



Flex Growth

A smarter option for North Carolina communities

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POLICY REPORT

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Executive Summary

In recent years, an increasing number of local governments across the nation and across North Carolina have adopted “Smart Growth” policies. While the specific policies differ by community, the emphasis is invariably upon restricting the physical size of urban areas, imposing denser development standards in areas where development is allowed, and reducing funding for roads while spending heavily on transit in general and rail-based transit in particular.

Such policies are both misguided and ineffective — misguided, in that they do not create communities in which most people really want to live and ineffective in that the cost of “sprawl” and the benefits of Smart Growth are both overstated.

Specifically, Smart Growth misdefines efficiency to mean simply maximizing production of a particular product (typically housing) while using the minimum of a particular resource (land). This definition is in conflict with basic economic theory.

A number of economic studies, meanwhile, have shown that Smart Growth policies are not less costly than what its proponents dismiss as “sprawl.” Smart Growth does, however, impose additional costs upon society which make economic growth less likely.

Instead of focusing on the past, North Carolina should look to the future and adopt a flexible growth agenda — Flex Growth. Flex Growth is a market-based system of principles for government land use and development policy, especially at the state and local government levels, based upon the idea that people — and not government bureaucrats and planners — know what is best for themselves.

The following nine recommendations should guide policymakers when they consider various responses to growth and development:

1. **Let growth pay for itself** — Local governments should adopt marginal cost pricing for public services to avoid distorting land development decisions and enable growth to pay for itself.
2. **But without impact fees for schools** — The con-

cept of user fees — whether they are called “impact fees,” “real estate transfer fees,” or an “adequate public facilities ordinance” — should not extend to funding public school construction.

3. **Reform zoning** — Local zoning codes should be changed in several ways to take advantage of market incentives to reflect the true costs of development. Public policy should also afford communities the flexibility to adapt to the new demands and practical requirements they face.
4. **Strengthen private property rights** — The value of land is based upon its market potential, not its current use. For the full market potential of land to be realized, it must be available for sale, but to be available for sale, a clear set of private property rights must be in place.
5. **Let the market provide open space** — Each individual is willing to pay a different amount for open space, be it a private back yard or communal park land. The market is best suited to meet people’s actual demands rather than government mandates to provide a set communal open space.
6. **Pursue economic policy neutrality** — Policymakers should aim for strict neutrality in their economic development and industrial recruitment efforts. This includes local governments staying out of the utility and broadband businesses.
7. **Avoid TIFs** — Local governments should avoid tax increment financing (TIFs) to borrow money for economic development projects.
8. **Ensure an adequate highway system** — Transportation funding is finite. It follows then that the state and its localities should make the best possible use of this scarce resource by funding the projects that give the greatest return on investment.
9. **Fund transit intelligently** — The same resource usage considerations that drive our approach to roads should also drive our approach to transit: aim to fund only those projects that provide the most bang for the buck.

Smart growth. Managed growth. These terms seem omnipresent in all facets of public policy discussions today — about taxes, schools, zoning. Proponents wax eloquently of “quality-of-life issues,” “sustainable” growth (whatever that means), lots of green space, small lots, mixed-use development, environmental conservation, mass transit, urban high-rises, high population density, “walkable” communities, “traffic calming” devices (narrow streets, barriers between walkways and roadways, etc. designed to slow down traffic), and the like. But many of these terms are contradictory, much like the aims of the various groups within the coalition supporting Smart Growth.

In any case, Smart Growth, with its rigid emphasis on limiting the size of urban areas via government restrictions, represents a flawed model. It ignores consumer preferences. Smart Growth also drives up the cost of land, thus increasing the cost of living, particularly hurting the poor. It also increases government power and bureaucratic discretion.

What North Carolina needs instead is a flexible approach to growth.

I. WHAT IS SMART GROWTH?

Smart Growth is a theory of urban development that seeks to more highly concentrate urban growth through increased government regulation of development, housing, and transportation.

In an entry obviously written by a proponent of the policy, Wikipedia lists 10 objectives associated with Smart Growth¹:

1. Mix land uses.
2. Take advantage of compact building design.
3. Create a range of housing opportunities and choices.
4. Create walkable neighborhoods.
5. Foster distinctive, attractive communities with a strong sense of place.
6. Preserve open space, farmland, natural beauty, and critical environmental areas.

7. Strengthen and direct development towards existing communities.
8. Provide a variety of transportation choices.
9. Make development decisions predictable, fair, and cost effective.
10. Encourage community and stakeholder collaboration in development decisions.

As applied, Smart Growth policies typically aim to restrict, or even eliminate, development in new areas, preventing what Smart Growth advocates derisively label “sprawl,” which they claim is inefficient and ugly. At the same time, Smart Growth policies encourage public transit, particularly pricey new rail transit lines, at the expense of roads. These new transit lines, which by their nature serve a limited geographic area, are to act as magnets for redevelopment, including new medium-rise condominium developments.

A second, newer concept that has helped drive the push toward Smart Growth policies in certain communities is Richard Florida’s controversial theory of the “creative class.”² Florida argues that knowledge workers, intellectuals, and artists of various sorts will be the leading force for economic growth in coming years. The places that can attract the creative class will prosper, he says, while those places that can not attract these individuals will stagnate.³

Local government officials often take this theory to mean that communities are essentially in a bidding war for the creative class — that they must provide more of the types of things the creative class is said to value or risk the economic consequences. And as it happens, the creative class is said to value most of the key Smart Growth objectives.

II. SMART GROWTH’S FAILINGS

Despite being all the rage for planners and environmentalists, Smart Growth represents a fundamentally flawed approach. It does not represent how most people truly want to live. It transforms transportation policy into a form of economic development policy. Smart Growth also is based upon economic misconceptions and embraces an elitist sense of aesthetics.

A. Most Americans prefer the suburbs

At its most basic level, Smart Growth is a backward-looking economic development model. It looks back a century to the densely built, rail transit dependent cities of the late 19th and early 20th centuries as its inspiration. Smart Growth advocates assume that this earlier vision is how most Americans want to live, that we as a people have simply been deluded by automobile manufacturers and real estate agents into giving up apartments and condos in high-rise buildings along subways and light-rail lines in favor of detached houses on quarter-acre lots out in the suburbs. In this, Smart Growth advocates are wrong.

To be sure, a percentage of Americans do want to live in densely-built urban areas. The number, though, is relatively small and constant.⁴ Over the past decade, nearly 80 percent of housing built in the country's 51 metropolitan areas with populations of over 1,000,000 were single-family, detached houses.⁵

It is often argued that Millennials — those born between 1982 and 2003 — are different. There is scant evidence to support this conclusion. A large plurality (43 percent) of Millennials say that suburbs are an “ideal place to live.”⁶ And many of those who currently enjoy an urban lifestyle will move to the suburbs to settle down and have kids — or to settle down and have their parents move in after they retire. Or both, as the number of multi-generational households grows.⁷

B. Smart Growth misdefines efficiency...

One of the more common arguments against “sprawl” is that it is somehow “inefficient.” Of course, the key is how one defines the concept of “efficiency.”

The typical environmentalist definition regards low-density suburban housing as inefficient because relatively few people live on an acre of land. A productive resource, land, is not used as intensely as it could be; with denser development, more families could live in the same amount of space.

While this may seem a logical definition of “efficiency,” it is in fact far off the mark. Economic theory tells us that efficiency — which involves the best allocation of resources within society — is associated with

people acting to maximize their personal happiness and involves the benefits of something balancing with the costs of that product or item.

Unfortunately, the environmentalist definition of efficiency has nothing to do with making people happy, but everything to do with maximizing production with the minimum of a particular resource. The two approaches are fundamentally different.

C. ...and is shown not to cost less

A more sophisticated version of this inefficiency argument contends that sprawl is undesirable as it imposes additional costs upon society as compared to denser forms of development (i.e. Smart Growth).

In general, it is asserted by Smart Growth advocates that lower local government costs are associated with higher population densities, lower rates of population growth, and older municipalities. Whether this is true or not is an empirical question that Wendell Cox and Joshua Utt addressed in a 2004 paper for the Heritage Foundation.⁸ Their analysis found “no practically significant difference in expenditures per capita between the more sprawling and less sprawling communities.”⁹

What the two researchers did find was that differences in employee compensation explained most of the variation in municipal expenditures. As Cox and Utt noted, “It seems much more likely that the differences in municipal expenditures per capita are the result of political, rather than economic, factors — especially the influence of special interests.”¹⁰

Writing in the *Journal of the American Planning Association*, four British researchers reached similar conclusions about the impact of Smart Growth in a 2012 paper.¹¹ Marcial H. Echenique, Anthony J. Hargreaves, Gordon Mitchell, and Anil Namdeo found that Smart Growth was not inherently preferable to less dense land use patterns based on an analysis of the experiences of three British areas. The authors concluded that “Smart growth principles should not unquestioningly promote increasing levels of compaction on the basis of reducing energy consumption without also considering its potential negative consequences. In many cases, the potential socioeconomic consequences of less housing choice,

crowding, and congestion may outweigh its very modest CO2 reduction benefits.”¹²

In the alternative, it has been argued that sprawl is inefficient in that it creates transportation externalities. A new paper by two Florida State University economists examines the issue and finds no relationship between degree of sprawl and commute times, automobile ownership, miles driven, fatal auto accidents, air pollution, or highway expenditures.¹³ Indeed, a strong argument can be made that, all other things being equal, higher population density, more intense traffic congestion, and higher concentrations of air pollution all go together.¹⁴

D. Smart Growth reduces economic growth

As the events of the Great Recession make abundantly clear, government cannot magically generate economic growth. Adopting Smart Growth does not change that. Indeed, the costs associated with Smart Growth impose significant burdens that make economic growth less likely. Smart Growth uses scarce public resources in an unwise manner that does not produce the greatest possible return. It also makes housing more expensive by limiting the amount of land available for development, thus increasing the local cost of living.¹⁵

While the focus in recent years has usually been on generating (creative class) jobs, Smart Growth has also been used as a rationalization for policies to explicitly restrict in-migration to communities. This typically involves limiting the amount of land available for development through urban growth borders, requirements for open space, and/or a call for “preservation” in order to establish “sustainable” growth patterns.

Ironically, such policies often work in favor of those who moved to a community for exactly the same reasons that later arrivals are coming. These elitist schemes also necessarily limit opportunities for existing residents.

III. FLEX GROWTH: AN AGENDA FOR THE FUTURE

Instead of focusing on the past, North Carolina should look to the future and adopt a flexible growth agenda — Flex Growth. Flex Growth is a market-based system of principles for government land use and development policy, especially at the state and local govern-

ment levels, based upon the idea that people — and not government bureaucrats and planners — know what is for best for themselves. Flex Growth is built upon basic economic principles, and recognizes the importance of free markets.

First and foremost, Flex Growth requires that, with the exception of schools, growth pay for itself, but nothing beyond that. It also seeks to strengthen property rights and reform zoning. Flex Growth calls for keeping government from picking winners and losers and engaging in questionable economic development schemes.

Flex Growth also recognizes that transportation dollars are a scarce resource and should be treated as such. Too often transportation projects, especially transit lines, are funded not because they represent the most efficient way of improving mobility within society, but for political reasons. Flex Growth seeks instead to put transit dollars to their best possible use, to get as much bang-for-the-buck as possible.

Nine specific recommendations for Flex Growth are:

1. Let growth pay for itself

Local governments should adopt *marginal cost pricing* for public infrastructure services. This would help avoid the distortion of land development decisions and would enable growth to pay for itself. For example, utilities operated by municipalities should collect the full “cost-of-doing business,” including capital costs, for on-site services. The true cost of connecting a specific new development to water mains should be the basis for a hookup fee, rather than the average cost. In other words, the price will reflect such considerations as existing water capacity, labor markets, and expected future demand. The principle should be that the user, as much as possible, should bear the costs of services. In the case of water and sewer hookups, street access, and garbage collection, most communities are already using devices such as user charges or fees to impose the cost of new development on those (such as future homebuyers) who will benefit.

The economic analysis to determine costs of providing services, and by extension whether to charge im-

impact fees either directly or through an Adequate Public Facilities Ordinance, should be done by qualified uninterested parties. Too often, localities rely upon consultants who are selected exactly because they are likely to provide reports to justify higher impact fees.¹⁶

2. *But without impact fees for schools*

Where many local leaders have gone awry in recent years is treating public education as one of the services to which the principle of user fees or impact fees can and should apply. This is mistaken. At least two important characteristics of public schools distinguish them from public utilities:

Public education is an entitlement. Or so, at least, the N.C. Supreme Court has ruled. Unlike streets or sewer service, which government provides because alternative provision is believed to be either inefficient or impossible, government funding of public education is justified because of the need for a self-governing republic to have an educated citizenry. In North Carolina, the primary responsibility for funding public school operations lies with the state, with local governments funding most of the capital needs.

The needed nexus between development and impact is lacking. Unlike street or sewer use, school use bears no direct relationship to the construction of a new home. For example, the purchasers of that home might already live in the county, with a child already in the public schools in that school district. Moving from one house to another does not increase the number of children in the school system. Similarly, a purchaser from outside the county may have no children or choose to send them to a private or charter school or home school. While there may be a general, county-wide correlation between population growth, commercial or residential development, and school enrollment, the correlation breaks down at the house or neighborhood level.

For these reasons, a system that charges “impact fees” or “real estate transfer fees” in an attempt to collect revenue for new schools is inequitable and inefficient. Indeed, given the unique way that public education is consumed — disproportionately by relatively younger families with little history of property tax payment — it is simply impossible for any “user” to prepay, through

property or other taxes, the cost of housing a student in a public school. Both newcomers and longtime residents therefore are subsidized by other taxpayers when their children attend public schools. Both groups pay this subsidy back through property taxes over time. The same is not true for streets, water service, or sewer service, which is paid for by every resident of a new development through immediate, monthly charges based on usage (including gas taxes) and initial hookup fees.

3. *Reform zoning*

Originally, land-use regulations were intended to control for “nuisances,” or negative effects on neighbors, such as congestion, noise, and loss of open space. However, zoning actually diminishes the importance of these nuisances, also called “externalities,” in land development. With Smart Growth, zoning often becomes focused on “preservation” or restricting in-migration.

Instead, public policy should afford communities the ultimate in flexibility to adapt and change to the new demands and practical requirements facing them as well as to mitigate specific nuisances or harms. Communities can evolve if state and local land policies do the following:¹⁷

- Focus on the actual impacts of development, not on land uses per se;
- Restrict detailed planning to public infrastructure investments; and
- Abandon comprehensive zoning, which creates a political environment impeding change and subordinating property rights to political pull.

The model in limiting restrictive land-use policies is Houston, which not coincidentally also enjoys a low cost of living — particularly housing prices — for such an economically dynamic city.¹⁸

A property rights based approach allows a property owner to lodge a complaint against a particular land use by showing that it has a direct, demonstrable impact on other property owners. A nuisance-creating owner then compensates other property owners for the effect of the nuisance. But unsubstantiated complaints are not allowed to scuttle developments from which many unrep-

resented people, such as prospective homebuyers, will benefit.

Real estate developers already make economical choices when the prices of public services reflect the full cost of providing them to a new development. And developers are already responding to consumers who want the aesthetic benefits of open space but not the hard work of maintaining a large yard. Local zoning codes, however, are often at odds with such responses because they use antiquated design standards and impose costly approval processes that allow groups or individuals to protest a development for almost any reason. Local codes should be changed to take advantage of markets in the following ways:

- Accommodate mixed uses explicitly in the zoning code to minimize the need for continuous amendment;
- Use performance-zoning criteria such as open space or landscaping provisions to allow projects to qualify for quick administrative approval once they meet certain design thresholds; and
- Establish a presumption in favor of development-project approval in the zoning process.

4. Strengthen private property rights

A smoothly functioning real estate market requires a well-defined and enforceable system of property rights. Unfortunately, property right protections are not as strong as they could be in North Carolina.

The value of land is based upon its market potential, not its current use. In order to obtain the full market potential of land, it must be available for sale. As homeowners in places like Cary can attest, it is a hollow form of property rights to allow land ownership but restrict, often arbitrarily, when it can be developed. The result is lost value — and in the case of families whose land is intended as retirement savings or inheritance, economic turmoil.

A related concern is who determines when a property is developed and for whose benefit. In 2005, the U.S. Supreme Court held in *Kelo v. City of New London* that the U.S. Constitution does not prevent the government

from taking private property through eminent domain to transfer to another private party for its use. Typically such a transaction happens as part of an economic development proposal.

North Carolina law does prohibit such use of eminent domain, but this is a weak protection, as the General Assembly may at any time alter state law. This is especially an issue as major incentive deals often require enabling legislation from the General Assembly. A stronger safeguard would be to place a prohibition on *Kelo*-type uses of eminent domain in the state Constitution. North Carolina is the only state that does not currently address eminent domain in its constitution.¹⁹

5. Let the market provide open space

At its core, Smart Growth seeks to make open space in urban areas communal. It does this through aiming to restrict traditional home homeownership, with its associated quarter-acre lot, while seeking to impose requirements that developers provide a fixed percentage of open space in their developments. This approach is misguided.

Each individual places a different value upon communal open space, as opposed to the privately owned open space called a back yard, and is willing to spend differing amounts to be around each. Developers recognize this and respond to these desires accordingly. For example, golf communities provide lots of open space and charge for it. Buyers know that their prices include open space.

On the other hand, government mandates for a certain percentage of open space in a development often mean that residents are forced to buy open space that they do not want. A side effect of such policies is that they also increase the price of housing.

Policies that give developers the option of providing money for public lands in lieu of providing open space in their developments are just as questionable. Such policies may also fail in practice. Wake County eliminated its requirement because it was unable to use the funds to provide open space near the developments in question.²⁰

There remains, of course, nothing wrong with lo-

calities putting bond referendums before voters for the purchase of parkland, provided that such land is not acquired through eminent domain.

6. Pursue economic policy neutrality

Policymakers should aim for strict neutrality in their economic development and industrial recruitment efforts. Rather than subsidize one industry at the expense of another, for whatever reason, government policies should have the ultimate aim of allowing the free market, by far the most efficient mechanism of resource distribution that exists, to coordinate economic growth.²¹

Absurd examples of government interference abound, including simultaneously awarding incentives to companies to come to a region and enacting Smart Growth policies aimed at restricting growth.

Municipalities should also avoid getting into the utility business. The experience with municipality-owned power systems over the past 30 years has been unpleasant for the towns and cities involved. The higher rates that member municipalities of the North Carolina Municipal Power Agency Number 1 and the North Carolina Eastern Municipal Power Agency charge their customers makes it more difficult to attract new businesses to their communities.²²

In recent years, a number of cities and towns have entered into the broadband business. While not all of these ventures have been abject failures, the experience of Mooresville and Davidson, which have been forced to raise taxes and cut services to subsidize a local broadband and cable system, illustrates the risks involved.²³

7. Avoid TIFs

Since 2004, North Carolina law has allowed local governments to make use of tax increment financing (TIF). TIFs are a way for local governments to fund economic development projects without seeking approval from voters. A municipality or county borrows money to pay for a project, with the bonds repaid over time by the additional property tax revenue from higher property values that the project brings about in a specially designated zone near the project.

Many local government officials and economic developers favor TIFs as they can claim that a project literally pays for itself. In doing so, they are trying to outguess the market with no personal risk if the project fails.

There are several problems with TIFs. Projects built with a TIF can be self-financing only if the development lives up to expectations. To put it another way, after you build it, additional development had better come to the TIF zone. If it does not come, the county or municipality issuing the bonds for the project is effectively on the hook to make up the difference.

The Randy Parton Theatre debacle in Roanoke Rapids highlights this danger. The town of Roanoke Rapids spent \$21.5 million to build a theater that would be run by Randy Parton, Dolly Parton's brother, in the first use of TIFs in North Carolina. The idea was to have the theater anchor an entertainment district.

Attendance at the theater was anemic and there was no subsequent development nearby. The town offered the theater for sale in 2011 for \$7.1 million and has had to increase property taxes and reduce services to cover the cost of debt service.²⁴ Roanoke Rapids is now trying to lease the theater out as a bar and sweepstakes parlor.²⁵

Economists have questioned whether TIFs are an effective economic development tool in general. An examination of TIFs in suburban Chicago, for example, found that overall property values grew at a faster rate in towns that *did not* use TIFs.²⁶ Other studies have shown that TIFs only direct where new development happens within a community; they do not generate additional growth if used for residential properties.²⁷

8. Ensure an adequate highway system

Of course, not all daily transportation takes place on highways; there are also sidewalks, bike paths, bus lanes, and train tracks. But they play, and will inevitably continue to play, a relatively minor role in commuting, shopping, and other routine trips. No amount of subsidy or regulation will change that.

A number of studies have clearly demonstrated the damaging impact of road congestion on local economies. Simply put, as roads become more clogged and it

takes people more time to get to work and conduct their every-day errands, economic growth is slowed.²⁸ Conversely, a recent study showed that a 10 percent reduction in congestion would increase production of goods and services by one percent.²⁹

Transportation funding is finite. It follows then that the state and its localities should make the best possible use of this scarce resource by funding the projects that give the greatest return on investment, with congestion relief being the key measure.

Unfortunately, North Carolina has historically not done a good job of getting the most out of its limited transportation dollars.³⁰ The state relies heavily on funding formulas that do not adequately consider road condition and congestion in determining which projects are funded.³¹ Until very recently, funding for urban loop roads was purely discretionary, which is to say politics was a key consideration.

So not every proposed major road project is a wise use of funds. Many are nothing more than pork.

Likewise, congestion at a very localized level may be a sign of a vibrant community or neighborhood. It may be difficult or even undesirable depending upon circumstances to try to eliminate all traffic tie-ups even if the resources are available.³²

9. Fund transit intelligently

The same resource usage considerations that drive our approach to roads should also drive our approach to transit: aim to fund only those projects that provide the most bang for the buck. It is exactly at this point that most rail transit projects fail as they are simply poor *transportation* solutions in that they move relatively few people for the large amounts of money they require. Transit thus is, in the best of circumstances, in no way a substitute for roads. Indeed, when you factor in the impact of waiting at lights to allow passenger rail vehicles to pass, rail transit can even make road congestion worse.³³

Unfortunately, the current local funding method for rail lines, a dedicated ½ cent additional sales tax for transit, is far from the best of circumstances as it invites poor use of resources. The politics of getting the tax

passed may result in the inclusion of certain lines or routes as little more than pork to help ensure passage. In the case of Wake County's proposed transit plan, this phenomenon even extends to express bus service to smaller towns.

The creation of agencies with a dedicated funding source to build transit lines is also problematic, as their natural tendency is to build more transit lines, whether justifiable or not. This is especially the case if some originally promised lines prove to be unbuildable. That the Charlotte Area Transit System's proposed Red Line commuter rail to link downtown Charlotte to the north Mecklenburg County towns of Huntersville, Cornelius, and Davidson is still receiving serious consideration despite having no chance of obtaining federal funding shows how hard bad projects are to kill off.³⁴

The federal government has historically proven to be rather generous in funding rail transit lines. Having the feds agree to pick up half the cost of a proposed line is not necessarily an indication that a proposed line is a wise use of local and/or state transportation dollars. However, when a proposed line is unable to secure Federal Transportation Administration funding, it should serve as a clear signal that the project simply should not proceed.

A better solution than having a dedicated tax for transit is to have a dedicated tax for transportation, allowing the local money to be used as appropriate for either roads or transit.³⁵

CONCLUSIONS

Though popular in many communities in North Carolina and across the country, Smart Growth represents a backward-looking model for economic development that does not represent how most people want to live. Advocates of Smart Growth justify its use through questionable economic logic while ignoring contradictory data.

Instead of attempting to return to the 19th Century, communities should adopt a flexible, market-based economic development model which lets growth pay for itself while private property rights are strengthened. Zoning should be reformed and given more flexibility

to meet the needs of evolving communities while letting the market provide for as much open space as residents are willing to pay for.

Local governments should also avoid picking winners and creating losers by offering incentives to local companies. They should avoid potential traps by foregoing the use TIFs and staying out of the utility business.

Lastly, the state and municipalities should recognize transportation funding as a scarce resource and act to ensure that limited dollars available are put to the best possible use. This extends to transit projects, which all too often are not about moving people about efficiently, but rather are economic development schemes of questionable value.

This paper is based upon the 1999 JLF Policy Report “Flex Growth: A Market-Friendly Development Policy for North Carolina’s Growing Communities” by Michael Lowrey and Jonathan C. Jordan.

END NOTES

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“To prejudge other men’s notions
before we have looked into them
is not to show their darkness
but to put out our own eyes.”

JOHN LOCKE (1632–1704)

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