Review: [untitled]
Author(s): Thomas S. Ulen
Reviewed work(s):
  Regulatory Takings: Law, Economics, and Politics by William A. Fischel
  Compensation for Regulatory Takings: An Economic Analysis with Applications by
    Thomas J. Miceli ; Kathleen Segerson
Source: Land Economics, Vol. 74, No. 4 (Nov., 1998), pp. 570-574
Published by: University of Wisconsin Press
Stable URL: http://www.jstor.org/stable/3146887
Accessed: 19/01/2009 14:00

Your use of the JSTOR archive indicates your acceptance of JSTOR's Terms and Conditions of Use, available at http://www.jstor.org/page/info/about/policies/terms.jsp. JSTOR's Terms and Conditions of Use provides, in part, that unless you have obtained prior permission, you may not download an entire issue of a journal or multiple copies of articles, and you may use content in the JSTOR archive only for your personal, non-commercial use.

Please contact the publisher regarding any further use of this work. Publisher contact information may be obtained at http://www.jstor.org/action/showPublisher?publisherCode=uwisc.

Each copy of any part of a JSTOR transmission must contain the same copyright notice that appears on the screen or printed page of such transmission.

JSTOR is a not-for-profit organization founded in 1995 to build trusted digital archives for scholarship. We work with the scholarly community to preserve their work and the materials they rely upon, and to build a common research platform that promotes the discovery and use of these resources. For more information about JSTOR, please contact support@jstor.org.
A regulatory taking occurs when a valid governmental action reduces the value of a private owner’s property—for example, when an administrative agency forbids a property owner to build on his unimproved land because it is a protected wetland. Generally, the government does not have to compensate the private property owner for his lost value. This form of taking is to be contrasted to that in which the government exercises its power of eminent domain and compels the private owner to sell the property for a public use—for example, when the government purchases property to build a wildlife preservation area. For physical takings, as they are called, the government must pay the private owner just compensation (usually, fair market value) for her property. Indeed, the Fifth Amendment to the United States Constitution and the constitutions of 48 states (excepting only New Hampshire and North Carolina) require government to pay just compensation when they (physically) take private property.

There has been academic controversy for years about whether or not efficiency and justice require the government to compensate property owners for regulatory takings. The legal view on the duty to compensate for a regulatory taking comes from *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922). The rule articulated there by Justice Holmes is that the government must compensate the property owner only if the regulation “goes too far” in lowering the property’s value. But since 1922 the Court has not clearly defined what constitutes a regulation that “goes too far.” Indeed, it was not until 1992 (*Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992)) that the United States Supreme Court used the Mahon rule to require compensation in a contested regulatory taking, and even then the circumstances were extreme in that the plaintiff, owing to a statute that prevented further building in coastal areas, lost the entire economic value of his beachfront property.

The unsettled state of the law with respect to compensation for regulatory takings has given rise to two opposing views. One group believes that the current state of affairs, in which courts give great deference to the regulators by making compensation for regulatory takings extremely unlikely, is desirable: government regulators should have great discretion. Another group believes that the current state of affairs is undesirable in that it provides too much protection for regulators and too little for property owners. As a result, they argue, property rights are less secure than they should be, and property is less efficiently used than society would like.

These views compete not only in the academy but also in the public policy arena. For instance, the national and various state legislatures have debated (but not yet enacted) es-
tablishing a bright line rule for when compensation ought to be paid—for example, if, following regulation, the private property falls in value by one-third or more, the government must compensate the owner.

These two books seek to shed light on this troubled issue through the use of law and economics. From that methodology, however, they isolate slightly different issues, employ different law-and-economics tools, and reach somewhat different conclusions. Taken together, as they should be, these books significantly advance our understanding of the advisability of compensation for regulatory takings.

Fischel’s Regulatory Taking

William Fischel, a professor of economics at Dartmouth College and an accomplished law-and-economics scholar, resolves the puzzle of when to compensate for regulatory takings by focusing on the ability of the political process to provide protection to private owners. His proposal is that compensation for regulatory taking should occur only for regulations by local governments of property that is immovable or in inelastic supply. Loss due to regulation of property by the federal and state governments should generally not be compensable.

Fischel argues that there is no reason to require compensation for federal and state regulatory taking because, at those levels, the democratic political process works to constrain governmental excess in regulating property. As a result, the property regulations that emerge from those governments are likely to be efficient. The federal government certainly and the state governments only slightly less so are broadly representative. All those who stand to gain and all those who stand to lose from a regulation may have a voice in the process. Politicians respond to these contesting groups in such a manner as to pass only those regulations that have clear net gains. Moreover, politicians seek to spread the benefits and costs of any regulation equitably across the population because, at the federal and state levels, Fischel asserts, there are relatively few underrepresented outsiders onto whom the legislatures can shift the burdens of regulation.

By contrast, Fischel believes, the democratic political process often does not work to constrain local governments, so that they might regulate property in inequitable and inefficient ways. For instance, local governments have opportunities to adopt regulations that confer benefits on residents and costs on outsiders. Municipalities frequently make precisely that calculation in deciding to raise revenue by imposing a tax on hotel and motel guests rather than by raising or instituting a local sales tax. With respect to property regulation, any government (including federal and state governments) would prefer to regulate property that is owned by outsiders or that is immobile or in inelastic supply.

I think that Fischel may overstate the likelihood that local governments will misbehave with respect to property regulation of these underrepresented groups. Because many resources are mobile and can, therefore, move to jurisdictions that promise the least interference, local governments especially (and state governments only slightly less so) must be certain that they do not discourage future investment by outsiders. Moreover, any future investor who might think to make what will be an immobile capital investment will avoid jurisdictions that have taken advantage of immobile property. Indeed, as a condition for making the investment in the first place, such an investor may insist that the local government agree not to regulate his property in the future. And, finally, the owner of immobile capital will certainly have a very strong incentive to participate fully in the local political process so as not to be the one upon whom regulations fall disproportionately.

There is much more of note in Fischel’s book than the elaboration of this intriguing proposal. For example, no student of land use should miss his detailed discussion of the facts in Pennsylvania Coal v. Mahon. There is much more to that case than we have ever thought before. Additionally, Fischel develops an intriguing theory of cycles in the judicial and legislative willingness to compensate owners when their property is taken. The
theory holds that the introduction of a new technology—typically in transportation—sets off a cycle of governmental taking of private property. At the beginning of the cycle, the social benefit of introducing the technology is very large; the quantity of private property taken is also large; and because the government’s principal concern at the early stage of the cycle is the efficient introduction of the new technology, both the legislature and the judiciary are reluctant to implement expansive rules of compensation for the private property taken. However, as the implementation of the new technology proceeds, the social benefits of further introduction begin to diminish. Eventually, the net social benefit of the property taken grows smaller and smaller, and, as it does, the judicial and legislative concern for the equity of more expansive compensation for the private property owner increases. Finally, the book contains an extensive, nontechnical, and superb summary of the law-and-economics literature on various aspects of regulatory takings.

I have only two reservations about the book’s central claims. First, I am not as sanguine as is Fischel about the abilities of the political process, even at the state and federal level, to minimize the inefficient and inequitable regulation of property. Our democracy may be the envy of the world, but it is still sometimes a funny business. For instance, it is said that someone intent on running for the United States Senate today must raise $10,000 each day of the six years prior to the election (a total of about $20 million) in order to compete effectively. Second, if the United States Supreme Court were to take Fischel’s suggestion to heart and to announce next term that it would no longer grant writs of certiorari in inverse condemnation actions in which the defendant was an agency of the federal or state government, I am almost certain that those governments would have a heightened incentive to overregulate. Any system can be profitably gamed, and one in which the Court scrutinizes only the actions of local governments for compensation for regulatory takings is no exception.

Miceli and Segerson’s Compensation for Regulatory Takings

Thomas Miceli and Kathleen Segerson, professors of economics at the University of Connecticut and also accomplished law-and-economics scholars, have written an important contribution to the literature on whether or not to compensate for regulatory takings. They divide their work into three parts—a general introduction and overview, a theoretical model of how private owners and government regulators behave in light of different rules of compensation for property losses due to regulation, and an extension of the insights of the theoretical model to other public policy issues.

The introductory part is brief and rehearse in sparse fashion the same material covered at much greater length in the Fischel book. But Miceli and Segerson’s terse statement of the central problem in deciding on compensation is superb and worth quoting in whole: “Part of the difficulty in distinguishing regulations [for which no compensation is due] and takings [for which it is] is that the law requires an all-or-nothing solution (either compensate or do not compensate) to what is essentially a continuous problem” (p. 3).

The heart of the theoretical model in part two is the recognition that the decision to compensate or not has asymmetric, but equally inefficient, effects on private owners and government regulators. If the government always compensates the private owner whose property loses value because of a regulation, then private owners have an incentive to use their property inefficiently. That is, the duty to compensate creates a situation of moral hazard for the private owner: she knows that the value of any investment she makes in improving her property will be fully compensated in the event that the government reduces the property value through regulation. The opposite extreme—a rule of never compensating for property values lost through regulation—would create incentives for inefficient overregulation by governmental bodies. Miceli and Segerson refer to this governmental misperception of the cost of
overregulation as "fiscal illusion," and they further say that the "fundamental economic trade-off underlying the takings question [is] the trade-off between moral hazard and fiscal illusion."

They propose to solve this dilemma by means of two rules. The first rule, which they call the ex ante rule, gives compensation to the landowner if he "engaged in the offensive land use efficiently in an ex ante sense" (p. 59). For instance, if the landowner's use of the property was well within the community norms and not a nuisance (a reading of "reasonable land use" originally made by Fischel), then his use was efficient, and he is entitled to compensation. The second rule, which they call the ex post rule, requires governmental compensation of the landowner if the regulation was inefficient—for example, if the regulation imposed greater social costs than social benefits. The first rule induces landowners to behave efficiently; otherwise, they will not get compensated. The second rule induces regulators to behave efficiently; otherwise, they will owe compensation.

Miceli and Segerson apply these rules to some well-known issues in land-use regulation, such as "coming to the nuisance," the nuisance exception, and noxious use; to some well-known scholarly arguments on the duty to compensate for regulatory taking, such as Richard Epstein's Takings (1985); and to some well-known U.S. Supreme Court cases on regulatory taking. In most instances they argue that their ex ante and ex post rules capture the logic of the doctrines, literature, and cases. As an example, consider their excellent analysis of Lucas v. South Carolina Coastal Council, 112 S.Ct. 2886 (1992). Lucas had purchased two lots on an island in Charleston harbor in the early 1980s, with the intention of building a residence for his family on one and eventually selling the other. The island was an exclusive residential enclave on which there were already many luxurious homes. Several years after Lucas's purchase but before he began building, the South Carolina legislature passed the Beachfront Management Act, which, among other things, forbade the construction of new residences within a designated zone along South Carolina's coast and required that all existing structures within that zone be evacuated or destroyed by the year 2040. Lucas brought an action for compensation against the South Carolina Coastal Council, the agency charged with enforcing the Act, on the ground that the Act took all the value of his property. Miceli and Segerson argue that the Act did not violate their ex post rule in that the regulation, which sought to protect the public good aspect of the South Carolina coast, was efficient but that it did violate their ex ante principle in that Lucas's proposed use of his property as a residence was efficient (because it was well within prevailing community norms) and not subject to any of the exceptions, such as nuisance or noxious use. As a result, Lucas was entitled to compensation, which is the result that the U.S. Supreme Court also reached.

The authors point out the different informational requirements of their rules. The ex ante rule requires the court to determine efficient land uses in the event of litigation for compensation (and for landowners to know, when they make investments in their property, that the court will make this determination accurately). Miceli and Segerson suggest that community norms constitute a ready guideline for this determination, but they also recognize that these norms may not be dispositive, so that there may be considerable case-by-case litigation of this matter. By contrast, they argue that the specification of efficient regulatory standards (the ex post rule) will require less information.

I am not convinced that they are correct on either score. The prudent landowner and the prudent regulator will not necessarily perceive either rule as having greatly advanced their ability to predict the circumstances in which regulation is or ought to follow land-use regulation. The authors consider this possibility in a single paragraph at the end of Chapter 5, but it deserves greater attention.

Chapters 7 and 8 deal with the economics of the amount and timing of land-use development expenditures as affected by rules for compensation for regulatory taking. One of the factors that the U.S. Supreme Court has identified as important in determining
whether or not compensation ought to be paid is the presence of "investment-backed expectations" (Penn Central Transportation Co. v. New York, 438 U.S. 104, 127 (1978)). Miceli and Segerson note that this factor by itself is not an adequate criterion for inducing efficient land-use decisions. The "investment-backed expectations" criterion rewards (in the form of compensation) those who have made expenditures in reliance upon the investment's not being at risk from regulation and to disfavor those who do not undertake those expenditures. The authors suggest that this is inefficient because the distinction between those who have and those who have not made reliance expenditures seems arbitrary and because the rule invites strategically sophisticated landowners to undertake otherwise inefficient land investment as a method of improving their likelihood of being compensated. Miceli and Segerson argue—persuasively, I believe—that their ex ante rule is superior in that it induces only efficient investment and is not subject to the gaming that might plague the "investment-backed expectations" factor. In the last chapter of this section (Chapter 8) they show that the timing of investment expenditures may be inefficiently affected by the "investment-backed expectations" criterion, as when developers hurry to complete an investment in anticipation of a regulatory change. Courts have dealt with this behavior in a fashion that is in keeping with the authors' ex ante rule, which requires that the investment be reasonable or in good faith.

The final section of the book extends the insights of the basic model to environmental protection and natural resource use. Chapter 9 deals with mining, zoning, and the protection of historic places; Chapter 10 deals with the protection of endangered species and of wetlands; and Chapter 11 deals with water allocation.

In their concluding chapter Miceli and Segerson make two policy proposals for their approach. First, they suggest that their ex ante rule ought to be applied principally in instances in which the landowner may have been "singled out" for regulation. By contrast, the ex post rule ought to be applied to situations of general impact, for in those instances the central issue ought to be whether or not the regulation (or the process by which it was reached) is an efficient one. Second, they believe that in those instances in which the landowner can affect the probability of a land-use regulation's being passed, the focus of the efficiency analysis should be on whether or not the regulation was efficient, not on whether or not the landowner's use was reasonable or in good faith. The force of this second proposal is not evident to me and might have been more apparent if the authors had elaborated and provided examples.

Comparison

These two books, taken together, give a first-rate introduction to the topic of compensation for regulatory takings. Fischel has written a discursive and less technical work that will be of particular appeal to legal scholars. His contention that, at least at the federal and state levels, the democratic political process provides guarantees against inefficient and unjust land-use regulation is extremely important. Miceli and Segerson are, in comparison, terse and technical, with much of the argument turning on mathematical and graphical demonstrations. As a result, their book will be more appealing to economists than to lawyers. Their ex ante and ex post rules for determining when compensation ought to be paid for a regulatory taking are tremendously important insights. They appear to have significantly advanced the cause of finding applicable legal rules that can simultaneously constrain individual landowners and regulators to behave efficiently.

Thomas S. Ulen
University of Illinois
at Urbana-Champaign