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The Progressive Potential in Privatization

OPTING OUT OF PUBLIC PROVISION: CONSTRAINTS AND POLICY CONSIDERATIONS

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In his thought-provoking article, Professor Clayton Gillette draws an analogy between contractual default theory and opting out of public provision.¹ This creative approach provides an interesting framework within which to study the propriety of opting out of government services. Given the current trend toward private governance and the controversial nature of this topic, Gillette's article should prove to be only the beginning of an important dialogue on the propriety of opting out of public provision.

With his characteristic completeness, Gillette astutely anticipates a myriad of possible concerns and directly addresses them. So, rather than laboriously reviewing his analysis, I have chosen instead to build upon his framework and identify issues that warrant further consideration and discussion. Specifically, I explore the constraints on an individual's freedom to opt out of certain governmentally supplied services by drawing further analogies to contract law.

This article begins with a brief discussion of default theory and its application in the public provision context. Various constraints on opting out of public provision are then described, and the appropriateness of these restrictions is considered. The article also examines how the default level of services is set and how opting out may alter the default level.

I. CONTRACTUAL DEFAULT THEORY AS APPLIED TO PUBLIC PROVISION

The default theory concept² is deceptively simple. Contractual default

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1. Clayton P. Gillette, *Opting Out of Public Provision*, 73 DENV. U. L. REV. 1185 (1996).

2. While Gillette uses the contractual default model for his analogy, default rules are prevalent in other areas of the law that have contractual aspects, such as divorce law, the law of intestacy, tort law, and property law. For example, under the law of intestacy, default rules fill any testamentary gaps. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 88 n.10 (1989); W. David Slawson, *The Futile Search for Principles for Default Rules*, 3 S. CAL. INTERDISCIPLINARY L.J. 29, 30 (1993).

rules establish contract rights and obligations when an agreement is silent with respect to certain topics.³ Default rules often provide supplementary contract terms when the parties have not agreed otherwise.⁴ The parties, however, are free to opt out of these standard default provisions by private agreement if they strike a different bargain.⁵ For example, if a contract by a merchant for the sale of goods is silent with respect to warranties, a warranty of merchantability is implied.⁶ The parties, however, may waive the warranty or opt for a different provision by express agreement.⁷

Gillette proposes we view the level of goods and services the government provides as a default or background level, since it is available to all residents simply by virtue of their membership in the community.⁸ He argues individuals should be permitted to opt for a different level by privately contracting for more, or possibly even opting for fewer,⁹ goods or services.¹⁰ Gillette suggests the decision to select one level of service over another may simply reflect a desire to achieve individual preferences where that individual is unable to satisfy his preferences through the political process.¹¹ He submits allowing individuals to opt out of public provision may be no more momentous than opting out of the default rules under contract law.¹² Consequently, we should not necessarily draw any negative inferences from the fact that some individuals may opt for a different level of service,¹³ just as they may decide to opt for a different contract term. Gillette concludes the propriety of opting out should be determined by weighing the competitive benefits of opting out (efficiency and satisfaction of individual preferences) against the costs of opting out (in terms of political participation and effect on community).¹⁴

However, even in the contract law context, default theory is not without constraints and controversy. The freedom to contract itself is limited. For example, some contracts are unenforceable on public policy grounds, such as

3. The term "default rules" became popular when Ian Ayres and Robert Gertner used it in their seminal article, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, *supra* note 2. Ayres and Gertner noted that default rules also have been called "background, backstop, enabling, fallback, gap-filling, off-the-rack, opt-in, opt-out, preformulated, preset, presumptive, standby, standard-form and suppletory rules." *Id.* at 91 & n.25. For a small sampling of the literature on contractual default theory, see *Symposium on Default Rules and Contractual Consent*, 3 S. CAL. INTERDISCIPLINARY L.J. 1 (1993).

4. Steven J. Burton, *Default Principles, Legitimacy, and the Authority of a Contract*, 3 S. CAL. INTERDISCIPLINARY L.J. 115, 116 (1993).

5. See, e.g., U.C.C. § 1-102(3) (1994) ("The effect of provisions of this Act may be varied by agreement . . .").

6. See U.C.C. § 2-314 (1994).

7. *Id.*

8. Gillette, *supra* note 1, at 1195.

9. *Id.* at 1216-20.

10. Even though Gillette presents a balanced approach in his inquiry into the propriety of opting out by addressing the various concerns voiced by Symposium participants, the article, taken as a whole, generally supports the position that individuals should be free to opt out of public provision. Implicit in his analysis is the assumption that one should be free to opt for a different level of government services.

11. Gillette, *supra* note 1, at 1188.

12. *Id.* at 1196-97.

13. *Id.* at 1196.

14. *Id.* at 1192-93, 1219.

contracts that restrain trade.¹⁵ A number of these contractual constraints have been cast as immutable rules applicable to all contracts that may not be varied by private agreement.¹⁶ The duty to act in good faith, for instance, is an immutable part of any contract.¹⁷ The parties to a contract may not disclaim their obligations of good faith, diligence, reasonableness, or care.¹⁸

In the contract law context, there is also debate as to how default rules should be set.¹⁹ Should default rules reflect what the parties would have wanted? Should they be designed simply to foster economic efficiency or preserve contractual relationships? Should default rules promote a certain result, such as encouraging parties to reveal information? Or should they reflect communitarian values, such as fairness? This debate focuses on whether default rules should just describe contracting behavior or prescribe appropriate rules.

While Gillette discusses the propriety of opting out of public provision, he only briefly addresses the constraints on one's freedom to opt out of certain governmentally supplied services.²⁰ If we are going to apply default rule theory in the public provision context, we must also consider *whether there are*, and *whether there should be*, certain constraints and immutable rules. In addition, we must gain a better understanding of what the default or background level of services *reflects* and consider what it *should reflect*.

II. CONSTRAINTS AND IMMUTABLE RULES

A. Constraints on Opting Out of Public Provision

Few will quarrel with the general proposition that an individual should be free to purchase greater security protection or opt out of the public school system for a private alternative. Nevertheless, there are clearly constraints on

15. E. ALLAN FARNSWORTH, *CONTRACTS* ch. 5 (2d ed. 1990 & Supp. 1995); JOHN E. MURRAY, JR., *MURRAY ON CONTRACTS* § 98 (3d ed. 1990). Public policy grounds cited by courts to justify nonenforcement include moral values (policies against impairment of family relationships and against gambling), economic grounds (policies against restraint of trade and restraints on alienation of property), and the need to protect government institutions (policies against improperly influencing government officials). FARNSWORTH, *supra*, § 5.2, at 351.

16. *See, e.g.*, U.C.C. § 1-102(3) (1994) (good faith, diligence, reasonableness, and care may not be disclaimed by agreement); U.C.C. § 1-105(2) (1994) (limits a party's right to choose applicable law); U.C.C. § 1-204(1) (1994) (provision for disregarding a clause which fixes a time that is unreasonable); U.C.C. § 2-718 (1994) (liquidated damages clauses are allowed only where the amount involved is reasonable); U.C.C. § 2-719(3) (1994) (consequential damages clauses may not operate in an unconscionable manner).

17. U.C.C. § 1-203 (1994) ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.")

18. U.C.C. § 1-102(3) (1994) (providing that "the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement").

19. The following articles discuss the debate regarding how default rules should be set and contain citations to the literature in the area: Ayres & Gertner, *supra* note 2, at 89-95; Burton, *supra* note 4, at 116-18; Slawson, *supra* note 2, at 33.

20. For example, in passing, Gillette suggests raising the cost of exit, up to the point of prohibition, to transform the background service level from a default rule to an immutable rule, but then notes that such constraints necessarily impose the costs of noncompetitiveness and result in the inability of some residents to satisfy their individual preferences. Gillette, *supra* note 1, at 1204.

an individual's freedom to opt out of public provision. At some point, the arms and explosives you have stockpiled for increased security protection endangers yourself and possibly others, so the government will step in.²¹ If the private school system you and your neighbors have established endangers your child either because it uses corporal punishment or because it does not meet certain minimum standards, the government intervenes.²²

The constraints on one's freedom to opt out of public provision are strikingly similar to the constraints found in contract law. As previously noted, contract law recognizes many important limitations on the freedom to contract. Restrictions are placed on the right to contract by legislation and by public policy.²³ As examples, parties cannot create a binding contract to commit a crime or to commit a tort on a third party.²⁴ There are also certain immutable rules that may not be varied by agreement, such as the duty to act in good faith.²⁵

These contractual constraints and immutable rules are designed to protect the parties to the contract²⁶ or the parties outside the contract²⁷ from the socially deleterious effects of unregulated contracting.²⁸ These rules limit the freedom to contract on the grounds that parties internal or external to the contract cannot adequately protect themselves or others without government intervention.

21. See, e.g., COLO. REV. STAT. § 18-12-109 (1986 & Supp. 1995) (prohibits the possession or control of an explosive or incendiary device); N.D. CENT. CODE § 62.1-02-11 (1995) (prohibits possession of explosives); WYO. STAT. § 35-10-301 (1994) (prohibits storing explosive materials in or near any residence); see also *People v. Rowerdink*, 756 P.2d 986 (Colo. 1988) (defendant convicted of possessing incendiary devices); *State v. Johnson*, 417 N.W.2d 365 (N.D. 1987) (defendant convicted of criminal possession of explosives).

22. Christopher L. Eisgruber, *The Constitutional Value of Assimilation*, 96 COLUM. L. REV. 87, 92 (1996) ("Parents cannot elect to send their children to a school which refuses to teach reading or to a school which practices brutal corporal punishment."); see, e.g., IOWA CODE ANN. § 280.21 (West 1996) ("An employee of an accredited public school district, accredited nonpublic school, or area education agency shall not inflict, or cause to be inflicted, corporal punishment upon a student."); MINN. STAT. ANN. § 120.101 (West 1993 & Supp. 1996) (sets forth compulsory instruction standards, including curriculum areas and requirements for instructors); OKLA. STAT. ANN. tit. 70, § 21-107 (West 1989) (authorizing a state board to set minimum standards for private schools); VT. STAT. ANN. tit. 16, § 1161a(c) (1989 & Supp. 1995) ("No person employed by or agent of a public or approved school shall inflict or cause to be inflicted corporal punishment upon a pupil attending the school or the institution.").

23. See *supra* note 15.

24. RICHARD A. LORD, 5 WILLISTON ON CONTRACTS § 12:1, at 570 (4th ed. 1993).

25. See *supra* notes 16-18.

26. Several of the nonvariable provisions in the Uniform Commercial Code are intended to prevent one party from taking undue advantage of another. See, e.g., U.C.C. § 2-302 (1994) (protecting against unconscionable contracts); U.C.C. § 1-203 (1994) (protecting against bad faith).

27. Several Uniform Commercial Code provisions are designed to protect the interest of third parties. See, e.g., U.C.C. § 2-403 (1994) (protects good faith purchasers for value); U.C.C. § 2-702(3) (1994) (protects the rights of buyers in the ordinary course and other good faith purchasers). Earlier drafts of U.C.C. § 1-102 provided that "[e]xcept as otherwise provided by this Act the rights and duties of a third party may not be adversely varied by an agreement to which he is not a party or by which he is not otherwise bound." The subsection, however, was deleted reportedly because it was deemed unnecessary. JAMES J. WHITE & ROBERT S. SUMMERS, 1 UNIFORM COMMERCIAL CODE § 3-11, at 183 (4th ed. 1995).

28. See Ayres & Gertner, *supra* note 2, at 88-89; Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983).

This same rationale explains certain constraints on an individual's freedom to opt out of public provision. In some situations, opting for more or less government services may have socially detrimental effects. Government intervenes to protect the parties themselves or to protect third parties from the possible consequences of an individual's actions. Intervention generally takes the form of prohibitions or restrictions on an individual's right to opt for a different level of services.²⁹

For example, one's freedom to opt out of public provision is constrained by common law and by legislation. The term legislation is used here in the broadest sense, to include not only constitutions and statutes but also administrative regulations and local ordinances. Such constraints can be federal, state, or local. Assume, for instance, that your local government conducts a spraying program in your town each summer to control the mosquito population. The type of spray a local government may administer must comply with federal regulations.³⁰ Your local government is prohibited from using a pesticide that would be harmful to humans or a pesticide that would harm a local endangered species.³¹ If the approved form of pesticide fails to eliminate all the pesky mosquitos in your yard, your individual ability to privately opt out and use a more lethal spray or a larger dosage may be constrained by federal, state, or even local regulations. Such constraints may be in part to protect you from the harmful effects of such a spray, to protect your neighbors from the

29. This is not to say that it might not be better, from an economic perspective, to use financial penalties to discourage harm-producing behavior and financial rewards to encourage harm-reducing behavior. Several commentators have observed that it is economically inefficient for government to prohibit or restrict behavior. They have suggested that it would be better, on economic grounds, for government to create market incentives to engage in socially desirable conduct, rather than to prohibit socially undesirable behavior. See, e.g., Bruce A. Ackerman & Richard B. Stewart, *Reforming Environmental Law: The Democratic Case for Market Incentives*, 13 COLUM. J. ENVTL. L. 171 (1988); Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 112-14 (1995).

30. See, e.g., 7 U.S.C. § 136a (1994) ("[N]o person in any State may distribute or sell to any person any pesticide that is not registered under this subchapter. To the extent necessary to prevent unreasonable adverse effects on the environment, the Administrator may by regulation limit the distribution, sale, or use in any State of any pesticide that is not registered under this subchapter . . .").

31. For instance, the United States Fish and Wildlife Service determined *Bufo hemiophrys baxteri* (the "Wyoming toad") had virtually disappeared from all known sites, in part, due to the use of certain herbicides and mosquito control techniques. The Service concluded that the Wyoming toad was an endangered species and therefore protected under the federal Endangered Species Act of 1973 (ESA). Endangered and Threatened Wildlife and Plants; Determination That *Bufo Hemiophrys Baxteri* (Wyoming Toad) is an Endangered Species, 49 Fed. Reg. 1992, 1992-93 (1984). The ESA makes it unlawful for any person to harm an endangered species, unless the Secretary of the Interior grants a permit allowing the activity under such terms as the Secretary shall prescribe. See Endangered Species Act of 1973, 16 U.S.C. §§ 1532(19), 1538(a)(1), 1539(a)(1)(B) (1994) (the ESA prohibits "taking" of endangered species, defines "taking" to include "harm," and authorizes the Secretary of the Interior to grant permits for certain takings). Compare *Babbitt v. Sweet Home Chapter of Communities for a Great Oregon*, 115 S. Ct. 2407, 2409-10 (1995) (facial challenge to the United States Fish and Wildlife Service definition of "harm," as part of the definition of "take," under the ESA; the United States Fish and Wildlife Service definition of "harm" specifically includes habitat modification that results in disruption of essential behavior patterns). Use of herbicides and mosquito control techniques that would harm the Wyoming toad therefore are prohibited, unless a permit is obtained and the herbicides and mosquito control techniques used comply with the terms of the permit.

effects, and also possibly to protect the environment and endangered species from your actions.

There also appear to be constraints in the public provision context analogous to immutable rules. Immutable rules are mandatory requirements applicable to all contracts which may not be altered by private agreement.³² These rules often set minimum standards or basic requirements that apply to all contracts, such as the obligation to act in good faith. In the public provision context, there are standards and requirements applicable to all which are similar to immutable rules. As an example, compulsory education laws set minimum standards that apply to all.³³ A parent may decide to opt out of the public school system for a private alternative, but may not decide to forgo his or her child's education completely. Additionally, states often set minimum requirements for all schools, both public and private, by specifying curriculum areas, teacher certification standards, and the number of days or hours of instruction.³⁴ Another example is mandatory immunization programs. Many states require school children to be immunized against certain communicable diseases.³⁵

Clearly, there are numerous constraints on an individual's freedom to opt out of public provision. Gillette, however, fails to address these constraints in his analysis. Given the pervasiveness of such constraints, it is difficult, if not impossible, to examine the propriety of opting out without first discussing the limitations on opting out. For Gillette's analytical framework to prove useful, we must either recognize and describe these limitations, or, at least, directly address why such constraints are not necessary.

B. *The Propriety of Constraints on Opting Out of Public Provision*

These limitations on the freedom to opt out of public provision raise the question: to what extent is government intrusion into private arrangements justified? The law and economics movement has fought long and hard in the contract law context to restrict the number and impact of governmentally imposed constraints and immutable rules. Yet even the most ardent supporters of the law and economics movement recognize the need for certain limitations on an individual's freedom to contract, such as when constraints are necessary to

32. See *supra* notes 16-18.

33. See, e.g., MINN. STAT. ANN. § 120.101 (West 1993) (compulsory instruction); see also Jon S. Lerner, Comment, *Protecting Home Schooling Through the Casey Undue Burden Standard*, 62 U. CHI. L. REV. 363, 370 (1995) ("[E]very state has enacted compulsory education laws, and many additionally regulate curriculum content, teacher certification, and the number of hours and days of instruction."); David M. Smolin, Comment, *State Regulation of Private Education: Ohio Law in the Shadow of the United States Supreme Court Decisions*, 54 U. CIN. L. REV. 1003, 1013 (1986) (noting that "every state has a compulsory education law, and every state regulates private education").

34. See *supra* notes 22 & 33.

35. ARIZ. REV. STAT. ANN. § 36-673 (1993) (local health department shall provide for required immunization of pupils attending school at no cost); COLO. REV. STAT. § 25-4-905 (Supp. 1995) (local health department shall provide, at public expense, required immunizations); FLA. STAT. ANN. § 232.032 (West Supp. 1996) (immunization shall be required for certain communicable diseases and shall be available at no cost from local county health units).

protect the interests of third parties.³⁶ It is generally agreed that if individual actions produce harm to others, government intervention is appropriate.³⁷ Similarly, one can argue that constraints on the freedom to opt out of the default level of services are warranted when such constraints protect the interests of third parties, including the general interests of society at large.

Most of the debate in the contract law area has focused on the propriety of what have been termed "paternalistic" constraints.³⁸ In general, any legal rule that prohibits an action on the grounds that it would be contrary to the actor's own welfare is considered paternalistic. Examples of contractual constraints that have been categorized as paternalistic include rules invalidating agreements to waive the right to obtain a divorce or to file for bankruptcy relief.³⁹ An example of a paternalistic constraint in the public provision context would be laws that make education compulsory.⁴⁰

Gillette notes that, in the context of public provision, constraints impose on society the cost of noncompetitiveness and result in the inability of residents to satisfy their personal preferences.⁴¹ But should economic considerations and personal preferences be considered sovereign? Commentators, such as Professor Daniel Farber, suggest that limited rationality, imperfect information, and transaction costs limit the ability of individuals to protect themselves.⁴² The result is that an individual's ability to order his or her affairs through voluntary transactions is limited and therefore government intervention may be warranted in some situations.

In his seminal article, *Legal Interference with Private Preferences*, Professor Cass Sunstein criticizes the notion that existing private preferences should determine what government can and should do.⁴³ Sunstein concludes that, even where private arrangements do not harm others, a wide variety of factors may justify government intervention to overturn or counteract existing preferences. He suggests that there are distortions in a system based on individual preferences, distortions analogous to the problem of market failure, and that such distortions require collective action.

Sunstein identifies four basic categories where interference with private preferences may be justified.⁴⁴ First, sometimes the majority may have a collective preference that differs from the choices of its individual members. The public, acting through government, may wish to bind itself against its own

36. See, e.g., ANTHONY T. KRONMAN & RICHARD POSNER, *THE ECONOMICS OF CONTRACT LAW* 253-54 (1979) (acknowledging that certain limits on the freedom to contract may promote efficiency, reduce transaction costs, and facilitate voluntary transactions).

37. Cass R. Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. 1129, 1130 (1986). Admittedly, in this era of relativism, it may be difficult to agree on what type of "harm to others" is sufficient to justify legal intervention.

38. See, e.g., MICHAEL J. TREBILCOCK, *THE LIMITS OF FREEDOM OF CONTRACT* ch. 7 (1993); Kronman, *supra* note 28; Sunstein, *supra* note 37, at 1130.

39. See Kronman, *supra* note 28, at 764.

40. See *supra* notes 22 & 33.

41. See Gillette, *supra* note 1, at 1204.

42. See, e.g., Daniel A. Farber, *Contract Law and Modern Economic Theory*, 78 NW. U. L. REV. 303, 306 (1983).

43. See Sunstein, *supra* note 37.

44. *Id.* at 1138-68.

misguided choices. The second category includes preferences that are the product of legal rules or socialization. For instance, preferences may become distorted by the absence of available opportunities or the existing distribution of wealth and entitlements. In some circumstances, the endogenous character of these preferences will justify intervention. The third category consists of preferences that reflect motivational distortions, such as addictions, habits, and myopic behavior. When there is such a problem, government intervention may make the individual better off in terms of welfare and perhaps autonomy. Finally, personal preferences are sometimes based on inadequate information, including lack of knowledge or cognitive biases when dealing with low-probability events. When a decision is based on imperfect information, government may either provide the information or ban the decision entirely.

Other commentators have defended the notion that government may constrain an individual's freedom to contract on various grounds, such as considerations of economic efficiency⁴⁵ and distributive justice,⁴⁶ the idea of personal integrity,⁴⁷ and notions of sound judgment.⁴⁸ The same concerns and considerations appear equally applicable in the public provision context. Government intervention in the public provision context may be warranted to protect third parties, to secure collective preferences, to promote economic efficiency and distributive goals, and to address the problems created by endogenous preferences, motivational distortions, and inadequate information.

The formulation of a comprehensive theory to describe and evaluate the various limitations on an individual's freedom to opt out of public provision is well beyond the scope of this short article. My intent is to suggest that certain constraints are warranted,⁴⁹ and to indicate the need for a conceptual framework to describe and evaluate these constraints before we can even begin to

45. In *Paternalism and the Law of Contracts*, Professor Anthony Kronman argues that certain contractual rules, such as nondisclaimable warranties, are efficiency-enhancing adjuncts to the fraud remedy that reduce transaction costs. Kronman, *supra* note 28, at 766-70.

46. Kronman suggests that prohibitions against waiver of contractual entitlements may promote distributive goals. For example, the nondisclaimable warranty of habitability promotes the redistributive goal of providing minimally decent housing for all. *Id.* at 770-74.

47. Kronman contends that prohibitions against contracting away too large a part of one's personal liberties protect against the threat such contractual provisions would pose to a promisor's integrity or self-respect, especially in situations where the promisor's values could change dramatically after entering into the contract. This explains, in part, prohibitions against agreements waiving the right to sue for divorce. *Id.* at 774-86.

48. Restrictions prohibiting enforcement of agreements entered into while the promisor's reasoning may have been impaired, such as when the promisor is a minor, incompetent, or during mandatory "cooling-off periods," have been justified as reflecting a respect for the notion of sound judgment. *Id.* at 786-97.

49. This is not to suggest that government intervention is some form of panacea. I agree with Pildes's and Sunstein's assessment that modern regulation suffers from "myopia, interest-group pressure, draconian responses to sensationalist anecdotes, poor priority setting, and simple confusion." Pildes & Sunstein, *supra* note 29, at 4. Government intervention is not without risk. Government action does not necessarily make things better and the risks inherent in interfering with individual preferences can be formidable. The risk of abuse is also significant. Nevertheless, government intervention in some situations appears warranted. The solution is not to completely reject the notion of intervention, but instead to consider regulatory reform, such as market incentives rather than outright prohibitions. See *supra* note 29.

assess the propriety of allowing individuals the unrestrained ability to opt out of public provision.

III. THE DEFAULT LEVEL

A. *The Default Level and What It Represents in the Public Provision Context*

Gillette proposes we view the level of goods and services the government provides to its constituents as a default or background level.⁵⁰ He suggests this default level serves the same function as contractual default rules in that it applies to those who do not expressly bargain for a contrary outcome. But how is the default level of goods and services determined and what does it represent?

Obviously the package of goods and services the government provides is determined in large part through the political process. Gillette observes that the default level may not necessarily reflect the preferences of a majority of constituents.⁵¹ Instead, the mix may reflect the preferences of the median voter or the desires of a discrete, yet dominant, minority.⁵²

As is clear to anyone who has complained about police protection, street paving, snow removal, or mosquito control, the level of public services provided does not necessarily reflect consumer demand. One must remember, however, that government plays an allocative role.⁵³ The default level reflects a myriad of considerations and a variety of goals. Since unrestrained voluntary market transactions do not always produce socially optimal results, the government's role is also to correct market deficiencies, such as problems created by externalities, distributional inequities, informational disabilities, and free riders. As a result, the mix of goods and services provided reflects, among other things, an allocation of resources, political compromise, regard for external effects, distributional considerations, and other societal interests.

Allocation of resources. Only a finite amount of resources and a limited amount of tax dollars are available for governmentally supplied services. Given these constraints, the government must allocate resources. Theoretically, the government examines and prioritizes its constituents' wants and needs, and then determines what and how much of each good and service to provide. In theory at least, the government represents the interests of society at large. The

50. See Gillette, *supra* note 1, at 1195.

51. *Id.* at 1199-1201. Gillette suggests that since any government service typically can be provided on a continuum and individual services in the mix may be traded against each other, a majority of constituents is unlikely to prefer any particular package, even though a majority might prefer a certain level of an individual service. *Id.* at 1200-01.

52. See *id.* at 1199-1201. Public choice theory indicates the level of services provided by the government will correspond to the preferences of the median voter. The median voter reflects the position that can attract more support than any other position in an election. *Id.* Gillette hypothesizes that on issues where a certain group of voters exhibit great intensity of interest, and other voters appear less interested in the issue, the default level is more likely to reflect the preferences of the interested minority. *Id.*

53. See CLAYTON P. GILLETTE, LOCAL GOVERNMENT LAW, CASES AND MATERIALS 37-55 (1994) (discussing government functions and collective action problems).

mix of services the government provides constitutes an allocation, reflecting social costs and benefits.

Political compromise. Compromise is inevitable. No one should be surprised that the mix of governmentally provided services reflects majoritarian preferences with respect to the level of some services, but also reflects the desires of dominant minorities with respect to the level of other services. No individual or group has all of its preferences satisfied.

External effects. In deciding whether and how much of a service to provide, the government takes into account external effects that individual self-interested transacting parties may not consider. The default level reflects a weighing of the positive and negative effects of services on parties and nonparties. Implicit in the level of services provided are the legislative and public policy constraints previously discussed.

Distributional considerations. The maintenance of a minimum or baseline standard of living is also implicit in the mix. Government serves a redistributive function.⁵⁴ It limits variations in wealth, or at least insures that the financially or physically disadvantaged do not fall below a given baseline. Redistribution efforts take the form of nonfinancial rights and policies, such as passage and enforcement of civil rights legislation. Redistribution efforts also take the form of services and financial support, such as welfare payments, social security disability benefits, and Medicaid which are funded by a progressive taxation scheme. In effect, government provides a social safety net which is reflected in its allocation of goods and services.

Other societal interests. The default level also reflects notions of fairness, equality, and social contract. For example, the common law doctrine of equal service provision obligates the government to offer the same level of services to all its constituents.⁵⁵ It may not discriminate. The mix of governmentally supplied goods and services includes the provision of basic services on an equal basis to all constituents, such as public education and public health services. The mix includes goods and services to which all are entitled regardless of ability to pay.

B. *The Effect of Opting Out of the Default Level in the Public Provision Context*

But what should the default level reflect? In the contract law context, a central focus of recent scholarship has been a debate over the role and content of contractual default rules.⁵⁶ Commentators have questioned whether contractual default rules should reflect what the majority of parties would have

54. *Id.* at 57.

55. *See, e.g.,* Veach v. City of Phoenix, 427 P.2d 335 (Ariz. 1967); *see also* CHARLES M. HAAR & DANIEL W. FESSLER, *THE WRONG SIDE OF THE TRACKS, A REVOLUTIONARY REDISCOVERY OF THE COMMON LAW TRADITION OF FAIRNESS IN THE STRUGGLE AGAINST INEQUALITY* (1986); Clayton P. Gillette, *Equality and Variety in the Delivery of Municipal Services*, 100 HARV. L. REV. 946 (1987) (reviewing Haar and Fessler's book, *The Wrong Side of the Tracks*, and offering theoretical bases to support the doctrine of equal service provision).

56. *See supra* note 19.

wanted, principles of economic efficiency, communitarian values, or norms implicit in the parties' relationship. The default level in the public provision context appears susceptible to the same type of inquiry and critical analysis. Should the default level in the context of public provision reflect majoritarian preferences, simply correct market deficiencies, provide a social safety net, or promote communitarian values? Without a greater understanding of what the default level of services represents and without considering what it should reflect, it is difficult to assess the propriety of opting out of the default level.

Gillette suggests that if the default level of services does not reflect majoritarian preferences, then opting for a different level of services might be appropriate because opting out does not remove you from the core of the community and it may play a productive signaling role.⁵⁷ On the other hand, there are strong reasons not to allow individuals to bargain their way out of the default level. If the default level reflects an allocation of resources, political compromise, consideration of external effects, redistributive goals, and other societal interests, opting out may disrupt what appears to be a very delicate balance. Opting out may very well change the default level and what it represents, without the benefit of public deliberation and debate.

Effect on the mix of goods and services provided. Unconstrained opting out may alter the mix of governmentally supplied goods and services, thereby changing the default level. For instance, if certain economies of scale are necessary for the provision of a service, opting out may adversely affect the feasibility of providing the default level preferred by those who remain.⁵⁸ Opting out may lead to a situation where public provision of a service is abandoned because there remains an insufficient number of people to make the investment worthwhile or the increased per capita cost results in the service becoming prohibitively expensive.

Political impact. As Gillette indicates, opting out may also impose political costs by reducing the ability of those who remain to form effective coalitions to obtain public provision at the level they desire.⁵⁹ Additionally, if those who opt out of public provision must pay for the default level, they may actively encourage reduced outlays for services they do not use or refuse to support the default level.⁶⁰ Unconstrained opting out therefore may affect the allocation of resources, the default level of services provided, the political dynamics, and even undermine to some extent, collective provision.

57. See Gillette, *supra* note 1, at 1202-04.

58. *Id.* at 1211.

59. *Id.* at 1201-02.

60. *Id.* at 1207. For example, Daniel Bell observed:

Local government officials and even state legislatures are facing demands from [Residential Community Association (RCA)] members for tax reimbursements for the provision of local services such as snow and ice removal, street lighting, and the collection of garbage. RCAs argue that since they pay for their own services through homeowner associations, why should they pay property taxes for duplicating public services that they do not need?

Daniel A. Bell, *Residential Community Associations: Community or Disunity?*, 5 RESPONSIVE COMMUNITY 25, 34 (Fall 1995).

Social consequences. The default level currently serves as a social safety net by providing certain basic services to all constituents. If opting out results in a reduction in the level or availability of these basic services, then opting out may tear at the social safety net and undermine redistributive goals.

Many current government services are a response to the needs of disadvantaged groups that were ignored by the private sector. If opting out results in the elimination of certain public services, private providers may be unwilling to render the services to some segments of society. Private firms have a strong economic incentive to skim off the best clients and the most profitable services.⁶¹ Opting out may leave those most in need of certain services without private providers and therefore without services. As a result, opting out is likely to have a disproportionate effect on the disadvantaged.

Gillette notes that in the public provision context the law only requires equality of opportunity, not equality of result.⁶² Thus, if everyone is free to opt out, the equal service requirement is not violated. As Gillette himself pointed out in an earlier writing, this argument has the "quality of denying the rich as well as the poor the right to sleep under bridges."⁶³ Since many public services are now available to all regardless of the ability to pay, the disadvantaged will be most affected if public services are reduced. The disadvantaged may find themselves with certain public services eliminated, with the right to opt for more services, but with no ability to pay for such services and no private providers. Hence, opting out provides a vehicle to grant the disadvantaged a meaningless right in exchange for a possible decrease in benefits.

Opting out also has the potential to create and magnify social division and conflict. Individuals who pay for private services are likely to resent paying for duplicate public services they do not need.⁶⁴ This resentment may result in a decreased sense of loyalty and commitment to the larger community.⁶⁵ We have already witnessed the trend that Robert Reich characterized as "the secession of the successful."⁶⁶ The wealthy have begun to withdraw to residential communities that privately provide their own parks, streets, swimming pools, and security guards, from which the public is excluded. Exclusive communities and gated neighborhoods exacerbate the schism between the rich and

61. ROBERT J. DILGER, NEIGHBORHOOD POLITICS, RESIDENTIAL COMMUNITY ASSOCIATIONS IN AMERICAN GOVERNANCE 85 (1992) (citing as an example experiences under the Job Training Partnership Act).

62. Gillette, *supra* note 1, at 1214.

63. Gillette, *supra* note 55, at 955. Gillette was paraphrasing a quote from Antole France's *Le Lys Rouge*, "The law, in its majestic equality, forbids the rich, as well as the poor, to sleep under bridges, to beg in the streets . . ." See *id.* at 955 n.26 (quoting A. France, *Le Lys Rouge* (1894), also quoted in *Griffin v. Illinois*, 351 U.S. 12, 23 (1956) (Frankfurter, J., concurring)).

64. EVAN MCKENZIE, PRIVATOPIA, HOMEOWNERS ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT 186 (1994); see also *supra* note 60.

65. Gillette counters that residents who are able to opt out might choose to pay for benefits they do not enjoy either out of altruism or to protect property values. Gillette, *supra* note 1, at 1209-11. William Schneider may have dealt with this type of argument best when addressing the problems facing urban centers: "But isn't it 'in the national interest' to bail out the cities? The suburbs have given their answer: walled communities." William Schneider, *The Suburban Century Begins*, THE ATLANTIC, July 1992, at 33.

66. Robert Reich, *Secession of the Successful*, N. Y. TIMES, Jan. 20, 1991, § 6 (Magazine), at 42.

the poor. As Gillette points out, these and other institutions that would be used to effect opting out are consistently under attack as exclusionary, discriminatory, and elitist.⁶⁷ A preoccupation with the virtues of competitive benefits and individual autonomy may cause one to overlook other interests vital to our well-being as a nation, such as fairness and decency.

Cause for Concern. Certain characteristics of public provision are themselves valuable, such as the process of public deliberation and debate. Implicit in proposals such as Gillette's that champion unconstrained opting out is the belief that private contract and personal preferences should be sovereign and inviolable, therefore insulated from public review. Yet opting out of the default level has public consequences. It is more than simply a matter of private contract and personal preference. Such private transactions have public effects: effects on the parties to the contract, effects on third parties, and effects on the community. As previously discussed, some individual preferences are objectionable, such as when they harm third parties, when they interfere with collective preferences, or when they are the product of cognitive distortions.⁶⁸ Proposals that champion unconstrained opting out are attempting a sleight of hand by dressing up something that is public as private, and then suggesting it is sacred and outside the realm of public debate. Given the public effects of opting out and the potential effect on the default level itself, these private choices must continue to be subject to critical scrutiny, public debate, and regulation, not canonized.

Gillette characterizes opting out as an alternative form of privatization.⁶⁹ The danger of this form of privatization is that it does not require a conscious public decision to shift government functions to private providers.⁷⁰ Privatization occurs without public discussion, without consideration of other approaches, without analysis of the costs and benefits, without knowing the implications of the decision, and without government action. Opting out results in de facto privatization as government functions are gradually transferred to private providers. The default level of services is altered without public deliberation and debate, despite possibly significant public consequences. Before we enthusiastically embrace the concept of opting out, we must collectively consider the broader economic, political, and social implications.

IV. CONCLUSION

Professor Gillette's use of default rule theory in the public provision context provides an excellent framework within which to examine the propriety of opting out of public provision. By drawing further analogies to contract law, I have attempted to build on his analysis and identify issues that warrant

67. Gillette, *supra* note 1, at 1190; see, e.g., MCKENZIE, *supra* note 64; Bell, *supra* note 60; David J. Kennedy, Note, *Residential Associations as State Actors: Regulating the Impact of Gated Communities on Nonmembers*, 105 YALE L.J. 761 (1995).

68. See *supra* part II.B.

69. Gillette, *supra* note 1, at 1187.

70. Cf. MCKENZIE, *supra* note 64, at 180 (arguing community-interest developments constitute de facto privatization undertaken without the benefit of public deliberation or debate).

consideration and discussion. For example, the constraints on one's freedom to opt out of public provision appear analogous to the limitations on one's freedom to contract. Many of these constraints on opting out may be defended on the same grounds used to justify limitations on the freedom to contract. Unless one is willing to blindly accept the virtues of unconstrained opting out, a more sophisticated theoretical framework, which describes these constraints and evaluates the propriety of such constraints, appears needed. In addition, parallels are drawn between the default level in the public provision context and contractual default rules. The role and content of contractual default rules have been a focus of recent contract scholarship. The default level in the public provision context appears susceptible to the same type of inquiry and analysis. Since opting out may potentially alter the default level of services provided, what the default level reflects and what it should reflect must be considered, particularly in light of the possible economic, political, and social effects of opting out.

Edmund Burke wrote, "The effect of liberty to individuals is that they may do what they please; we ought to see what it will please them to do, before we risk congratulations . . ." ⁷¹ We should heed Burke's warning. Before enthusiastically embracing the concept of unconstrained opting out of public provision, we should first examine what individuals may desire to do and then consider the consequences.

71. EDMUND BURKE, REFLECTIONS ON THE REVOLUTION IN FRANCE 8 (J.G.A. Pocock ed., Hackett Publishing Co. 1987) (1790).