and important, does not provide a satisfactory justification for ignoring positive externalities.

This leaves us with Dari-Mattiacci's final point about the cost advantage of internalizing negative externalities. Evidently, the argument in its strongest form does not hold water. Court dockets are brimming with negligence cases and there is no shortage of cases in which defendants are found negligent and ordered to pay their victims. Hence, merely setting the legal standard cannot reliably stem the problem of negative externalities.¹¹⁰ But even if Dari-Mattiacci were right, his argument would fall short of justifying the current stance of the law on the issue of positive externalities. Both liability regimes and restitution regimes share the same goal: they aim to guide behavior. Lawmakers should provide actors with the right set of incentives to engage not only in activities that do not harm others but also in activities that benefit others. Liability regimes achieve the former goal. Currently, no adequate legal framework exists to ensure the latter. Of course, cost is an important factor in any legal scheme, but it is not a goal in and of itself. In the final analysis, therefore, from an economic standpoint, both negative and positive externalities should be internalized whenever the benefit from externalization exceeds the cost.¹¹¹

110. See SHAVELL, *supra* note 102, at 224-30 (describing problems in the determination of negligence and the implication thereof); Mark F. Grady, *Why Are People Negligent? Technology, Nondurable Precautions, and the Medical Malpractice Explosion*, 82 NW. U. L. REV. 293, 293 (1988) (describing the explosion of medical malpractice cases).

111. A recent contribution by Oren Bar-Gill and Lucian Arye Bebchuk, *Consent and Exchange*, 39 J. LEGAL STUD. 375 (2010), offers a somewhat different take on these issues, from an ex ante contractual perspective. They assume a model in which "sellers" can offer a product to "buyers." Under a rule that allows capture of benefits, sellers can force buyers to pay for the product they receive. But what is the appropriate price? The parties know the quality of the goods involved in a transaction, but courts are assumed to be unable to determine the quality and are limited to knowledge of the *average* quality of all goods sold. This has two effects: First, it encourages low-quality sellers to enter and force buyers to "buy." Second, it encourages avoidance behavior by low-valuing buyers. Fearing they will be forced to buy from a low-quality seller, for a negative-value transaction, low-value buyers will be discouraged from participating in the market at all, even though without a restitution rule,

In sum, regardless of whether there are suitable private law mechanisms for internalizing positive externalities, the efficiency case for doing so seems compelling. We conclude that private law remedies for recouping benefits conveyed are highly limited; moreover, whether or not there *should* be more scope for such private law solutions to the positive externalities problem, they do not currently exist. Thus, in the urban development context, positive externalities can be internalized only via some mechanism that lies outside of the common law. This insight motivates the discussion that follows.

II. OF CITIES, SHOPPING MALLS, AND EXTERNALITIES

Building on the theoretical discussion in Part I, in this Part we present the economic literature on cities and shopping malls. By contrast with their neglected role in legal scholarship, positive externalities hold pride of place both in urban economics writ large and in the much smaller body of economic writings on shopping malls.

Urban economists believe that positive spillovers are key determinants of the success of cities: spillovers—especially, but not limited to, those arising from human capital or expertise—account for the very existence of dense urban areas.¹¹² Following Alfred Marshall, economists have identified agglomeration effects—posi-

they would have been willing to buy from many sellers. *See id.* at 375-80. In the extreme case in which courts base their valuations not on the full range of buyers, but only on the subset who actually enter the market, the restitution rule may create a reverse lemons problem. *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970) (explaining that uncertainty in individual transactions can drive the price down for entire markets). The reverse lemons problem can cause the market to unravel altogether: as low-valuing buyers drop out, the average value of the remaining buyers increases, making the market less attractive to buyers—and more attractive to low-quality sellers—in a vicious circle of adverse selection. *See* Bar-Gill & Bebchuk, *supra*, at 379 (referencing, but distinguishing, Akerlof's lemons market).

One problem with the Bar-Gill-Bebchuk model is that it assumes away any litigation costs; such costs will certainly deter many benefit-providers from seeking restitution by eating into the gains from successful litigation in many cases. Nor is it obvious that valuing benefits is more difficult than valuing losses, a problem that tort law confronts in every lawsuit. Moreover, even if Bar-Gill and Bebchuk are right that private law should not offer a remedy for deliberate conferral of benefits, this does not mean that no such remedy for positive spillovers should *ever* exist.

112. *See, e.g.*, Paul Krugman, *Increasing Returns and Economic Geography*, 99 J. POL. ECON. 483, 486-87 (1991).

tive spillovers arising from spatial proximity—as a key variable affecting economic growth.¹¹³ The economic literature on shopping malls also positions positive spillovers among stores at the heart of the analysis.¹¹⁴ However, as Peter Pashigian and his coauthors demonstrate, malls are specifically designed to capture positive externalities, and it is the ability of developers to internalize them that determines the performance of shopping malls.¹¹⁵ Combining the two literatures points to the conclusion that cities should borrow a page from shopping mall developers’ book in designing commercial areas.

A. *The Economics of Cities*

Although property theory and law undervalue positive externalities, the same cannot be said for leading theories of economic geography, according to which positive externalities are crucial to the very existence of cities. Such externalities can take many forms, but their existence is a necessary condition for agglomeration of economic activity.

Paul Krugman received the 2008 Nobel Prize in Economics in part for his work in economic geography, which offers an explanation for the growth of cities.¹¹⁶ Positive externalities are a key to this work. The prize committee summarized Krugman’s contribution by noting that “[t]he new economic geography initiated by Krugman broke with ... tradition by assuming *internal* economies of scale and imperfect competition. Agglomeration is then driven by [positive] *pecuniary externalities* mediated through market prices[,] as a large market allows greater product variety and lower costs.”¹¹⁷

113. See *id.* at 484-85.

114. See Eric D. Gould et al., *Contracts, Externalities, and Incentives in Shopping Malls*, 87 REV. ECON. & STAT. 411, 411-12 (2005); Peter Pashigian & Eric D. Gould, *Internalizing Externalities: The Pricing of Space in Shopping Malls*, 41 J.L. & ECON. 115, 140-41 (1998).

115. See Gould et al., *supra* note 114, at 421.

116. Press Release, The Royal Swedish Acad. of Scis., The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2008 Awarded to Paul Krugman (Oct. 13, 2008), available at http://www.nobelprize.org/nobel_prizes/economics/laureates/2008/press.html.

117. PRIZE COMM. ROYAL SWEDISH ACAD. OF SCIS., TRADE AND GEOGRAPHY—ECONOMIES OF SCALE, DIFFERENTIATED PRODUCTS AND TRANSPORT COSTS 12 (2008), available at http://www.nobelprize.org/nobel_prizes/economics/laureates/2008/advanced-economicsciences2008.pdf; see also Krugman, *supra* note 112, at 484-85.

Krugman's model starts from the assumption that "consumers have a taste for variety."¹¹⁸ That taste can be satisfied either by local production or by goods brought in from somewhere else, although the latter are more expensive due to transportation costs.¹¹⁹ Some goods will be too expensive to import but can be produced locally. As there are some fixed costs in production, however, there are economies of scale—larger markets will be able to produce goods at a lower unit cost than smaller ones.¹²⁰ Moreover, larger markets will also tend to have *more* goods, and hence, a greater variety, than smaller ones.¹²¹ Given that consumers desire additional variety, the greater range of goods, in combination with cheaper prices, gives cities an advantage in attracting residents.¹²² Importantly, that advantage gets larger as the city grows in size; there are increasing returns to scale, so growth in size begets further growth.¹²³

Tests of the Krugman model have proven difficult, in part because of problems with measuring the prices of relevant goods across cities with sufficient precision. However, a recent paper by Jessie Handbury and David Weinstein provides empirical support for Krugman's theory.¹²⁴ The paper aggregates tens of millions of precise observations on prices across cities—prices for "identical products sold in the same store chain [and purchased] by the same type of shopper"¹²⁵—and concludes that with appropriate controls, the prices of identical goods do indeed fall with an increase in city size. Conversely, the variety of traded goods increases.¹²⁶

118. PRIZE COMM. ROYAL SWEDISH ACAD. OF SCIS., *supra* note 117, at 4.

119. *See id.* at 8.

120. *See id.* at 14.

121. *Id.*

122. *See id.*

123. *See id.*

124. Jessie Handbury & David E. Weinstein, *Is New Economic Geography Right? Evidence from Price Data* (Nat'l Bureau of Econ. Research, Working Paper No. 17067, 2011), available at <http://www.nber.org/papers/w17067>.

125. *Id.* at 3.

126. *Id.* at 4. They find that:

[R]esidents of New York (population 9.3 million) can choose between 97,000 different types of groceries, whereas residents of Des Moines (population 456,000) only have access to 32,000 varieties. This greater availability of varieties in larger cities means that variety-adjusted costs [the key drivers of scale advantage in Krugman's model] are likely to be substantially lower in large cities.

Empirical work by Joel Waldfogel is also supportive of these general patterns, although not necessarily of Krugman's precise model.¹²⁷ For example, Waldfogel shows that because of high fixed costs, larger cities can support more radio stations and offer more programming variety than smaller ones.¹²⁸ When people differ in their tastes in music, as Waldfogel shows to be the case for various racial groups,¹²⁹ significant positive externalities arise from being located near others who share one's preferences.¹³⁰ Black radio listeners get access to significantly more variety in the kind of music they prefer when they live in cities with large black populations as opposed to those with small black populations.¹³¹ In general, "people get what they want only if [they are located near] others [who] are also prepared to pay for it. As a result, consumers benefit from participating in a product market with others who share their preferences."¹³² Waldfogel terms this effect a "preference externality."¹³³

Krugman's elegant mechanism is far from the only one that invokes positive externalities to explain why people bunch together in cities. Rather than focusing on the consumption externalities Krugman stresses, other theorists have focused on externalities in the *production* of goods and services. More than one hundred years ago, the English economist Alfred Marshall proposed that new ideas diffused more rapidly when firms are located in physical proximity to one another, because employees can easily move between employers or otherwise exchange ideas.¹³⁴ That, in turn, means that

Id.

127. For an accessible summary and introduction, see generally JOEL WALDFOGEL, *THE TYRANNY OF THE MARKET* (2007).

128. *Id.* at 43-44.

129. *See id.* at 46-49.

130. *See id.* at 51.

131. *Id.* at 49-50.

132. *Id.* at 51.

133. Joel Waldfogel, *Preference Externalities: An Empirical Study of Who Benefits Whom in Differentiated-Product Markets*, 34 *RAND J. ECON.* 557, 557 (2003).

134. Marshall wrote that:

[w]hen an industry has ... chosen a locality for itself, it is likely to stay there long: so great are the advantages which people following the same skilled trade get from near neighbourhood to one another. The mysteries of the trade become no mysteries; but are as it were in the air, and children learn many of them unconsciously. Good work is rightly appreciated, inventions and improvements in machinery, in processes and the general organization of the business have

firms in the same industry benefit from colocation because their presence lowers information costs for the group as a whole.¹³⁵

Whatever their source, some sort of positive spillovers are at the heart of economic theories of why cities exist in the first place. Without such benefits to colocation, we would expect economic activity to be randomly dispersed across the landscape. Instead, however, at “the end of 2008, one-half of the world [population] ... live[d] in cities.”¹³⁶

It is important to note that agglomeration effects—whether in consumption or production—are different from the positive externalities we have discussed so far. In garden variety positive externalities, a firm or consumer provides benefits for others who are located nearby, without being able to capture any of these benefits for itself. When Amy cultivates a beautiful garden, for example, she provides an uncompensated benefit to passersby, but—crucially—receives no symmetric benefit from their presence as viewers of her garden. In the case of agglomeration effects, however, the spillover benefits are mutual: by collocating, each firm provides—but also receives—benefits from all others situated nearby.¹³⁷ Thus, agglomeration effects are dynamically reinforcing: the larger the population, the greater the effects, and the more attractive it becomes for a firm or consumer to locate near others.¹³⁸ No such mechanism is at work in standard positive externalities.

their merits promptly discussed: if one man starts a new idea, it is taken up by others and combined with suggestions of their own; and thus it becomes the source of further new ideas. And presently subsidiary trades grow up in the neighbourhood, supplying it with implements and materials, organizing its traffic, and in many ways conducing to the economy of its material.

ALFRED MARSHALL, *PRINCIPLES OF ECONOMICS* 271 (8th ed. 1920).

135. In their work, Adam B. Jaffe, Manuel Trajtenberg, and Rebecca Henderson, *Geographic Localization of Knowledge Spillovers as Evidenced by Patent Citations*, 108 Q.J. ECON. 577 (1993), measure geographic spillovers using the relationship between the location of an original patent and the location of a subsequent patent that cites the original. Their careful empirical analysis concludes that “there is a clear pattern of localization [of patent citations] at the country, state, and SMSA levels. Citations are ... two to six times as likely ... to come from the same SMSA as control patents.” *Id.* at 591. They are “roughly twice as likely to come from the same state as the originating patent.” *Id.* The authors interpret this as evidence of local spillovers of knowledge accumulation. *Id.*

136. Edward L. Glaeser, *Introduction to AGGLOMERATION ECONOMICS* 1, 1 (Edward L. Glaeser ed., 2010) (discussing former population projections prior to 2008).

137. See Schleicher, *supra* note 3, at 1519.

138. See *id.*

B. The Economics of Shopping Malls

The economic literature on shopping malls is also centered on positive externalities. Here, however, the story takes an interesting turn. Unlike cities that evolved organically over a long period of time and have been shaped by multiple forces and pressures, shopping malls grow out of careful and discrete planning.¹³⁹ Moreover, they are designed with one goal in mind: commercial success.¹⁴⁰ Finally, whereas the composition of stores in a particular mall changes over time, the overall layout and combination remain fairly constant.¹⁴¹ As a result, shopping mall owners must be very circumspect about selecting the optimal mix of stores; one means by which they do so is to adopt a pricing mechanism that enables them to take account of the relative contribution of each business to other stores. The use of differential rents—which often diverge significantly—allows mall owners to attract businesses of all sizes and come up with a mix of stores to make the enterprise attractive to both businesses and patrons.¹⁴²

Here is an example that illustrates the basic economics of mall development. Shoelace Shack (Shack) is a small retailer that, unsurprisingly, sells shoelaces. In deciding whether to make a purchase at Shack, its customers have to factor in two separate but related kinds of costs. The first is the cost of the shoelaces themselves. But in addition, because customers live at varying distances from Shack, and transportation is costly, customers must also take account of their travel costs, in terms of both time and money. Assuming that all customers have identical tastes for shoelaces, this means that there is some maximal distance a customer is willing to travel to purchase his shoelaces from Shack. Beyond that distance, the costs of travel outweigh the utility gained from buying shoelaces, making

139. See Gould et al., *supra* note 114, at 421.

140. See Pashigian & Gould, *supra* note 114, at 117.

141. See Charles C. Carter & Kerry D. Vandell, *Store Location in Shopping Centers: Theory and Estimates*, 27 J. REAL EST. RES. 237, 238 (2005).

142. See Pashigian & Gould, *supra* note 114, at 116-17.

a visit to Shack uneconomical.¹⁴³ At any given price for shoelaces, then, Shack will face a spatially constrained demand.

Imagine that Spears Roadblock (Spears) is a large retailer, selling clothes, tools, washing machines, TV sets, and so on. Like Shack, Spears has customers who are spatially dispersed and who must incur some transportation costs to visit the store. Note, however, that because Spears sells many big-ticket items, its customers' willingness to incur transportation costs are larger than Shack's; they are willing to drive farther to buy a \$750 TV set than the distance Shack's customers will drive for a \$2.50 pair of shoelaces. Thus, Spears has a wider catchment area within which it can attract customers than does Shack.

Consider what will happen if Shack and Spears are located on immediately adjacent and independently owned plots of land. Some customers, who would not patronize Shack if it were located by itself, are willing to drive to Spears. While these customers are at Spears to buy a TV set, the marginal cost of stopping by Shack to pick up a pair of shoelaces is essentially zero because they have already sunk the fixed costs of the trip from their home to Spears, and all it takes to get to Shack is a walk next door. Shack thus benefits by being located next to Spears because Spears pulls in some additional customers for Shack that it could not attract on its own. Crucially, the relationship is not reciprocal: nobody goes to Shack to pick up a pair of shoelaces and then decides to buy a TV set from Spears while they are there. Thus, whereas Shack gains from being located next to Spears, Spears gets nothing from the additional customers it generates for Shack. Spears creates a positive externality, but there is no way it can charge Shack to recover the benefit of any extra customers it provides: Spears can no more bill Shack for these additional customers than a homeowner with a

143. See George S. Tolley, *The Welfare Economics of City Bigness*, 1 J. URB. ECON. 324, 327 (1974) ("In a large city, because of the greater distances to commuting and shopping margins, land has a greater travel savings value at a given distance from trip destination points than in a smaller city, making rent plus travel costs higher in the large city."). This story is taken from the classic spatial competition model of Harold Hotelling. See generally Harold Hotelling, *Stability in Competition*, 39 ECON. J. 41 (1929). For a model with flexible prices, see generally C. d'Aspremont et al., *On Hotelling's "Stability in Competition,"* 47 ECONOMETRICA 1145 (1979) (discussing this model of competition when prices can be changed).

nice garden can charge passersby for the views and smells the garden affords.

An important feature of shopping mall design and management is the internalization of precisely these externalities. If Shack and Spears are both located in a mall—with a single owner who charges rent to both stores—the owner can use the rental rates it charges to allow Spears to recoup some of the extra business it provides for Shack.¹⁴⁴ The internalization occurs via differential rents charged by the mall developer: Shack pays a higher rent per square foot to reflect the fact that it provides essentially no customers for Spears, whereas Spears pays a lower rent per square foot to reflect the fact that it draws in additional customers for the other stores located in the mall.

The size of these rent discounts are quite substantial, reflecting the significance of the externalities involved. Peter Pashigian and his coauthors have found that “[o]n average, anchor stores occupy over 58% of the total leasable space in the mall and yet pay only 10% of the total rent collected by the developer.”¹⁴⁵ Interestingly, Pashigian and Gould point out that large commercial tenants in office buildings do not pay lower rents because such tenants provide no significant externalities for those who locate near them.¹⁴⁶

Table 1 demonstrates that anchor stores pay only one-seventh the rent per square foot, and only about one-quarter the rent per dollar of sales, as their nonanchor cotenants. Indeed, Gould, Pashigian, and Prendergast speculate that not only do many anchor stores pay no rent at all, it may even be the case that some stores actually *receive* payments (pay negative net rent) from mall developers.¹⁴⁷

144. For providing this service, and others, the mall owner can also earn a profit for herself.

145. Gould et al., *supra* note 114, at 411.

146. Pashigian & Gould, *supra* note 114, at 125.

147. However, these stores were not included in the data that the authors analyzed, so the existence of negative net rent was somewhat speculative. Gould et al., *supra* note 114, at 413 n.4.

	Anchor	Non-Anchor	Ratio: Anchor/ Non-Anchor
Rent/Sq. Ft	\$4.13	\$29.37	14.1%
Sales/Sq. Ft	\$185.34	\$317.68	58.3%
Rent/\$ Sales	\$0.022	\$0.092	24.1%

Gould, Pashigian, and Prendergast use their data to estimate the externality generated by an average anchor store in their sample. They find that the average anchor generates about \$60 million in additional sales for its nonanchor neighbors.¹⁴⁹ This, in turn, creates about \$3.9 million in additional rents for the mall developer, but most of this, about \$2.6 million or 66 percent, is returned to the anchor via lower rent.¹⁵⁰

The key takeaway from all of this is that the Spearses of the world are more profitable when they can take advantage of the spillover benefits they create for nearby complimentary sellers. A single owner of a common asset who sets rents so as to capture these spillovers provides the mechanism through which Spears can recoup some of its beneficial traffic-inducing effects. But unless the same party owns both Spears and Shack, or controls some asset common to both, such as land or buildings, Spears cannot recover any of the benefits it provides its neighbors. Given a choice, then, between locating in a mall, where it can recover some of its spillover

148. *See id.* at 412 tbl.1.

149. *Id.* at 415-16.

150. A puzzle still remains, however. An anchor store sees very little of the total extra sales it generates; it gets to keep only two-thirds of the extra *rent* it generates. But something seems wrong about this: why does the developer not charge the nonanchor stores more instead, because they seem to be getting \$60 million in positive externalities, and keep it or use it to subsidize the anchor? Or, to put the question differently, why does the anchor store not insist on getting a share of the surplus it generates for other stores? One possible answer to the latter question is that anchor stores do not have enough bargaining power to secure a bigger share. This alone does not explain why developers do not charge higher rent to nonanchor stores. Hence, the bargaining power explanation ought to be complemented by another one. One such explanation may be transaction or accounting costs. It may simply be too expensive to apportion the surplus generated by anchor stores for nonanchor stores with any degree of precision.

benefits, or a city center, Spears has very strong reasons to prefer the former.

Besides mapping out the *size* of the externality created by anchor stores, Gould, Pashigian, and Prendergast make another fundamental contribution to the analysis of internalization-by-contract. Shopping malls create difficult contractual design problems by virtue of the crosscutting incentives that internalization generates.¹⁵¹ Gould, Pashigian, and Prendergast show how shopping mall contracts are carefully written to manage such incentives.¹⁵²

All the parties involved in a mall want the anchor store to behave well—that is, to undertake activities such as advertising that are discretionary but that strengthen the spillover benefits the anchor creates.¹⁵³ The parties also want the *developer* to behave well, by keeping the mall clean and well maintained, advertising, providing parking, and so on.¹⁵⁴ Providing each actor with incentives to undertake the right amount of such activities—given that some of the benefits are captured by others—requires a fairly complex percentage rent system. Each store typically has a fixed rent component, which in some cases entails a zero fixed rent for anchors; a sales threshold, above which the store owes additional rent; and a percentage rate on sales above the threshold.¹⁵⁵

Managing all of this is not straightforward: the appropriate tradeoffs between fixed and percentage rent depend on how sensitive sales are to promotional activities, risk aversion, and a host of other factors that are subject to business judgment.¹⁵⁶ The bottom line is that running a mall, and setting the percentage rates correctly, is quite a tricky undertaking. It is probably not the kind of thing a municipal government would have the skills to handle, even if it had the inclination. This kind of complexity, then, suggests the infeasibility of a governmentally run mall. If there are to be urban-mall equivalents at all, they will probably need to be privately managed.¹⁵⁷

151. See Gould et al., *supra* note 114, at 419.

152. *Id.*

153. See *id.*

154. See *id.*

155. *Id.* at 411.

156. See *id.* at 411, 420.

157. A cautionary note: positive externalities are frequently extolled as a justification for

III. TOWARD A NEW APPROACH TO URBAN DEVELOPING

The traditional way of attracting businesses to a locality is to offer them financial benefits either in the form of direct cash grants or via various tax breaks.¹⁵⁸ Past experience teaches that both of these approaches typically fail.¹⁵⁹ A combination of reasons account for this result. First, setting subsidies and tax breaks correctly is very difficult. The least amount a certain business, or industry, would be willing to accept to operate in a certain location is private information, known to the business alone.¹⁶⁰ Naturally, businesses have an incentive to overstate their “reservation subsidy” in order to extract bigger subsidies from municipalities. As a consequence, municipalities are likely to overpay businesses in order to attract them to the relevant jurisdiction.¹⁶¹ Second, subsidies and tax breaks breed corruption. Considering the fact that money used to attract business comes from the public fisc, rather than from the politicians’ own pockets, politicians may use it to reward their supporters in the business community, not the businesses that may spark economic development in the area.¹⁶² Such transfers are not only unfair, but also ineffective in that they provide an advantage

various kinds of urban planning policies—for example, sports arenas. Yet the research of Robert Baade and Richard Dye, as well as Roger G. Noll and Andrew Zimbalist, shows approximately zero effect on cities that add a sports team or build a sports arena. See Baade & Dye, *supra* note 7, at 13; Noll & Zimbalist, *supra* note 30, at 36. It is important to realize that a particular mechanism is implicated in the case of shopping malls and that this mechanism is not necessarily present in many development contexts. In other words, we are not writing a general brief for cities to “discover” positive externalities from any and all development projects, many of which lack both an empirical record of producing spillover benefits and a theoretical rationale.

158. ALAN ALTSHULER & DAVID LUBEROFF, MEGA-PROJECTS: THE CHANGING POLITICS OF URBAN PUBLIC INVESTMENT 4 (2003); see also *id.* at 2. A third way was to provide the infrastructure necessary to attract businesses to the locality. Provision of infrastructure could either complement subsidies and tax breaks or serve as an independent inducement for business. See Timothy J. Bartik, *Solving the Problems of Economic Development Incentives*, 36 GROWTH & CHANGE 139, 140 (2005).

159. See Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 397 (1996).

160. See Mark Taylor, Note, *A Proposal to Prohibit Industrial Relocation Subsidies*, 72 TEX. L. REV. 669, 688 (1994).

161. See Enrich, *supra* note 159, at 395.

162. See Taylor, *supra* note 160, at 685-86.

to inefficient businesses over more efficient ones.¹⁶³ Third, and relatedly, subsidies and tax breaks foment rent seeking and rent extraction. The prospect of receiving money from the government is liable to spark fierce competition for rents among business owners who would expend resources in an attempt to capture the relevant benefits.¹⁶⁴ Politicians, for their part, may also invest time and money to secure concessions and payments from the businesses vying for the government money.¹⁶⁵ Critically, both rent seeking and rent extraction are inherently wasteful activities that divert resources from productive activities to nonproductive ones. Fourth, subsidies and tax breaks come at the expense of the public. The money used to finance them might have been invested in other municipal services that would better serve the public.¹⁶⁶ Fifth, empirical studies have shown that subsidies and tax breaks have largely failed to produce sustainable economic growth.¹⁶⁷ At best, they have a limited short-term effect that cannot be parlayed into a long-term one.¹⁶⁸

After discussing the shortcomings of the traditional approach, we propose a different solution that uses public power to construct appropriately sized asset configurations, but then places them in private hands to develop.

In the remainder of this Part, we develop a blueprint that may help revitalize commerce in American cities without relying on subsidies or tax breaks. To this end, we draw on the insights discussed so far. Our plan involves two distinct steps. The first step involves asset configuration, which consists of creating tracts that are big enough for the creation of commercial districts. The second step is to create the right mix of stores to attract patrons.

163. See Enrich, *supra* note 159, at 404.

164. See Taylor, *supra* note 160, at 688-89.

165. See *id.* at 690-91.

166. See Enrich, *supra* note 159, at 402.

167. See, e.g., Justin Dahlheimer, *Years of Subsidizing Retail and Nothing to Show for It*, INST. FOR LOCAL SELF-RELIANCE (Feb. 18, 2009), <http://www.ilsr.org/retail/news/years-subsidizing-retail-and-nothing-show-it>.

168. See *id.*

A. Asset Configuration

Naturally, the establishment of commercial districts within a city requires the city to zone the relevant area for commercial use.¹⁶⁹ To be sure, municipalities have long used their zoning power to this end.¹⁷⁰ But designating areas for a commercial use is the beginning, rather than the end, of the process. In order to enable the creation of the right mix of businesses, local lawmakers must ensure the existence of parcels of various sizes and layouts *within* the commercial area. For example, the typical parcel necessary for a department store is very different from that necessary to support a small retail store, and even within a category of shops there may be different preferences with respect to size and other asset characteristics.

Indeed, asset definition, or configuration, is an important dimension of property law.¹⁷¹ Assets do not remain frozen in time. Rather, policymakers and owners constantly redefine assets in response to changes in the real world.¹⁷² As Robert Ellickson famously observed, the specific configuration of an asset depends on the owner's contemplated use:

For example, suppose that the optimal territorial scale of the Coase College campus, given its educational purposes, is 200 acres. But the optimal scale for exploitation of the oil pool beneath Coase is 7777 acres. And when Coase rents living space to a sophomore, an optimal space is ... a 150-square-foot dormitory room.¹⁷³

As Ellickson's example illustrates, assets may come in various sizes and with widely divergent bundles of features. In the case of land, for example, lot size may predominate over other features. Yet, even in the case of land, there are other variables that may be reconfigured. Land may be bundled with structures or environmen-

169. See JESSE DUKEMINIER ET AL., PROPERTY 938 (7th ed. 2010).

170. See *id.* at 929 (describing the proliferation of zoning laws in the early 1900s).

171. See Bell & Parchomovsky, *supra* note 59, at 1015 (naming asset configuration as one of the three dimensions that defines the scope of property rights).

172. See DUKEMINIER ET AL., *supra* note 169, at 954 (explaining the need for flexibility in zoning); see also *id.* at 319-22 (describing different arrangements for concurrently owned land).

173. Ellickson, *supra* note 56, at 1332-33.

tal amenities or may be offered without them. The list of options with respect to other goods is even greater. Consider the case of cars. Cars can assume different shapes and incorporate a wide array of mechanical specifications and safety features. The specific configuration is often left to the private owner or manufacturer of the asset whose primary motivation will be to maximize asset value, but it may also be dictated by a regulator whose main focus is health and safety concerns.

Of course, social preferences also evolve over time, which makes preexisting configurations, especially in the case of land, outmoded or suboptimal.¹⁷⁴ For instance, the optimal lot size in nineteenth-century Manhattan was almost certainly very different from what it is today. Subdivision and partition in kind allow owners to adjust lot size downward;¹⁷⁵ aggregation or land assembly allow for the opposite dynamic.¹⁷⁶ Critically, though, there is a difference between downward and upward adjustments of lot sizes. As scholars such as Francesco Parisi, Ben Depoorter, and Michael Heller have noted, it is much easier to break large parcels down into smaller lots than to aggregate smaller lots into a single large parcel.¹⁷⁷ Although the literature has primarily focused on fragmentation of property *rights*, rather than assets, the problem is essentially the same.¹⁷⁸

174. See DUKEMINIER ET AL., *supra* note 169, at 954.

175. See *id.* at 338.

176. See Michael Heller & Rick Hills, *Land Assembly Districts*, 121 HARV. L. REV. 1465, 1467-68 (2008).

177. See Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. 1163, 1173, 1179 n.82 (1998); Francesco Parisi, *Entropy in Property*, 50 AM. J. COMP. L. 595, 613 (2002); Ben W.F. Depoorter & Francesco Parisi, *Fragmentation of Property Rights: A Functional Interpretation of the Law of Servitudes* pt. III.A.1 (John M. Olin Ctr. for Studies in Law, Econ., & Pub. Policy Working Papers, Paper No. 284, 2003), available at http://digitalcommons.law.yale.edu/lepp_papers/284.

178. The fragmentation literature focuses on the problem of multiple rights holders, each in possession of a relatively small interest in an asset, typically realty. Fragmentation typically arises when a single owner transfers her rights to multiple recipients either while she is alive or at her death. The result is that the underlying asset will be underused since each recipient, by dint of having a property interest in the asset—albeit a small one—can veto any use of the asset that she does not like. A similar problem may arise when large assets are portioned in kind into smaller assets. Post partition, the assets may become too small for certain uses. In fact, the two problems are even more closely related than it first seems. When multiple parties own an asset and they cannot agree on how to use it, each of them can bring an action for partition. A court will then have to decide whether to order partition in kind or partition by sale. Under current law, the formal default rule is partition in kind. See DUKEMINIER ET AL., *supra* note 169, at 338-47 (collecting cases on partition in kind and by

Aggregation of rights—or “land assembly” as the practice is often called—can be accomplished either through voluntary market transactions (contracts) or through forced ones (eminent domain).¹⁷⁹ The first method, aggregation through voluntary market transactions, will often fall prey to high transaction costs. As many commentators have noted, serial acquisitions of land parcels invariably involve lengthy negotiations with the relevant title holders and, worse, often give rise to serious holdout problems.¹⁸⁰ In light of the fact that the acquirer needs to buy the rights to all relevant parcels, each of the current owners has veto power over the entire project and has a built-in incentive to hold out in an attempt to capture the greatest possible share of the bargaining surplus.¹⁸¹

The second method, taking by eminent domain, eliminates the holdout problem that undermines voluntary transactions. Indeed, Judge Posner posited that holdouts are “[t]he only justification” for the existence of the power of eminent domain.¹⁸² By virtue of this power, private property is protected vis-à-vis the government by what Guido Calabresi and Douglas Melamed termed “liability rules,”¹⁸³ meaning that the government can take title to private property as long as it is willing to pay just compensation to be determined by a court after the fact¹⁸⁴ and satisfies the “public use” requirement in the Fifth Amendment.¹⁸⁵ In more conventional economic parlance, the government holds a call option exercisable at market price on all private property.¹⁸⁶ Hence, the holdout problem does not arise when the government chooses to take property by eminent domain.

Some theorists have suggested that the takings power is necessary to address the problem of too many rights holders. We believe,

sale).

179. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF THE LAW* 70-71 (8th ed. 2011).

180. See, e.g., *id.*

181. *Id.*

182. Richard A. Posner, *The Supreme Court, 2004 Term—Foreword: A Political Court*, 119 HARV. L. REV. 31, 93-94 (2005).

183. Calabresi & Melamed, *supra* note 32, at 1092.

184. Posner, *supra* note 182, at 93 (explaining that just compensation is set at market value, which is often less than the subjective valuation of the original property holder).

185. See *Kelo v. City of New London*, 545 U.S. 469, 489-90 (2005) (defining “public use” broadly to include economic development).

186. See Posner, *supra* note 182, at 93.

however, that it actually addresses the problem of suboptimal configuration of land parcels. As Abraham Bell, together with one of us, explained, as far as the power of eminent domain is concerned:

[T]he underlying problem is not necessarily one of too many owners but rather of suboptimally configured assets. Assume that the government needs a large tract to construct a military base. The government would need to resort to land assembly only if there are not any individual tracts of adequate size. If there were sufficiently large tracts, fewer holdout problems would arise, and the government could acquire title to one or more of the tracts through voluntary negotiations.¹⁸⁷

Suboptimal asset configuration is also the main obstacle to development of vibrant commercial zones in American cities. In order to carry out our proposal, it is necessary to find tracts of sufficient size to support comprehensive commercial development. Alas, it is impossible to find large *vacant* tracts in most cities.¹⁸⁸ In fact, this is the reason that shopping malls are usually situated in suburbs. Accordingly, the first step on the way to implementing our scheme would require localities to use their power of eminent domain to piece together tracts of suitable size for comprehensive commercial planning.

The foregoing analysis would probably change if vertical malls were to gain popularity in the United States. Vertical malls in urban areas might permit the same kind of spillover-internalization that conventional “horizontal” malls offer the suburbs. And since their footprint is relatively small, vertical malls would not seem to require extensive aggregation or land assembly.

187. Bell & Parchomovsky, *supra* note 59, at 1042.

188. A few cities do have abundant vacant land. “Urban planners have estimated that Detroit contains between 30 and 40 square miles of vacant land, [one-fourth to one-third of the city’s total area].” John Gallagher, *Farming Plan Gains Traction in Detroit*, DETROIT FREE PRESS, Aug. 20, 2010, at A18; see *Detroit (city), Michigan*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/26/2622000.html> (last visited Sept. 27, 2012). But the reason there is so much vacant land is that the city has already succumbed to economic decline, so the construction of an urban mall would probably do little to help it. Moreover, although “[t]he city has a lot of vacant land, ... very few [parcels] are areas of 20 acres or more,” according to an executive at the Detroit Economic Growth Corporation. Christine MacDonald, *Recent City Relocation Projects Fall Short*, DETROIT NEWS, Mar. 9, 2011, at A1.

Although the idea of vertical malls may seem alien to American consumers and urban planners, such malls are common in major Asian, European,¹⁸⁹ and Latin American cities.¹⁹⁰ There are also some examples of vertical malls in the United States, although they are relatively few and far between. The first domestic vertical mall was constructed in Chicago in 1976 as part of Water Tower Place skyscraper.¹⁹¹ Recently, plans have been made to open another vertical mall in Los Angeles.¹⁹² Although vertical malls are apparently less appealing to consumers because they offer a less convenient and more time consuming shopping experience, land scarcity may force American consumers to adjust their shopping experience. Land scarcity is an important determinant of architecture. As land becomes increasingly in short supply, the optimal configuration of malls changes too. Increasing traffic congestion and rising gas prices may expedite the shift from horizontal to vertical malls.

A shift to vertical shopping malls, if it is to occur, would probably have little effect on our analysis. In fact, it would make the implementation of our proposal easier since the amount of land necessary for the construction of malls would be smaller. This means that there may be less need for eminent domain exercises in order to assemble enough tracts to support mall construction. Indeed, in many cases private developers would conceivably be able to complete the land assembly phase without government assistance. Even in such cases, however, private developers may need municipalities to relax zoning restrictions to allow for the construction of sufficiently tall buildings that can accommodate enough stores.

189. Roger Vincent, *Developers Have High Hopes for Vertical Mall*, L.A. TIMES, Sept. 25, 2008, at C1.

190. See Mario Castro F., *Vertical Shopping Centers in Latin America*, ICSC CERTIFIED PROFS. NEWSL. (Int'l Council of Shopping Ctrs., New York, N.Y.), Feb. 2008, available at http://www.icsc.org/srch/education/newsletter/CPNews0208/12_VerticalSCs.pdf.

191. *Water Tower Place*, CHI. ARCHITECTURE INFO, <http://www.chicagoarchitecture.info/Printer.php?ID=1351> (last visited Sept. 27, 2012).

192. Vincent, *supra* note 189.

B. Arriving at the Right Combination

Once the lots necessary for the establishment of a commercial area have been assembled, cities will have to tackle the challenge of creating the right combination of stores to attract patrons. There are two possible ways to accomplish this task. First, cities can maintain ownership of the retail spaces and rent them out to commercial outfits. In this process, cities will be well advised to consult shopping mall planners both about the optimal combination of stores and about pricing. Second, cities can simply auction off the land to mall developers and let them decide to whom to rent the space and at what price. The remainder of this Part discusses the advantages and disadvantages of each of the options.

1. Self-Development

The option of self-development may be attractive to cities for political reasons. Under this option, the city would essentially go into the mall-management business by designing the mall, supervising its construction, fixing rents, finding tenants, and so on. This strategy has both advantages and disadvantages. Politically, it may be easier to embark upon large-scale condemnations if the lots remain municipal property. Exercises of eminent domain that are followed by transfers of rights to private actors can engender negative political reactions and in some cases result in a backlash, as the case of *Kelo v. City of New London* illustrates.¹⁹³ There, the city of New London sought to take multiple private lots in order to facilitate the construction of a new headquarters for Pfizer.¹⁹⁴ Even though the plan passed constitutional muster, it was never carried out, owing to the harsh public reaction it prompted.¹⁹⁵ As a matter of public perception, exercises of eminent domain in the service of commercial entities are problematic, presumably because they are widely perceived as a sharp deviation from principles of equality and fairness.¹⁹⁶

193. 545 U.S. 469 (2005).

194. *Id.* at 473-75.

195. See JEFF BENEDICT, *LITTLE PINK HOUSE* 376-77 (2009).

196. *See id.*

If the government maintains ownership of the taken property in the aftermath of a taking, the public reaction will likely be much less negative. Even the staunchest critics of the Supreme Court's extant takings jurisprudence agree as a matter of positive law that when the government maintains an ownership interest in the condemned property, the taking is legitimate.¹⁹⁷ Consequently, politicians, like all other self-interest maximizers, will be far more inclined to embark upon projects that do not pose a threat to their political careers.

Although retaining ownership over the land seems far more attractive initially, one must bear in mind that over time the political calculus may change. Continuous ownership would subject local politicians to ongoing scrutiny from the public and local media. Rent adjustments—especially rent increases—may result in disgruntled store owners, and in some cases, prolonged legal battles. Finally, long term management of the commercial space will expose cities to multiple political pressures from commercial actors seeking favors and concessions.

We suspect it is unwise for cities to attempt to develop the commercial areas by themselves, as they clearly lack the expertise necessary for the task. The informational obstacle might not be insurmountable, however, if cities can turn either to current mall developers or to former employees of such companies for advice on how to achieve the optimal mix of stores. Indeed, it is even possible that there are independent experts who sell consulting services to mall developers and can also assist cities in their quest to achieve the right combination of stores. As far as pricing is concerned, cities can once again buy advice from independent companies or mall developers, or, if they are courageous enough, they can even consult the economic literature on the subject.¹⁹⁸ However, all of these suggestions entail agency costs, which are likely to be substantial, precisely because cities lack the knowledge to adequately monitor the advice and behavior of any experts they hire. For example, consultants may be tempted to give self-serving advice; and even if they are honest, hired consultants are not the residual claimants on profit flows from the project, in the way that mall owners are. Thus,

197. See *Kelo*, 545 U.S. at 517 (Thomas, J., dissenting).

198. See *supra* Part II.B.

their incentives are not properly aligned to yield efficient advice. And on the other side, public development and management run the risk of corruption and featherbedding—for example, packing the operation with patronage appointments.

2. Auctioning Off the Project

The second option available to cities is to auction off their rights to the highest bidder and allow the winner to develop the commercial space as she sees fit. We have two principal reasons for our endorsement of the auction mechanism. First, from an economic standpoint, a properly administered auction will yield cities the highest possible payoff for their rights. Secondly, the law of many jurisdictions mandates the use of auctions by municipalities in commercial transactions.¹⁹⁹ The law's preference for auctions should come as no surprise. Economic theory suggests that properly designed auctions can induce bidders to reveal their true valuations,²⁰⁰ as well as maximize the revenues of the seller.²⁰¹ But perhaps more importantly, the use of auctions reduces the risk of political favoritism that may lead to suboptimal allocation of resources by public authorities.²⁰² Auctions constrain the ability of public officials to dole out political favors to their supporters, forcing them, instead, to focus on the good of the public. Auctioning off the rights to the taken lots will relieve cities of the need to devise optimal development and pricing schemes for the planned commercial area. Furthermore, some of the proceeds of the auction may be used for compensating the previous owners of the lots, and the remainder may be used to finance other public projects. Finally, parting

199. 10 EUGENE MCQUILLIN, *THE LAW OF MUNICIPAL CORPORATIONS* § 29:80 (3d ed. 2009) (“[C]harter provisions that certain contracts of municipal corporations be awarded to the lowest and best, or lowest responsible, bidder are made for the protection of public interests and must be complied with by the municipal authorities for the benefit of the public.”).

200. Jason F. Shogren et al., *Bid Sensitivity and the Structure of the Vickrey Auction*, 76 *AM. J. AGRIC. ECON.* 1089, 1089 (1994) (describing auctions as a standard valuation for nonmarket goods).

201. Roger B. Myerson, *Optimal Auction Design*, 6 *MATHEMATICS OPERATIONS RES.* 58, 72 (1981) (investigating a variety of auctions to maximize seller value).

202. See CHARLES W. SMITH, *AUCTIONS: THE SOCIAL CONSTRUCTION OF VALUE* (1990) (arguing that auctions are often used when parties to a transaction need to assure the public that a price has been arrived at in a fair and legitimate manner).

company with the rights will stem political pressures from various interest and lobby groups who can potentially benefit from the project.

At this point, one may wonder whether cities may use their eminent domain power to acquire rights to land and then proceed to transfer the rights to private developers without violating the public use requirement of the Constitution.²⁰³ The answer is clearly “yes.” The Supreme Court has construed the public use requirement very broadly. In *Berman v. Parker*, the Court upheld a large-scale urban renewal plan in Washington, D.C. that required condemnation and transfer of multiple private lots to private developers.²⁰⁴ The Court explained that the public use prong is met whenever the government acts within its police power²⁰⁵ and that “[t]he role of the judiciary in determining whether that power is being exercised for a public purpose is an extremely narrow one.”²⁰⁶

Since *Berman*, the Court has adhered steadfastly to this position. For example, thirty years later, in *Hawaii Housing Authority v. Midkiff*, the Court sanctioned Hawaii’s Land Reform Act of 1967, which empowered tenants to force their landlords to relinquish their fee simple interest in the property and transfer it to the tenants.²⁰⁷ A unanimous Supreme Court upheld the Hawaii legislation, pronouncing that the Public Use Clause is coterminous with police power.²⁰⁸ And, of course, in *Kelo*, the Supreme Court approved a planned taking of numerous private properties by the city of New London in order to free up land for the construction of an industrial park for Pfizer.²⁰⁹ The taking was justified on the ground that it was necessary for the economic development of the area.²¹⁰ Granted, the decision has sparked a hailstorm of public criticism.²¹¹ Lost in the

203. See Abraham Bell & Gideon Parchomovsky, *The Uselessness of Public Use*, 106 COLUM. L. REV. 1412, 1413-15 (2006) (surveying the critical responses to the *Kelo* decision).

204. 348 U.S. 26, 28-31, 36 (1954).

205. *Id.* at 32. The Court elucidated that “[p]ublic safety, public health, morality, peace and quiet, law and order—these are some of the more conspicuous examples of the traditional application of the police power to municipal affairs.” *Id.*

206. *Id.*

207. 467 U.S. 229, 231-33 (1984).

208. *Id.* at 240.

209. *Kelo v. City of New London*, 545 U.S. 469, 473-75, 490 (2005).

210. *Id.* at 483-84.

211. Ilya Somin, *The Limits of Backlash: Assessing the Political Response to Kelo*, 93 MINN. L. REV. 2100, 2101-02 (2009).

storm was the fact that the decision “broke no new legal ground;” it was perfectly consistent with the Supreme Court’s jurisprudence in this area.²¹²

Subsequent decisions that upheld economic development were met with relative equanimity. In *Goldstein v. New York State Urban Development Corp.*, the New York Court of Appeals upheld the taking of multiple private lots in Brooklyn in order to transfer them to a private developer for the purpose of building a basketball arena.²¹³ Naturally, the case had its critics,²¹⁴ but the overall reaction was a far cry from the reaction to *Kelo*. Finally, in *Kaur v. New York State Urban Development Corp.*, the New York Court of Appeals had little problem ruling that a taking designed to transfer land to Columbia University passed state constitutional muster.²¹⁵ In light of judicial precedent, the public use requirement will not present a serious legal hurdle to the implementation of our proposal.

At the end of the day, the choice between self-development and outsourcing depends on a host of variables that are likely to vary from one locality to another. The first variable is the attitude of the local population to exercises of the takings power designed to acquire rights for private entities. If the population is strongly opposed to the practice, auctioning off the rights is not a real option. The second variable is the planning horizons of local politicians and their attitudes toward risk. Politicians who are focused on the short term and are mildly risk averse will likely prefer to sell the rights to developers and receive a large one-time payment in exchange for the prospect of maintaining ownership and dealing with the potential pitfalls and uncertainty associated with managing the property. Finally, budgetary considerations may tip the scale in favor of outsourcing. Cities in need of an immediate infusion of money will clearly choose to auction off their rights and use the proceeds to balance their budget, rather than wait a long time to see how the development stage pans out.

212. Bell & Parchomovsky, *supra* note 203, at 1413.

213. 921 N.E.2d 164, 165-66 (N.Y. 2009).

214. See Ilya Somin, *Let There Be Blight: Blight Condemnations in New York After Goldstein and Kaur*, 38 *FORDHAM URB. L.J.* 1193, 1200-09 (2011); Ilya Somin, *The Judicial Reaction to Kelo*, 4 *ALB. GOV’T L. REV.* 1, 15-18 (2011).

215. 933 N.E.2d 721, 724 (N.Y. 2010).

IV. THE UNDERAPPRECIATED WELFARE EFFECTS OF OUR PROPOSAL

Moving stores to the city is obviously something that cities desire, and it is defensible purely on that basis. By increasing the tax base, generating jobs, and attracting foot traffic that makes streets safer, bringing in large stores can create obvious benefits for a city. But from a bird's eye, social welfare perspective, isn't the relocation of a large store from suburb *Y* to the center of city *X* subject to the classic zero-sum critique that the city's gain is just equal to the suburb's loss, with no net improvement in social welfare? The answer is clearly "no," because there are unpriced *negative* externalities associated with the low-density living in suburbs. Reducing these negative externalities would produce a net social gain. Consequently, moving stores from suburbs to cities is not just redistributive, but also has positive effects on overall welfare.

The economists Edward Glaeser²¹⁶ and Matthew Kahn²¹⁷ make a compelling empirical and theoretical case that low-density living raises transportation costs for both people and goods, increases energy consumption and pollution, and raises building costs.²¹⁸ Take pollution, for example. Lower density invariably entails less walking, more driving, and greater use of private rather than public transportation. Additionally, energy-efficient public transportation is less economical when the population is widely dispersed.²¹⁹ Although the negative effects of these pollution-generating activities could, in theory, be corrected by appropriate Pigouvian taxes of the type described earlier, in practice, we do not currently employ such corrective mechanisms.²²⁰ As a result, suburban/dispersed living

216. Edward L. Glaeser & Matthew E. Kahn, *The Greenness of Cities: Carbon Dioxide Emissions and Urban Development*, 67 J. URB. ECON. 404 (2010); Edward L. Glaeser & Matthew E. Kahn, *Sprawl and Urban Growth* 31-41 (Nat'l Bureau of Econ. Research, Working Paper No. 9733, 2003) [hereinafter Glaeser & Kahn, *Sprawl*], available at <http://www.nber.org/papers/w9733>.

217. KAHN, *supra* note 27.

218. See Reid Ewing, *Is Los Angeles-Style Sprawl Desirable?*, 63 J. AM. PLAN. ASS'N 107 (1997) (suggesting that the answer to this question is also "no," and making a persuasive case against sprawl); Peter Gordon & Harry W. Richardson, *Are Compact Cities a Desirable Goal?*, 63 J. AM. PLAN. ASS'N 96 (1997) (suggesting that the answer is "no").

219. See Glaeser & Kahn, *Sprawl*, *supra* note 216, at 40.

220. Indeed, free roads and highways are effective subsidies to automobile ownership.

generates negative externalities, and these would be reduced by encouraging greater density.

One might think that some of Kahn's and Glaeser's arguments for the relative "greenness" of cities do not actually entail externalities. For example, transportation costs are presumably priced into the products people buy and might also be capitalized into home prices. Higher building costs and heating expenses are surely passed on to consumers of housing. When the prices of goods or assets reflect the appropriate social costs of the resources associated with producing and consuming them, no externalities will exist. Alas, however, home and product prices do not fully reflect the costs of urban sprawl. True, the buyer of a suburban home pays for the higher energy costs used to heat and cool it. But the additional energy used does not incorporate the additional pollution costs, so the suburban resident pays for only a part of the resources her lifestyle uses up. Similarly, prices may reflect higher transportation costs but not the costs of the additional pollution or congestion that the transportation entails. This is the second-best justification for reducing sprawl at the margin by encouraging large stores to move downtown.

All this means that the standard "revealed preference" argument²²¹—people live in suburbs, thus they prefer them, and living there is efficient—is likely to be wrong. A combination of market, governmental, and legal failures is associated with sprawling cities. Market failures such as unpriced pollution mean that prices do not reflect the true economic costs of low-density living. Governmental failures such as overly restrictive building codes and zoning requirements also contribute to the problem.²²² And the legal system also plays a role because the law impedes the realization of appropriately sized land parcels.²²³ Under such conditions, the choices people make about where to live cannot be welfare-optimal because they are based on a whole variety of mispriced resources.

221. See, e.g., Cass R. Sunstein, *Social Norms and Social Rules*, 96 COLUM. L. REV. 903, 932 (1996).

222. See Edward L. Glaeser & Joseph Gyourko, *The Impact of Zoning on Housing Affordability* (Nat'l Bureau of Econ. Research, Working Paper No. 8835, 2002), available at <http://www.nber.org/papers/w8835.pdf>.

223. See Bell & Parchomovsky, *supra* note 59, at 1033-42 (explaining how property regimes may set inefficient asset configurations); Heller & Hills, *supra* note 176, at 1472-82 (describing challenges with private and public land assembly).

Although correcting all these failures would be even better than inducing large stores to move to city centers, substantial policy changes such as increases in gasoline taxes and cap-and-trade programs for carbon emissions are politically fraught. Moreover, many such policy prescriptions are available only at a national level. Our more modest proposal, by contrast, is less likely to run into political obstacles and can be enacted by any city on its own.

CONCLUSION

In this Article we have proposed a new way of creating better planned commercial districts that may help attract consumers to American downtowns. The mechanism we advance is designed to create a higher volume and more attractive mix of stores by allowing for internalization of positive externalities among retailers. Attracting consumers back to city centers also has the potential to reduce the negative externalities associated with urban sprawl and enhance agglomeration effects within cities. However, we would like to end this Article on a cautionary note. Our proposal should not be thought of as a foolproof recipe for rekindling economic growth in urban spaces. Mario Palèse correctly notes that “[c]ities, like people, are too diverse to allow anything but fairly commonsense prescriptions. A lot of grand theories have been advanced—targeted tax incentives! bike paths!—but they have proven of little practical use.”²²⁴ He further points out that “[t]he history of local economic development is a story of academic fads.”²²⁵ In the 1960s, the prevalent philosophy among academics was that it was imperative to attract strategic industry to cities via various financial incentives and investment in infrastructure.²²⁶ Then high-tech industrial parks became trendy among academics, and municipalities were called upon to build them and offer perks to high-tech companies in order lure them in.²²⁷ The 1980s saw the coming of “industrial clusters.” The harbinger of this new trend was Professor Michael Porter of the

224. Mario Palèse, *Urban-Development Legends*, CITY J., Autumn 2011, at 115, available at http://www.city-journal.org/2011/21_4_urban-development.html.

225. *Id.*

226. *Id.*

227. *Id.*

Harvard Business School.²²⁸ The 1980s were also the heyday of the idea of “community economic development,” which led to the establishment and financing of copious local business-development corporations.²²⁹ All these ideas yielded mixed results—some of the localities in which they were implemented achieved long-term economic success; many others did not.²³⁰

If history is to teach us something, it is that urban development should be approached with a healthy dose of modesty. This may be the main virtue of our proposal. We would like readers to think of our idea as a mere component of a more general urban policy intended to spark economic growth. The main advantages of our proposal over past schemes lie in its low cost and its reversibility. Unlike the more ambitious plans of the past, it requires only modest expenditures on planning and land assembly, and does not involve the risk that large expanses of land will go to waste or lie fallow should the plan fail. Commercial districts are already in existence in all American cities. We merely propose a way to improve them. In the case of failure, new stores will replace existing ones, as would happen in any normal business cycle. Hence, the risk associated with our plan is relatively low. The upside of our proposal, on the other hand, could prove quite significant.

228. *Id.* at 115-16.

229. *Id.* at 116.

230. *See id.* at 117-19.