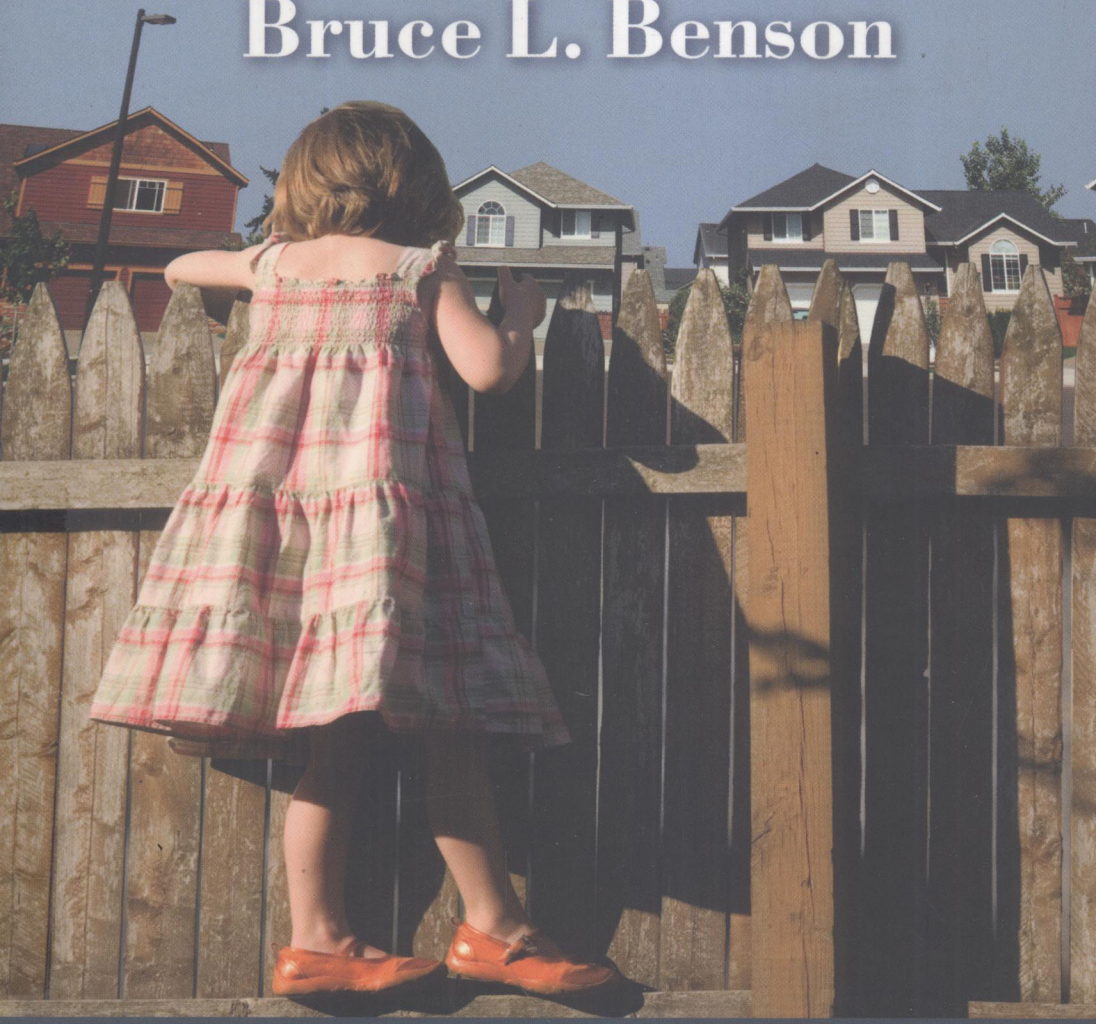
Property Rights

Eminent Domain and Regulatory Takings Re-Examined

Edited by

Bruce L. Benson



THE INDEPENDENT INSTITUTE

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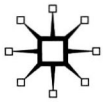

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Bruce L. Benson

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INTRODUCTION

EMINENT DOMAIN, REGULATION, AND THE TAKINGS BACKLASH

Bruce L. Benson

The first decade of the new century may prove to be a watershed in the evolution of both state powers and private property rights. The eminent domain powers of government for very broadly defined "public" purposes, including transfer to private developers, were reaffirmed in *Kelo v. City of New London* (545 U.S. 469 (2005)). While the decision was predictable, given precedents (e.g., *Berman v. Parker* 348 U.S. 26 (1954)), *Kelo* has served a dramatic political focal point, resulting in a widespread backlash against government use of eminent domain. This backlash has produced legislation in many states that at least appears to constrain takings powers. This *Kelo* backlash is actually part of a larger takings backlash, however. Regulatory takings through police power have also come under attack. This is exemplified by Oregon's Measure 7 passed by voters in 2000. This measure was intended to amend the Oregon Constitution by mandating compensation for takings through land-use regulation. It was declared unconstitutional by the Oregon Supreme Court (*League of Or. Cities v. Oregon,* 56 P.3d 892 (Or. 2002)), but Oregon voters responded by passing Measure 37 in 2004, this time requiring compensation by amending Oregon statute law.[1] This measure withstood court scrutiny. In 2006, Arizona passed a similar Measure. There has also been a revival of academic interest in the issues of eminent domain and regulatory takings, both among legal scholars and economists.

The papers in this volume were presented at an April 2007 symposium at Florida State University's Law School, which brought together a diverse group of scholars and practitioners in order to explore the uses and abuses of eminent domain and regulatory takings. The range of expertise is illustrated by a list of participants, including the attorney who represented Susette Kelo before the U.S. Supreme Court (Scott Bullock from the Institute of Justice), the legal scholar whose comprehensive treatise on *Regulatory Takings,* now in its third edition, is the leading resource on the relationship between government takings powers and private property rights (Steven Eagle), an expert on land value determination who has frequently served as an appraiser and expert witness in takings cases (Wallace Kaufman), an economist widely recognized as one of the leading experts on takings

and compensation determination (Perry Shapiro), and a land-use policy expert who serves as Director of Urban and Land Use Policy at the Reason Foundation (Sam Staley). Other participants are recognized legal or economic exports on environmental regulation, regulatory policy, entrepreneurial activities, and economic behavior.

All of the chapters in this volume are critical of takings practices, although the degree of criticism varies. Views range from arguments that market failure justifies takings but that the current process is flawed and should be fixed, to arguments that government failure is inevitable and undermines any justification for government takings. The chapters address four categories of topics (note that several papers could be placed in more than one category).

First, two chapters offer solutions to what the authors see as abuses of or problems arising from eminent domain powers in light of the *Kelo* ruling. Steven Eagle from George Mason University' College of Law contends that eminent domain is desirable to overcome transactions costs in assembling large parcels of land for private development, but that it is also problematic because it can be inequitable (indeed, it can be used to intentionally transfer wealth in the face of rent seeking by developers). He notes that a more restrictive definition of "public use" might alleviate the potential abuses, but instead of making an extensive case for such a redefinition (an argument made by others), he proposes alternatives. Eagle contends that owners be provided with real opportunities for planning and equity participation in redevelopment, noting that his argument applies to both eminent domain and regulatory takings. In partial contrast, Sam Staley from the Reason Foundation argues that eminent domain is usually not necessary to promote redevelopment, but rather that it is used to achieve political expediency as private developers use it to avoid market transactions. Staley recommends a "checklist" for assessing whether eminent domain actually does generate public benefits for an urban redevelopment project: (1) it should only be used as a tool of last resort, (2) hold out problems should be demonstrated, (3) the project should have broad public benefits, (4) the process should be transparent, and (5) there should be true economic blight. Staley shows, in part by examining recent takings cases such as *Kelo,* that very few development projects would qualify for eminent domain takings if these criteria were applied.

The Eagle and Staley arguments recognize that part of the problem with eminent domain arises because individuals whose land is taken are unfairly compensated. Two chapters directly focus on this issue. Paul Niemann and Perry Shapiro, economists from the University of California, Santa Barbara, point out that pre-takings "market value" basis for determining compensation in eminent domain takings is inefficient in that it creates a moral hazard problem and induces inefficient investments. They demonstrate that an equitable compensation rule wherein owners of condemned land are to be paid the value of the property had it not been taken also can induce efficient resource use. Thus, in theory at least, it appears that appropriate compensation could be paid. Wallace Kaufman, an expert on land value determination who has frequently testified in takings cases, takes us from theory to practice. He also emphasizes limitations of the "market value" definition used to determine compensation, but in addition, he stresses that the practical determination of compensation tends to be distorted and corrupted at many points in the appraisal process and legal proceedings in eminent domain cases. The result is that compensation is rarely what it "should be" from an equity or efficiency

perspective. Furthermore, in contrast to conventional wisdom, compensation often is high rather than low. Therefore, Kaufman stresses the loss of liberty rather than the transfer of wealth, as the primary problem with eminent domain.

The next set of chapters examines the politics of eminent domain. Scott Bullock, Senior Attorney at the Institute for Justice, explains the inadequacy of the planning process as a substantive check on eminent domain, thus arguing against the Supreme Court's justification for allowing the *Kelo* takings. He emphasizes the tremendous private influence on public planning, using both theoretical public-choice analysis and the practical knowledge he has drawn from his experience litigating eminent domain cases and challenging eminent domain abuse. Ilya Somin from George Mason University's School of Law explores the political backlash against *Kelo*. He examines the state legislation produced by this political backlash, identifying those few states that have significantly constrained the use of eminent domain. He also explains why many of the new laws are ineffective, despite the existence of wide spread popular outrage at *Kelo* and "economic development" condemnations, including the political power of development interests that stand to benefit from condemnation (echoing Staley) as well as the rational political ignorance of most voters. Thus, he argues against the view that the legislative reaction to *Kelo* demonstrates that the political process can provide sufficient safeguards for property owners. Finally, economists Bruce L. Benson (Florida State University) and Matthew Brown (Florida State University and the Charles G. Koch Charitable Foundation) compare the likely market failure problems that would arise in the absence of eminent domain powers to assist private development (the hold-out problem that can prevent the assembly of large parcels of land, as suggested by Eagle) to the government failure problems arising with eminent domain (the rent-seeking and wealth transfer issues raised by Eagle, Staley, and Bullock, and the unlikely success of any judicial or legislative efforts to effectively constrain such activities, as suggested by Somin). The conclusion is that even if there is a potential market failure limiting the ability of private developers to assemble land (the authors agree with Staley that this problem is much less than is typically suggested), the high likelihood of government failure undermines the market-failure justification for an eminent domain solution. The paper concludes on a cautionary note, however, reminding us that takings also occur through the regulatory process (police powers) and that regulatory takings do not require compensation. Therefore, while limitations on eminent domain are justified when government failure is recognized, such limitations should be considered in the broader political context. If local governments' abilities to transfer wealth through eminent-domain condemnation and compensation are limited, these governments may substitute uncompensated regulatory takings for eminent domain (e.g., rather than condemnation in order provide low income housing, a local government can mandate that private developers provide low income housing as part of a development, land use regulation might be used rather than eminent domain to preserve environmentally sensitive or historical areas), and these regulatory takings have many undesirable consequences.

The final set of chapters turn to regulatory takings. They provide examples of the undesirable consequences of regulatory takings, whether the regulations are "justified" by alleged public benefits or are recognized as wealth transfer mechanisms. These consequences often arise because of the incentives that the regulations create. For example, economists Peter Boettke (George Mason University), Peter Leeson (George Mason University), and Christopher Coyne (West Virginia

University) explore the impact of takings on entrepreneurial activity, focusing on how takings change the rules of the game and therefore the opportunities that entrepreneurs face, thereby altering the entrepreneurial discovery process. Jonathan H. Adler, Case Western Reserve University School of Law, explains that failing to compensate private landowners for the costs of environmental regulations discourages voluntary conservation efforts, encourages the destruction of environmental resources, and means that land-use regulation is "underpriced" relative to other environmental protection measures so it is "overconsumed." Economists Matthew Brown (Florida State University, and the Charles G. Koch Charitable Foundation) and Richard Stroup (the Property and Environmental Research Center, and North Carolina State University) explain that the ability to use eminent domain and/or regulation to force historical preservation allows certain interest groups, including those with NIMBY (not-in-my-back-yard) or competitive concerns, to pursue their preferred outcome at low cost to themselves by shifting costs to taxpayers, landowners and to those who seek housing or other economic development. This leads to over-use of these solutions, altering incentives to landowners toward future potentially important discoveries, and to unintended incentives to hide or otherwise destroy the value of historic remnants. They explain that the professional codes of ethics published by professional archaeology societies, is an important factor in justifying such results, to the detriment of serious archaeology and its ability to generate both knowledge and the public's interest in that knowledge. Next, economists Tom Means from San Jose State University, Edward Stringham from Trinity College, and Edward López at San Jose State University, provide an empirical examination the consequence of inclusionary zoning (e.g., requiring a developer to set aside a certain percentage of his planned housing units to be sold at a below market rate price) on housing prices and availability, using data from California. They find that such city ordinances restrict the housing supply and raise overall housing prices. Indeed, they conclude that cities that adopt affordable housing mandates (mandates that some housing be made available at below market prices) drive up overall housing prices by an estimated 20 percent, and that they end up with 10 percent fewer housing units, relative to cities without such mandates. Thus, such mandates transfer wealth from all those who buy homes that are not part of the affordable housing mandate, from those who want to buy homes but cannot because prices are higher and quantity supplied is reduced, and from developers who must adjust prices and output in an effort to cover the costs imposed by the regulations.

The concluding chapter expands upon a number of points made in earlier chapters. For instance, Bullock criticizes the *Kelo* ruling, arguing against the Court's conclusion that an eminent-domain taking is justified if it is part of a government's development plan (and see Staley for complementary analysis). This argument is extended to encompass regulatory takings, by demonstrating that planning inevitably fails to do much of what its supporters claim it will do. In fact, planning, and subsequent efforts to implement plans through land-use regulations and eminent domain, inevitably is destabilizing as rules are constantly changing. It also is tremendously costly, but not just in terms of government expenditures. A more significant cost is the resources diverted into a never-ending competition to avoid and/or alter the plans and regulations, competition that plays out in markets, legislatures, bureaucracies, and courts. Many of the most significant costs are not even measurable, as regulation diverts the market's discovery process along a new evolutionary

path that is likely to involve innovations driven by regulation avoidance incentives rather than by welfare enhancement, as explained by Boettke, Coyne, and Leeson. The uncertainty that characterizes a constantly changing regulatory environment also shortens time horizons, altering investment and resource-use decision in ways that reduce the long-run productive potential of resources, as illustrated by Brown and Stroup and Adler. Somin demonstrates that *Kelo* produced a dramatic political backlash as states across the country passed statutes and referenda which appeared to restrict eminent domain powers, while Benson and Brown explain that the backlash against the *Kelo* decision actually is another in a long chain of backlashes against government efforts to expand the scope and strength of the claim that the state is the actual property owner. The concluding chapter provides further evidence of both expanding government efforts to strengthen government-ownership claims and of citizen resistance by examining Oregon's tumultuous comprehensive planning and land-use regulation history.

Justice Stevens noted that imposing a fifth-amendment just-compensation requirement for regulatory takings "would undoubtedly require changes in numerous practices that have long been considered permissible exercises of the police power.... [and] would render routine government processes prohibitively expensive or encourage hasty decision-making" (*Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 533 U.S. 302, 335 (2002)). But that is precisely the point of Oregon's Measure-37 and similar efforts in other states. Many citizens want to make impermissible those government practices that reduce the security of their property rights, even though they have been permissible. The process of taking wealth without compensation should not be "routine" for government. Furthermore, the *Kelo* backlash legislation indicates that requiring compensation is not enough for many citizens. They believe that the process of takings with compensation should not be routine either. Much more significant limitations on government's taking powers are widely desired. The chapters in this volume illustrate why by detailing many of the inefficient and inequitable consequences of government takings powers, whether through uncompensated regulatory takings, or compensated eminent-domain takings. Indeed, while some of the authors of chapters in this volume probably would not agree, the implication of these chapters as a group seems quite clear to this editor: those who are advocating limitations on government's taking powers are correct—much more significant limitations on government takings power should be imposed.

NOTE

1. Measure 37 was amended in 2007, weakening some of the constraints that 37 placed on governments in Oregon. See Benson (conclusion, this volume) for details.

2

Assembling Land for Urban Redevelopment

The Case for Owner Participation

Steven J. Eagle

Introduction

In *Kelo v. City of New London* (2005), the U.S. Supreme Court held that the condemnation of unblighted residential neighborhoods for economic development by private entities did not violate the U.S. Constitution's requirement that condemnation be limited to public use.[1] While the text of the 5–4 majority's opinion stressed deference to past precedent, the subtext was a settled belief that state and local governments would use what the dissent termed "uncabined" powers with fairness and skill. These assumptions arose from a lingering Progressive Era faith in the role of trained professionals as guides to good public policy and from an implicit perception that the institution of property itself had lost much of its coherence (Grey 1980).

The public uproar following *Kelo,* and the ensuing wave of legislative proposals and statures aspiring to undo it, indicate that the public is fearful that government officials and powerful interests would conspire to deprive citizens of their homes and small businesses. As information about the increasing use of eminent domain for private economic development has spread, these fears have grown (Somin 2007).

This chapter sets forth alternatives to condemnation as a mechanism for urban redevelopment. It does not address the constitutional issues in *Kelo,* but is premised on skepticism about its practical effects. This point was articulated in a speech delivered by Justice John Paul Stevens soon after he handing down his *Kelo* majority opinion (Stevens 2005). Similarly, Justice Anthony Kennedy, who provided the fifth vote for the majority, also wrote a concurring opinion that did not comment directly on the efficacy of condemnation for private economic development, but which did agree with the four dissenters that at least some classes of condemnations merit heightened judicial scrutiny (*Kelo*, Kennedy concurring, 493).

Justice Kennedy's wariness is well justified from a public choice perspective, since legislators and government administrators tend to subordinate even the sound judgments of disinterested professionals to contrary demands by interest groups (Buchanan, Tollison and Tullock 1980). Indeed, even the formal wisdom of experts