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The Hidden Function of Takings Compensation

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ESSAY

THE HIDDEN FUNCTION OF TAKINGS COMPENSATION

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INTRODUCTION

WILLIAM Blackstone famously proclaimed, "nothing strikes . . . the imagination, and affects and engages the affections of mankind, as the right of property."[1] Within the realm of property law, the same can be said about the takings power.[2] This extraordinary power has captured the hearts and minds of generations of property scholars who have sought to justify the power and elucidate its limitations.

The accepted lore among academics is that the takings power is necessary to enable socially beneficial development projects.[3] Without the power to force private property owners to transfer their title to the government, many desirable projects would be undermined by various holdouts. Without a mechanism like eminent domain, these desirable projects would grind to a halt.

The standard justification gives rise to a formidable challenge of a different kind: how does society ensure that politicians do not abuse the takings power? As elected officials, politicians are supposed to act in the best interest of the public. As individuals, how-

[1] 2 William Blackstone, Commentaries on the Laws of England 2 (Univ. of Chi. Press 1979) (1766).

[2] There have been many notable works in the vast literature on takings. See, e.g., Richard A. Epstein, Takings: Private Property and the Power of Eminent Domain (1985) (examining the Takings Clause in a range of contexts and in connection with the role of the individual and the state); Frank I. Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165 (1967) (analyzing the justifications for compensation in takings cases and proposing a fairness test).

[3] See, e.g., Nicole Stelle Garnett, The Neglected Political Economy of Eminent Domain, 105 Mich. L. Rev. 101, 138–39 (2006).

ever, they may prefer to promote their narrow self-interest rather than the interest of the public at large. Even well-meaning politicians may often act out of mixed motives and adopt policies that are not optimal for their constituents.

Consequently, the desirability of the takings power critically depends on the law's ability to negate the self-interest of politicians and thereby align their interests with those of the public at large. In this Essay, we argue that the main function of the compensation requirement, which has thus far eluded academic attention, is to provide a meaningful check on politicians' ability to abuse the takings power. Properly designed, the compensation mandate can go a long way toward protecting the public from abuse of the takings power and ensuring that it is only used to promote the interest of the public at large.

In a world without legally mandated compensation, politicians could exercise the takings power whenever doing so would yield them a personal profit, irrespective of the needs of the public at large. In such an environment, they could engage in various deals with developers that would enrich them and their partners at the expense of the general public. In other words, they could use the takings power to transfer wealth from the politically disempowered to the politically powerful. In this world, corruption would be rampant and property rights weak. Mandatory compensation dramatically reduces the profits politicians can derive from takings. As a result, it takes away much of the incentive to use the takings power to private ends and refocuses their attention on the public good.

This line of analysis yields a new and powerful justification for the constitutional compensation requirement. Inspired by public choice theory, we argue that takings compensation is intended to reduce the incentives for corruption by limiting the ability of politicians to profit from takings.

As we show, our theory not only adds an additional reason for requiring that the government compensate owners whose property is taken; it also yields important insights into the optimal structure of takings compensation. First, we show that current incentives to use eminent domain excessively in the service of private developers cannot be blunted by modifying compensation policy. These undesirable incentives can be reduced or eliminated only by a separate policy that involves charging developers for the benefits they receive. Second, we show that overcompensation is even worse than under-compensation insofar as corruption is concerned. For this reason, we should look skeptically at laws requiring the payment of a fixed percentage bonus above market value to property condemnees. Additionally, market value compensation might be attractive, notwithstanding its shortcomings, where judges are thought systematically to overrate the subjective value owners attach to their properties. Third, we show why a private insurance system for compensating property owners for takings is not only impractical but undesirable, as it could also encourage political corruption.

Our Essay proceeds as follows. In Part I, we analyze the existing justifications of the compensation requirement, with particular attention to those sounding in public choice. In Part II, we present and develop our new corruption-reducing justification for takings compensation and explain how it differs from preexisting justifications. In Part III, we explore the descriptive and normative implications of our corruption-reducing approach to legal policy. The Appendix provides a more formal model of our theory.

I. THEORIES OF TAKINGS COMPENSATION

The task of justifying takings compensation has preoccupied generations of property scholars.[4] Elementary fairness seems to

[4] See, e.g., Abraham Bell & Gideon Parchomovsky, Taking Compensation Private, 59 Stan. L. Rev. 871 (2007) (offering a mechanism by which property owners could be fully compensated); James Geoffrey Durham, Efficient Just Compensation as a Limit on Eminent Domain, 69 Minn. L. Rev. 1277, 1279 (1985) (arguing for limits on the government's power of eminent domain and government reimbursement for all large, concrete, and compensable costs resulting from takings); Daryl J. Levinson, Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs, 67 U. Chi. L. Rev. 345 (2000) (arguing that compensation remedies do not adequately deter constitutional violations by the government and other justifications for compensation are inadequate); Glynn S. Lunney, Jr., Compensation for Takings: How Much Is Just?, 42 Cath. U. L. Rev. 721, 724–25 (1993) (finding that courts have been inconsistent in applying the Takings Clause and identifying standards by which compensation should be measured); Thomas J. Miceli, Compensation for the Taking of Land Under Eminent Domain, 147 J. Institutional & Theoretical Econ. 354 (1991) (proposing an economic model to address the moral hazard that occurs when landowners believe they will be undercompensated in a government takings and thus overinvest in their land); Christopher Serkin, The Meaning of Value: Assessing Just Compensation for Regulatory Takings, 99 Nw. U. L. Rev. 677, 680–81 (2005) (arguing the level of

demand compensating those harmed by government action.[5] But the fact is that most government actions that harm citizens—from school closings to tax changes[6]—do not entitle the affected citizens to compensation. Even where the law mandates compensation, it often fails to pay for various harms suffered by aggrieved property owners.[7] For example, owners who lose their property in eminent domain actions receive only the market value of the taken property even where the owner has developed a particular emotional attachment that exceeds the market price.[8] Understanding the justifications for takings compensation is therefore vitally important for deciding when and how much compensation should be paid.

A. Fairness Justifications for Takings Compensation

Basic fairness is the most intuitively obvious reason for demanding that the state compensate owners whose property it takes. The Supreme Court pronounced this fairness-based justification for the compensation requirement in *Armstrong v. United States*,[9] where the Court wrote:

> The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.[10]

proper compensation is directly related to how effectively the damages awards can fulfill the goals of the Takings Clause).

[5] Cf. Michelman, supra note 2, at 1171–72, 1235 (arguing that the correct test for compensation is whether it is fair).

[6] Cf. Eduardo Moisés Penalver, Regulatory Taxings, 104 Colum. L. Rev. 2182, 2251 (2004) (arguing against compensation for takings that are indistinguishable from permissible taxes and suggesting courts should take harm into account when determining whether and how much compensation should be paid).

[7] See Bell & Parchomovsky, supra note 4, at 885–90; Lee Anne Fennell, Taking Eminent Domain Apart, 2004 Mich. St. L. Rev. 957, 958–59 (2004); Garnett, supra note 3, at 106–10; James E. Krier & Christopher Serkin, Public Ruses, 2004 Mich. St. L. Rev. 859, 866 (2004); Thomas W. Merrill, The Economics of Public Use, 72 Cornell L. Rev. 61, 82–83 (1986).

[8] See Coniston Corp. v. Vill. of Hoffman Estates, 844 F.2d 461, 464 (7th Cir. 1988).

[9] 364 U.S. 40 (1960).

[10] Id. at 49.

Frank Michelman elaborated on this fairness justification in his seminal 1967 article, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*.[11] Using John Rawls's framework for analyzing questions of justice, Michelman argued that compensation should be considered fair when it represents the compensation requirement that the citizenry would have chosen behind a veil of ignorance. Michelman claimed that if the citizenry knew of a governmental power of eminent domain in the abstract but did not know how that power would be exercised and the burdens distributed among the general public, it would nevertheless have a shared sense of the ideal "fair" scope of compensation.[12] Michelman argued that this shared notion of an acceptable risk of exposure to eminent domain and shared sense of "fair" compensation should serve as the baseline for judging whether compensation is just. It is generally believed that the Supreme Court's decision in *Penn Central Transportation Co. v. City of New York*[13] drew heavily from Michelman's analysis.[14]

Essentially, Michelman believed that citizens would not be willing to leave their property fully vulnerable to government taking.[15] Yet Michelman also believed that citizens would feel that *some* risk of eminent domain was acceptable—that is, Michelman's citizenry would accept the possibility of some takings being carried out without compensation.[16] In addition, Michelman believed that in some cases, the citizenry would consent to a rule of only partial compensation. Less-than-full compensation would be appropriate where, "it could be shown that some other rule should be expected to work out best for each person insofar as his interests are affected by the social undertakings giving rise to occasions of compensation."[17]

[11] Michelman, supra note 2.
[12] Id. at 1221–22.
[13] 438 U.S. 104 (1978).
[14] Steven J. Eagle, The Rise and Rise of "Investment-Backed Expectations," 32 Urb. Law. 437, 437–38 (2000) ("The takings-determination phase of investment-backed expectations spans the period from its origination in a seminal 1967 article by Harvard law professor Frank Michelman, through its incorporation into constitutional jurisprudence by Justice Brennan in *Penn Central Transportation Co. v. City of New York* . . . .") (footnotes omitted).
[15] Michelman, supra note 2, at 1214–24.
[16] Id.
[17] Id. at 1221.

Michelman did not suffice with general remarks about shared senses of fair risk of eminent domain and just compensation. Michelman sought to sketch a quasi-utilitarian calculus for determining what the citizenry would consider a fair compensation policy. On the one hand, Michelman proposed that compensation ought to be paid when the gains from the government action are dubious, the settlement costs (that is, the costs of arranging for compensation) are low, and "the harm concentrated on one individual is unusually great."[18] On the other hand, Michelman argued that it would be fair to deny compensation when property owners who are burdened by the government action also benefit from it or when the burden falls on the shoulders of many people.[19]

The fairness justification has proved difficult to translate into doctrine. The imprecision of the Supreme Court's ruling in *Penn Central* has been strongly criticized, and litigants and scholars continue to struggle over the definition of government actions that require compensation and those that do not.[20] In addition, even as "equal treatment justification remains today the most widespread explanation for the compensation requirement,"[21] critics like Nestor Davidson argue that it "has thin theoretical grounding and troubling doctrinal consequences."[22]

Saul Levmore offered an interesting variation on the fairness justification that tied it to some of the concerns of the next Section. Approaching the problem of political process and interest groups from a different direction, Levmore attempted to distinguish between compensable and non-compensable regulation by focusing

[18] Id. at 1223.

[19] Id. Subsequent commentators have interpreted Michelman's analysis as suggesting that government pay compensation when demoralization costs exceed settlement costs but not otherwise. Interestingly, this does not appear explicitly in Michelman's article. See David A. Dana & Thomas W. Merrill, Property Takings 35–36 (2002).

[20] The debate is generally phrased as identifying the difference between a government action that constitutes a taking—either a regulatory taking or a physical taking—and one that does not constitute a taking. For a collection of some of the many articles criticizing the Supreme Court's regulatory takings jurisprudence, see Abraham Bell & Gideon Parchomovsky, Takings Reassessed, 87 Va. L. Rev. 277, 284–89 (2001).

[21] Dana & Merrill, supra note 19, at 33–34.

[22] Nestor M. Davidson, The Problem of Equality in Takings, 102 Nw. U. L. Rev. 1, 3–4 (2008).

on the effects of the political process on minorities.[23] Echoing the concern voiced in *Armstrong v. United States,* Levmore wrote that the takings power was always vulnerable to a fear that the government might use its regulatory power to benefit strong interest groups.[24] While Levmore argued that the strong minorities or majorities might protect themselves in the political process, disempowered minorities would be left without political recourse.[25] Thus, Levmore summarized:

> A central theme of takings law is that protection is offered against the possibility that majorities may mistreat minorities. A paradigmatic case is that of a community of landowners who combine to expropriate the property of one landowner for their community's enjoyment. Such majoritarian, or gang, law is thought unfair because of an equal treatment principle, which is especially compelling when the community's needs would be met just as well by using any piece of land, or because of the realistic fear that the ganging up will too often be at the expense of the neighbor who is most different or most nonconforming.[26]

Levmore took these conclusions to a quite different conclusion than that offered by Michelman. Rather than focusing on settlement and demoralization costs of takings, Levmore suggested focusing on the size and political power of affected groups. Thus, for example, Levmore suggested that compensation is necessary where the government orders rent control schemes aimed at mobile home owners where there are very few mobile home parks in the jurisdiction, or "price or wage controls directed at one business, rather than at an entire industry (or at the economy as a whole)."[27] By contrast, wrote Levmore, "controls that do not go so far as to deny a minimal market rate of return and that are applied to an entire industry or economy are just the sort of thing that is resolved in the

[23] Saul Levmore, Just Compensation and Just Politics, 22 Conn. L. Rev. 285, 292–93 (1990).
[24] Id. at 306–07, 310–11.
[25] Id. at 306–07.
[26] Id. at 309.
[27] Id. at 313.

political arena where most of the affected parties are represented."[28]

B. Public Choice Justifications for Takings Compensation

Many scholars have supplemented the fairness understanding of takings compensation with additional theories grounded in an institutional understanding of government. In this Section, we closely examine the primary justifications for the compensation requirement of takings law offered in the public choice literature: overcoming fiscal illusion and politically powerful condemnees. Finally, we examine whether there have been earlier corruption-reducing theories of takings compensation.

Public choice is the branch of economic analysis that studies political problems, and, especially, the decisionmaking of the state.[29] As such, it represents a fertile ground for understanding why the law should mandate that the state pay compensation for its actions that are considered takings.

To date, public choice theorists have advanced two primary justifications for the compensation requirement. First, some scholars have argued that government decisionmaking is susceptible to fiscal illusion, namely, the claimed tendency of government decisionmakers to ignore all costs that do not find expression in the government budget.[30] The second justification advanced by some public choice scholars is that compensation helps ameliorate certain kinds of interest group pressures. This justification relies on Mancur Olson's seminal work on the power of interest groups in controlling government decisionmaking.[31] Olson's work suggests that small, well-organized groups can influence political processes to capture benefits at the expense of larger but more poorly organ-

[28] Id.

[29] See generally Dennis C. Mueller, Public Choice III (2003).

[30] See Bell & Parchomovsky, supra note 4, at 881–84; Lawrence Blume & Daniel L. Rubinfeld, Compensation for Takings: An Economic Analysis, 72 Cal. L. Rev. 569, 620–22 (1984); Thomas W. Merrill, Incomplete Compensation for Takings, 11 N.Y.U. Envtl. L.J. 110, 131–32 (2002); see also William A. Fischel, Takings and Public Choice: The Persuasion of Price, *in* 2 The Encyclopedia of Public Choice 549 (Charles Rowley & Friedrich Schneider eds., 2003) (discussing how the government determines just compensation).

[31] Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups (5th ed. 1975).

ized groups.[32] Theories influenced by Olson have appeared in several different variants, as presented below.

We conclude this Section with a discussion of Richard Epstein's theory of the Takings Clause and its possible connection to a rent-minimizing theory of takings compensation.[33] While Epstein's theory is not generally viewed as belonging to the public choice genre,[34] Thomas Merrill saw Epstein's requirement that all government action meet the conditions of Pareto optimality identified by welfare economics as an implicit endorsement of a connection between takings compensation and political rent-seeking.[35] Epstein's theory provides a useful comparative baseline for the corruption-minimizing theory of takings compensation we advance in Part II.

1. Fiscal Illusion

Fiscal illusion is perhaps the most common economic explanation of the constitutional mandate of just compensation.[36] Those who believe in fiscal illusion believe that government actors are generally well-intentioned and well-informed and make good decisions, but for a blind spot from which they all suffer. The blind spot (or fiscal illusion) concerns costs that do not directly affect government revenues and expenditures. Government actors operating under fiscal illusion are focused on the costs and benefits of government decisions, but only those costs and benefits that appear in their governmental budget. These government actors are blind to any costs their actions impose on private property owners save those that appear on the budget (such as lower tax yields or administrative costs). Scholars who believe in fiscal illusion justify the compensation requirement as a corrective to government actors' vision problems. Constitutionally required just compensation

[32] See id. at 3.
[33] See Epstein, supra note 2.
[34] Epstein's work is generally seen as based upon a Lockean conception of property and the state. See, e.g., Eric R. Claeys, Takings: An Appreciative Retrospective, 15 Wm. & Mary Bill Rts. J. 439, 443 (2006); William W. Fisher III, The Significance of Public Perceptions of the Takings Doctrine, 88 Colum. L. Rev. 1774, 1782 (1988).
[35] Thomas W. Merrill, Rent Seeking and the Compensation Principle, 80 Nw. U. L. Rev. 1561, 1562 (1986) (book review). We discuss the meaning of rent-seeking in Subsection I.B.4, infra.
[36] See generally Dana & Merrill, supra note 19, at 41–46.

forces the government to place in its budget the costs incurred by private property owners. This brings those costs into the field of vision of government actors that otherwise suffer from fiscal illusion, and thus prevents excessive takings.

The fiscal illusion justification provides, at best, only a partial explanation for current compensation doctrine and practice. Specifically, it suffers from the two following shortcomings. First, it is at odds with the legally mandated compensation standard: compensation at *market value*.[37] Taken to its logical conclusion, the fiscal illusion justification calls for a more generous compensation measure than that currently employed, namely compensation at *subjective value*. These numbers are not generally identical. Many owners realize greater value from their property than market price. Oftentimes, it is precisely this greater value that led the owners to purchase the property and to hold it thereafter. For a variety of reasons explored in the literature, one should often expect a subjective value that exceeds market value.[38] That is, in general, we expect that owners of property attach a greater value to their property than does the average person in the broader market. Since the fiscal illusion theory is concerned with full accounting for costs and benefits, the only measure that reflects the full cost of government projects is not payment of market value to the aggrieved owners but rather the payment of compensation at the owners' subjective value, which reflects their true loss as a result of the coercive transfer.[39] Compensation at market value, in other words, leaves subjective losses out of the government budget and, therefore, invisible to government actors suffering from fiscal illusion.

Second, the fiscal illusion justification, at least in its pure form, stands for the proposition that under no circumstances will com-

[37] See United States v. Miller, 317 U.S. 369, 374 (1943) ("In an effort . . . to find some practical standard, the courts early adopted, and have retained, the concept of market value."); Coniston Corp. v. Vill. of Hoffman Estates, 844 F.2d 461, 464 (7th Cir. 1988) ("'[J]ust compensation' has been held to be satisfied by payment of market value.").

[38] See Bell & Parchomovsky, supra note 4, at 885–90 (finding the subjective value may exceed market value due to surplus subjective value, goodwill, community premiums, and transaction costs); see also Krier & Serkin, supra note 7, at 866; Symposium, The Death of *Poletown*: the Future of Eminent Domain and Urban Development After *County of Wayne v. Hathcock*, 2004 Mich. St. L. Rev. 837 (2004).

[39] For further discussion of the importance of compensation at subjective value, see Bell & Parchomovsky, supra note 4, at 872–75.

pensation be rendered voluntarily without the constitutional requirement. After all, any time the state compensates individuals it adds costs to the state's budget without adding any corresponding revenue. This proposition is manifestly, empirically false. The Constitution does not require compensation for all regulations that harm private property value, but such regulations are often still accompanied by voluntary state-offered compensation.[40] The reason for this is clear: political actors are anything but blind to costs borne by the private sector to the exclusion of government. Excessive private costs translate in some degree into political costs for political actors, and, hence, to diminished politician utility. For this reason, it is also empirically false that politicians exclusively maximize budget surplus.

2. Condemnee Interest Groups

Focusing on property owners' political grievances created by uncompensated takings has led to a different group of justifications of the compensation requirement. We focus first on the version of this school found in the work of Daniel Farber.[41] Farber's model envisions that socially efficient takings may be thwarted due to opposition from politically powerful property owners who can and will stop the government from taking their properties unless they are paid enough money to remove their opposition.[42] Farber's model, in other words, sees compensation as a type of "bribery" to obstreperous, self-minded property owners to quiet them and pave the way for socially efficient projects. In Farber's view, the usual case in which such compensation is necessary involves a small number of affected properties to be taken, with widely spread public benefits. The owners of the properties targeted for taking will comprise a well-motivated and small interest group, while the benefiting public will be scattered and poorly motivated (as the

[40] For a discussion of the many ways in which the government voluntarily grants benefits to individuals, see Abraham Bell & Gideon Parchomovsky, Givings, 111 Yale L.J. 547 (2001).

[41] Farber's article does not rely solely on the public choice or rent-seeking account presented here; indeed, Farber acknowledged the plausibility of other economic explanations for the compensation requirement. Daniel A. Farber, Economic Analysis and Just Compensation, 12 Int'l Rev. L. & Econ. 125 (1992).

[42] Id. at 131–32.

benefits for any individual member of the public will be small).[43] In such cases, Farber suggests that the payment of compensation is necessary to alleviate the de facto veto power of the powerful property owner interest group by paying it off.[44] Compensation, in other words, is a bribe to pay off the powerful obstructionist minority opposition.

Farber's theory runs into several problems when measured up against the current legal regime. First, and most importantly, Farber's theory does not explain why it is necessary to mandate compensation by law. If Farber is right, the constitutional compensation requirement is superfluous. There is no need to mandate compensation legally because the government will always choose to pay compensation of its own accord in order to carry out efficient projects. It is interesting to note that this outcome stands in diametric opposition to the predictions of the fiscal illusion theory that assumes that the government will never pay compensation unless legally forced to do so. At best, in Farber's world, the compensation requirement can be seen as the government conceding in advance the inevitable to the politically powerful.

Second, and relatedly, compensation at market value—the prevailing compensation measure—is anomalous to Farber's analysis. If, as Farber suggested, the goal of compensation is to appease politically powerful homeowners, there is no reason to suppose the payment of market value will take care of the problem. At first blush, property owners will only be indifferent to the government action if they are reimbursed at the full subjective value they attach to the property. Otherwise, they will find the taking disadvantageous and will be motivated to oppose the taking. But further analysis from a game theory viewpoint shows there is no reason for targeted homeowners to suffice with subjective value compensation. It is much more realistic to assume that once they understand their power to hold out and block the project, they will require the payment of the largest amount they can extract from the government. This amount will be commensurate with the group's political

[43] Id. at 130–31.

[44] Id. at 125 ("Public choice theory suggests that legislators normally offer compensation to landowners whose property is taken for a project, because they would form a powerful lobby against the project if not 'bought off.'").

power and could range from zero to the full value of the project to society.

Finally, Farber's analysis is incapable of explaining why compensation ought to be paid in all those cases in which the affected property owners do not wield sufficient political influence to block the taking. On Farber's view, the payment of compensation in such cases is not only unnecessary but also a waste of resources. Farber's analysis proceeds on the assumption that all owners of taken properties are politically powerful, but in many cases this assumption does not seem to comport with reality.

3. Multiple Interest Groups

Like Farber, Timothy Brennan and James Boyd focused on the political power of landowners as one of the central concerns in examining the likelihood that politicians will decide to take property.[45] Brennan and Boyd's model, however, sought to make the analysis more comprehensive. Their model included a number of additional factors: it explicitly viewed politicians as self-interested and included the political power of members of the public seeking regulation (referred to as environmentalists) as well as taxpayers.[46] In addition, Brennan and Boyd addressed the incentive effects of compensation on landowners' development decisions, a factor extrinsic to our analysis.[47]

Compensation, in Brennan and Boyd's model, acts in a manner reminiscent of the Farber model. Compensation reduces landowner opposition to regulation. If compensation is high enough, landowners will even support regulation that harms land values. Brennan and Boyd add a peculiar observation as well: landowners can also be forced to pay a penalty whenever land use is regulated. If landowners are forced to pay a penalty tax regulation rather than

[45] Timothy J. Brennan & James Boyd, Political Economy and the Efficiency of Compensation for Takings, 24 Contemp. Econ. Pol'y 188, 190–95 (2006).

[46] Id. at 191–93.

[47] Id. at 195. For discussions of the problem that compensation may create "moral hazard" and incentivize over-development, see Abraham Bell, Not Just Compensation, 13 J. Contemp. Legal Issues 29, 35 (2003); Paul Burrows, Compensation for Compulsory Acquisition, 67 Land Econ. 49 (1991); Thomas J. Miceli & Kathleen Segerson, Regulatory Takings: When Should Compensation Be Paid?, 23 J. Legal Stud. 749, 750 (1994).

getting compensation—that is, if they are kicked while they are down by being forced to pay a sum to the government in addition to losing value through regulation—they can be induced to oppose regulation which they would otherwise accept.[48] Brennan and Boyd then asked how much compensation should be granted (or how much of a penalty assessed) in order to assure that government will reach socially optimal regulatory decisions.

Brennan and Boyd's model assumed that politicians seek at all times to maximize political support. In the regulatory takings puzzle, politicians make regulatory decisions in order to maximize the total political support emerging from three groups: taxpayers, environmentalists, and landowners. Compensation, in this world, affects political support from both landowners and taxpayers. Higher compensation reduces landowner opposition to regulation while increasing taxpayer opposition. Lower compensation increases landowner opposition but reduces taxpayer opposition. Environmentalists are indifferent to compensation; in Brennan and Boyd's model, the environmentalists care only about the regulation.[49]

Brennan and Boyd determined that the resulting compensation rule should depend on the expected political power (or "clout") of each of the three groups. If environmentalists and landowners have equal clout, no compensation should be paid. If environmentalists have considerably more clout, landowners should be penalized for regulation in order to induce them to increase anti-regulatory efforts. Conversely, if landowners are much stronger than environmentalists, compensation must be paid to reduce their opposition to regulation, as Farber observed. Full compensation, say Brennan and Boyd, is only necessary when the balance of clout between taxpayers (paying full compensation) and environmentalists would lead to optimal outcomes.[50] In such a case, the full compensation neutralizes landowners and leaves politicians to maximize political support from environmentalists and taxpayers through optimal regulation.

[48] See Brennan & Boyd, supra note 45, at 196, 200.
[49] See id. at 190.
[50] See id. at 191, 197.

Paul Pecorino modified Brennan and Boyd's model slightly by changing two assumptions.[51] First, he assumed that compensation would always be positive.[52] In other words, he disclaimed the possibility that government could ever kick property owners when they are down by taxing victims of a taking. Second, his model assumed only two relevant groups—landowners and environmentalists—each of which doubled as taxpayers.[53]

Pecorino's model, however, reached even more confusing results as a consequence of a number of other factors his model examined. Pecorino focused on regulations that are public goods but spread benefits in an uneven manner. In Pecorino's model, taxpayers bear burdens equally in their role as taxpayers, but not in their roles as regulatory beneficiaries and burdenees. Finally, Pecorino's model included the possibility that government might be biased (or unbiased) in favor of one or the other groups, as well as the possibility that taxes might (or might not) distort social welfare.[54]

Pecorino's model ultimately revolves around three questions: what is the level of bias (if any) of the government, what is the distribution of benefits among groups in the population, and how much (if at all) does raising revenue through taxation involve deadweight loss? As one might guess, the last of these questions proves pivotal in the model. Where taxation creates deadweight loss, compensation obviously is costly and should be used only to the degree necessary to overcome government bias. Where bias is small, no compensation should be offered at all. Conversely, where taxation creates no deadweight loss, issues of government bias fall away and the optimality of compensation depends on the distribution of regulatory benefits. In essence, regulatory benefits constitute partial compensation for regulatory burdens, so compensation should only be "full" where the burdenees of the regulation receive no regulatory benefit. Otherwise, compensation should be reduced in order not to incentivize excessive regulation. Interestingly, "full"

[51] Paul Pecorino, Optimal Compensation for Regulatory Takings (Univ. of Ala. Econ., Fin. & Legal Studies Working Paper Series, Working Paper No. 09-04-01, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1392927.

[52] See id. at 4, 6–7.

[53] See id. at 1, 4.

[54] Id. at 1.

compensation for Pecorino means compensation net of taxes,[55] so that regulatory burdenees might be entitled to gross compensation in excess of losses.

4. Rent-Seeking

By contrast with the theories described earlier, Richard Epstein's theory of takings is not generally associated with public choice analysis. In his controversial and magisterial *Takings*, Epstein argues that the Takings Clause of the Constitution embodies a principled view of limited government and its private property in which all persons have a moral claim to their property and the wealth that their property produces.[56] Drawing on the theories of John Locke, Epstein posits that optimally, government should not only refrain from interfering in private property, but also should grant to private property owners their share of many kinds of benefits created by government action utilizing that property. In Epstein's words, the compensation requirement "guarantee[s] a proportionate distribution of the gain [created by government action] among all of the parties from whom the government takes private property."[57] This guaranty ensures that the government remains within its "proper" bounds and that it seizes private property by eminent domain (or any other kind of taking) and devotes it to public use only where it is truly reasonable to believe that the owner would consent. It also ensures that government's powers strongly resemble those of private actors, which, according to Epstein, is only proper for a representative government.[58]

Epstein's work also offers a controversial overarching theory of the proper relationship of government to private property.[59] Ep-

[55] Id.
[56] Epstein, supra note 2.
[57] Id. at 15.
[58] Id. at 12–13, 36.
[59] See, e.g., Levinson, supra note 4, at 396–400 (attacking Epstein's "libertarianism"); Thomas O. McGarity, The Expanded Debate over the Future of the Regulatory State, 63 U. Chi. L. Rev. 1463, 1484–91 (1996) (describing Epstein as a "radical anti-interventionist"); Mark Kelman, Taking *Takings* Seriously: An Essay for Centrists, 74 Cal. L. Rev. 1829, 1829 (1986) (book review) ("*Takings* is a very poorly reasoned book; Epstein makes no serious substantive arguments for the positions he advances."); Joseph L. Sax, Takings, 53 U. Chi. L. Rev. 279, 279–80 (1986) (book

stein argues that aside from its ability to regulate or take property for public benefit, the government must not have powers different from those of private actors, and that those government powers must themselves be interpreted, as much as possible, to leave the private property owner in the situation in which she would find herself absent government interference. Thus, when compensating for takings, the government must pay the full subjective value of the property in the hands of its owner. In the absence of reliable mechanisms for determining the value, Epstein favors the payment of bonuses, such as a ten percent addition to market value.[60] Additionally, any surplus created by government ownership must be shared with the owners whose property was taken.

While Epstein grounds his theory of takings compensation in a philosophical theory of the proper role of government, he adds that it has the added benefit of eliminating rent-seeking. Epstein's proposed compensation scheme accounts for every dollar of government wealth associated with a taking (whether acquired by the taking itself or produced by government use of the property), and therefore, according to Epstein, completely eliminates the possibility of rent-seeking because "there are no economic rents to seek."[61]

It is important to insert here an explanation of the term "rents." Rents are non-competitive, non-market payments extracted by politicians in exchange for exercise of their powers.[62] Public choice analysis sees rent-extracting activities as intrinsic to the business of government. In the pessimistic view of public choice scholars, government powers are auctioned off to the highest bidder and are employed toward that bidder's desired end. Aside from the costs of auctioning, avoiding detection, and the like, government activity divides rents between interested bidders and politicians.[63] While Epstein's work does not offer a full-throated endorsement of public choice theory, it certainly does worry about the possible misuse of government powers and politicians' extractions of rents. In reviewing Epstein's book, Thomas Merrill identified this observation

review) (denouncing *Takings* as a "patchwork" that is "ahistorical," is "not . . . developed," and is not a "serious work of scholarship").

[60] Epstein, supra note 2, at 184.

[61] Id. at 199.

[62] See generally Mueller, supra note 29, at 333–35.

[63] See Robert D. Tollison, Rent-Seeking: A Survey, 35 Kyklos 575, 575–79 (1982).

regarding economic rents as the central contribution of Epstein's view of takings.[64] To Merrill, Epstein's basic argument is that any government action that possesses an element of redistribution presents an opening for rent seeking, and a broad reading of takings—together with a compensation policy that provides all adversely affected owners with subjective value plus an appropriate share of the surplus—closes this opening.[65] Thus, according to Merrill, Epstein's book is best read as "an essay on public choice theory."[66]

If Merrill's reading of Epstein is correct, then we share Epstein's opinion that the takings compensation requirement aims at minimizing rent-seeking, with the obvious difference that our framework focuses on rent-extraction, as opposed to rent-seeking—a distinction we will explain presently.[67] Yet, we maintain that Epstein's scheme of minimizing rent seeking is both too broad and too narrow.

On the one hand, dissipating the entire surplus created by government action in takings compensation does not guarantee optimal government decisionmaking. While Benjamin Hermalin has argued elsewhere that compensation at the full level of societal surplus will induce owners to develop their properties to the optimal level,[68] it does not follow that the state will reach optimal decisions if forced to pay out the full surplus. Indeed, full dissipation of social surplus and the inability to realize economic rents should dissuade government actors from undertaking socially beneficial takings. But more importantly, extraction of rents is possible even where the beneficiaries of every government action are known in advance. This is because government actors will enjoy the choice of engaging in projects that enrich (already identified) private property owners or refraining from doing so. The ability of government actors to bestow profits on private owners at their discretion permits politicians to confer those benefits for their own gain. One should therefore expect the surpluses to be diverted from owners to politicians, and the auction dynamic occasionally to lead to poli-

[64] See Merrill, supra note 30, at 1585–87.
[65] See id. at 1577–78.
[66] Id. at 1578.
[67] See infra Part II.
[68] Benjamin E. Hermalin, An Economic Analysis of Takings, 11 J.L. Econ. & Org. 64, 65–66 (1995).

ticians choosing projects sub-optimally to produce smaller societal surpluses but greater personal gain for themselves.

On the other hand, Epstein's formula is overly strict in demanding allocation of the full measure of surplus to owners in proportion to their contribution. Even if Epstein is right that pre-committing the surplus to identifiable parties in advance of a taking guarantees that there will be no rents to seek, it is far from clear from a public choice perspective why Epstein's proposed allocation is the right one. Indeed, any pre-commitment of surplus—whether proportionately to the affected owners as Epstein suggests, or to the poorest members of society as identified by some index, or even to named persons like Jane Doe and John Smith—should be enough to eliminate rent-seeking in this view. By this measuring stick, Epstein's choice is arbitrary. There are other ways to dissipate the rents stemming from government takings and regulation of private property, and there is no a priori reason to adopt Epstein's solution to the problem.

In addition to these theoretical problems with Epstein's approach, there is a very practical obstacle to its implementation. Simply put, it is difficult to imagine that anyone can calculate in advance the surplus to be created by government action. Even after the fact, it will be difficult to disentangle the effects of various private and public actions and determine the magnitude of the surplus. In advance of government actions, such calculations will be confounded by the additional element of speculation. Together, these practical problems suggest that it is not realistic to aim at eliminating rent seeking by pre-committing to distribute any societal surplus to affected property owners.

Finally, as we shall show in Part III, if Epstein's theory is truly to be understood as aiming at preventing rent-seeking, it makes a very serious error in endorsing the payment of fixed bonuses as proxy compensation for the subjective value owners attach to their property. Indeed, as we will show, Epstein's proposal would *increase* rather than decrease rent-seeking activity.

II. A RENT-MINIMIZING MODEL OF TAKINGS COMPENSATION

Having reviewed existing justifications for takings compensation and pointed out their shortcomings, in this Part we develop a new model for understanding the compensation requirement as a rent-minimizing device. Our central insight is that takings compensation is a powerful device for neutralizing politicians' incentives to utilize the takings power corruptly in order to enrich themselves at the public expense. Our model demonstrates that where property owners lack political power, requiring that the state pay full compensation at the owner's subjective value will reduce to a minimum the politician's incentive to act corruptly. We also show that where property owners have political power, the compensation requirement cannot be proved to have this salutary effect, but whether and how compensation affects political corruption is unknowable in the abstract.

We can describe the basic intuition behind our models as follows. Where politicians seek to enrich themselves corruptly from exercising the takings power, they do so by identifying two groups of individuals ready to pay the corrupt politicians. The first group is private property owners willing to pay to avoid having their private property taken. The second group is individuals willing to pay to have property given to them by corrupt politicians or, at least, to have corrupt politicians arrange to have the newly public property available to them. The less loss private owners suffer as a result of a taking, the less they will be willing to bribe politicians to forgo corrupt exercises of the takings power. Those wishing to obtain property or enjoy public property are not affected either way by compensation because what concerns them is only how much they will have to pay, not what the government must pay.

Our account draws on the insights developed in the scholarship of public choice focused on rent seeking, pioneered by Gordon Tullock,[69] and developed by James Buchanan,[70] Sam Peltzman,[71]

[69] See Gordon Tullock, The Welfare Costs of Tariffs, Monopolies, and Theft, 5 West. Econ. J. 224 (1967) (using economic modeling to show that the social costs of tariffs and monopolies are larger than the literature indicates).

[70] E.g., James M. Buchanan, Rent Seeking and Profit Seeking, *in* Toward a Theory of the Rent-Seeking Society 3, 3–15 (James M. Buchanan et al. eds., 1980) (shifting the focus of the study of rent seeking to nonmarket interactions and institutions as part of public choice theory).

[71] E.g., Sam Peltzman, Toward a More General Theory of Regulation, 19 J.L. & Econ. 211, 212–13 (1976) (developing a formal model of the "optimum size of effective political coalitions set within the framework of a general model of the political process").

Gary Becker,[72] and Anne Krueger,[73] among others. It owes a special debt to Fred McChesney's discussion of rent extraction by means of law.[74] In Gordon Tullock's view, government services are functionally items in commerce sold by decisionmakers to private bidders.[75] McChesney helpfully extended Tullock's model by describing the threat of adverse government action—such as tax increases—as business threats used to extort payments.[76] These views, it should be emphasized, are not a normative view of government, but rather a pessimistic description of the existing motivation behind government actions, undesirable though the motivation may be. While the rent-seeking view is rightly disconcerting for many, the theory provides an important explanation of various persistent inefficiencies of government policies. More importantly, it provides a guideline to the threats created by improvident design of the authority of government institutions and, therefore, an important mode of analysis for those seeking to ensure that the state pursue the public good.

We must also add that public choice analysis does not presume that all "payments" to government officials come in the form of naked bribes. Indeed, it is quite likely that in most contexts, even thoroughly corrupt politicians will be unable to or unwilling to take undisguised cash payments. Rather, corrupt politicians will seek to get paid indirectly. The payments may take a variety of forms, such as campaign contributions, business contracts with associates of the politician, and so forth.

Our analysis proceeds from the observation that the government's power to take private property and transfer it from one owner to another is of considerable pecuniary value. In theory, there is no limit to the value of assets that may be seized and trans-

[72] E.g., Gary S. Becker, A Theory of Competition Among Pressure Groups for Political Influence, 98 Q.J. Econ. 371 (1983) (presenting "a theory of competition among pressure groups for political influence").

[73] E.g., Anne O. Krueger, The Political Economy of the Rent-Seeking Society, 64 Am. Econ. Rev. 291 (1974) (developing a model of competitive rent seeking for when rents originate from quantitative restrictions upon international trade).

[74] Fred S. McChesney, Money for Nothing: Politicians, Rent Extraction, and Political Extortion (1997) [hereinafter McChesney, Money for Nothing]; Fred S. McChesney, Rent Extraction and Rent Creation in the Economic Theory of Regulation, 16 J. Legal Stud. 101 (1987).

[75] See Tullock, supra note 69, at 228.

[76] McChesney, Money for Nothing, supra note 74, at 55–66.

ferred through the power of eminent domain. Accordingly, if the government were not under a legal obligation to pay compensation to aggrieved property owners, one can surmise that the eminent domain power would be used much more frequently as a means of extracting rents.

We argue that takings compensation helps reduce the incentives for corruption by limiting the ability of politicians to extract "rents" from takings. Rent-seeking accounts of government focus on decisions motivated by rent-seeking interest groups or individuals who bid for government services. Politicians may derive rents from their takings power in one of two ways: first, they may threaten to take and demand payment from property owners in order to abstain from taking or, second, they may "offer" their services to property developers, allowing them to obtain coveted land without paying the asking price of the owner. Both possibilities are ubiquitous. Takings compensation, we show, reduces the first kind of rent extraction, without adversely affecting the second kind.

To demonstrate the importance of the compensation requirement, we offer a model of a world where politicians are self-seeking and make their decisions based on their desire to extract rents. Our model examines politicians' decisions with and without compensation. Our model includes the ability of private parties to solicit and receive grants of property from the government. Our model shows that where property owners are politically powerless, a full compensation requirement is the best way to reduce corrupt takings. It shows as well that the compensation requirement cannot affect the motivations of private parties to solicit grants from the government or the motivations of corrupt politicians to make these grants; instead, these motivations must be separately dealt with by another body of law. Finally, our model demonstrates that where owners are politically powerful, all bets are off and it is impossible to say whether compensation reduces or increases corruption.

Our model arrives at a very different conclusion than the interest group models described in the previous Part largely because we focus on ordinary physical takings, rather than regulatory takings. One of the distinguishing features of regulatory takings is that they combine givings (regulatory benefits) and takings (regulatory harms) in the same regulatory act. Ordinary physical takings, by contrast, generally do not combine givings in the same act. For instance, where a state takes a person's home in order to build an army base, two separate acts impose the harm and create the benefit. The taking of the home by eminent domain imposes the harm. The granting of the home to the army and the subsequent building of the army base confer the benefit (create the giving). Our model shows that this separation of givings and takings creates a situation where requiring compensation will almost always reduce rent-extraction.

We begin by presenting the assumptions on which our model is based. We then describe the findings of our model. The formal model itself appears in the Appendix. In the next Part, we illustrate some of the implications of our model.

A. Assumptions

We present here a model of politicians' takings decisions with and without compensation. In our model, there are three types of actors: property owners, property developers, and politicians. Property owners are those in possession of assets and double as voters. Developers are those desiring to acquire certain assets that they do not own; developers also double as voters. Politicians have the authority under the law to take assets from property owners and convert them to public property that will be used to provide services to the public (that is, to owners and developers), or to transfer them to developers to serve as the developers' private property.

We emphasize that the term *developers* is a broad one and covers all those who enjoy the benefits of the property as a result of the transfer of ownership. Thus, for example, where the state takes the property of the owner and converts the property to a post office, the private citizens who benefit from the use of the post office are, in the terminology of our model, developers.

Our model examines takings decisions property by property, on the assumption that there is no inherent limitation on the number of properties that can be taken. In our model, politicians make decisions on whether to take property on the basis of the utility they realize from taking the particular property. Specifically, politicians will seek to take property any time they realize positive utility from the taking.

This way of modeling politicians' behavior differs from the usual Peltzman models, in which politicians seek to maximize public support.[77] Our decision to deviate from the usual assumption is supported by several reasons. First, majoritarian politics do not require that politicians obtain votes beyond the margin of victory. While politicians may wish some additional votes beyond the minimum for purposes of insurance, the number cannot be infinite. Indeed, providing costly services for additional votes beyond the minimum required for majority victory is wasteful.[78] Second, public support is best seen as a means to an end rather than an end in itself. Politicians realize utility from public office as a result of public support, but their utility does not end there. Thus, it is more accurate to view politicians as seeking to maximize utility generally, rather than votes. Moreover, as each political decision is discrete, we feel it is best to analyze the utility of each decision.

Our model supposes that politicians' ability to extract rents using the takings power is subject to three major restraints. First, elections impose a de facto restriction on politicians' ability to transfer property. Excessive non-consensual takings of property may prevent politicians from being reelected, thus costing them their office. We call this the electability restraint. This restraint is only meaningful in two cases: if a politician by his actions alienates a sufficiently large number of property owners by imposing a large enough cost on each to lead them to vote the politician out of office, or if the politician alienates a smaller group of very powerful developers or owners who wield sufficient political clout to convince enough voters to bar the politician from being reelected. As a consequence of the latter case, we may essentially divide property into two basic kinds: clouted properties and unclouted properties. Clouted properties are those whose taking (or giving) induces a substantial political reaction. Generally, this is because the clouted properties are owned (or desired) by the politically influential. Unclouted properties are those that may be taken and given without inducing any significant political response. Generally, this is be-

[77] See Peltzman, supra note 71, at 214.

[78] See James M. Buchanan & Gordon Tullock, The Calculus of Consent 283–95 (1962).

cause the unclouted properties are owned by the politically marginalized.

Second, our model subjects politicians to what we call the legality restraint. In our model, certain kinds of explicit rent extractions—such as the taking of bribes—are illegal and punishable. Politicians must therefore hide the rents to avoid prosecution, such as by extracting rents indirectly in the form of campaign contributions.

Third and finally, we impose a transactional restraint on politicians in our model. Arranging rents and holding auctions for rent-seeking activity require the politicians' investment of time, information gathering, and administration. These transaction costs attend every rent-extraction initiative. Relatedly, politicians will have to invest some money in identifying properties from which rents can be extracted. Consequently, politicians will avoid activities that promise rents that are too small to justify the cost of seeking them.

In our model, politicians attempt to maximize their private returns from their state powers by selling off exercises of their political powers. Every piece of private property in the state is, at least theoretically, under threat of taking, and is therefore potentially the subject of a politician's sale of her taking power. At any moment, politicians may threaten to use their powers and "sell" a veto over that power to the property owner.

Thus, the politician's decision to threaten to take (or actually to take) any given property can be expressed as an examination of whether the politician is likely to realize positive utility as a result of the threat or taking, where the positive utility consists of rents extracted by the politician, net of electability, legality, and transaction restraints. The rents extracted by the politician will be some percentage (probably less than one hundred percent) of the potential loss to the owner in the event of the taking.

B. Findings of Our Model

1. Unclouted Properties

In our model, corrupt politicians examine any given property for the possibility of earning rents. These rents can be extracted from two sources: owners and developers. The maximum amount of rent that an owner will pay is the value of avoiding an unwanted taking or implementing a desired taking. That is, owners will pay some number up to the absolute value of the difference between the value they attach to the property (the subjective value to the owner) and the compensation they receive for the taking. Let us imagine that Olivia, the owner, values Blackacre at $1 million. Peter, the corrupt politician, seeks to extract rents from Olivia. If Peter threatens to take Blackacre, and no compensation is paid, Olivia will pay the corrupt Peter up to $1 million for a credible promise not to take Blackacre. If compensation is $500,000, Olivia will be willing to pay a rent of at most $500,000. If Peter demands $700,000 to forgo the taking, Olivia is better off allowing the government to take the property, collecting her compensation and suffering the loss of $500,000, rather than paying the $700,000 bribe. If the compensation is $1.2 million, however, Olivia herself may have an opportunity to engage in corruption. She may ask the corrupt Peter to take the property, and promise Peter a payment of up to $200,000 to encourage the taking.

The developer, meanwhile, operates under a different calculus. The maximum amount of rent that a developer will pay is the difference between the value of acquiring the property (through a government taking and transfer) and any charge assessed by the government for the giving. Here, imagine that David, the developer, values Blackacre at $900,000. If Peter is willing to arrange for the taking and transfer of Blackacre to David at no charge, David will willingly pay the corrupt David up to $900,000 to affect the taking and giving. If the law requires charging David $500,000 for the property, the maximum bribe David will pay goes down to $400,000. Any amount beyond that will deter David from engaging in the transaction.

In evaluating these sources of rents, politicians must take account of two facts: first, politicians are unlikely to be able to extract the full amount of potential rent and, second, politicians face costs in extracting rents. Corrupt politicians do not act alone. Corrupt rent-seeking activities will almost certainly require partners. As a result, we can guess that it is rare that politicians will enjoy the full "benefit" of the potential pool for rent extraction. Rather, we should consider that politicians would, at best, realize in rents some percentage of the amount owners and developers are willing to pay.

In addition, as we described earlier,[79] politicians must consider electability costs, as well as legality costs and transaction costs. If the properties are unclouted, electability costs become zero. We may therefore focus, in the first instance, on properties for which there are no such costs.

As demonstrated in the Appendix, within these constraints, we can conclude that guaranteed compensation at subjective value will minimize the number of takings or threatened takings motivated by rent extraction. Quite simply, this is because the pool for owner bribes dries up when compensation equals subjective value.

On the one hand, if the law sets the compensation standard *above subjective value*, politicians may profit by offering owners—in exchange for rents—the chance to have their properties taken, and likewise property owners will pay politicians to take their property. The amount by which the compensation exceeds subjective value will constitute pure profit for the owner, which she will readily share with the accommodating politician. On the other hand, if the law sets the compensation standard *below subjective value*, politicians may profit by extorting from owners shares of the value of the threatened property in exchange for refraining from taking the property. The amount by which subjective value exceeds compensation constitutes pure loss for the owner, who will readily buy an amount lower than that loss to avoid the taking. Correspondingly, property owners who fear that the government might take their property may bribe the government in order to block it from exercising its eminent domain power.

When owners are assured of receiving full compensation, there is no reason for them to submit to corrupt politicians' threats. In a world without compensation, the value of a politician's threat to seize property is the full subjective value of the asset to the owner. Once the owner is guaranteed compensation, however, the value of the threat is greatly reduced. Indeed, if owners are guaranteed subjective-value compensation any time their property is taken, they will be indifferent to threats of taking. As far as the owners are concerned, so long as guaranteed compensation truly reflects the value they attach to the asset, they should allow the assets to be

[79] See supra Section II.A.

taken with equanimity. The extortion threat thus becomes worthless.

One of the most curious findings of our model is the fact that developers' willingness to pay rents to encourage takings and subsequent givings of the properties does not affect the result that compensation at subjective value is optimal. As highlighted in controversial cases such as *Kelo v. City of New London*[80] and *Poletown Neighborhood Council v. City of Detroit*,[81] many of the properties taken by eminent domain are forked over to private parties.[82] In addition, even where taken properties remain under government ownership, it is almost inevitable that some private parties will enjoy greater benefit from use of the asset than they did prior to the taking. Consequently, even when developers are not formally part of the takings equation, they are an important part of the political decision.

Simply stated, the results of our analysis are not changed by the fact that politicians may extract rents by *giving* property as well as by *taking* it.[83] Indeed, within the constraints of our model, the ability to extract rents by givings should not be expected to alter in any way the utility of compensation in reducing rent-extracting activities. It is true, of course, that givings expand the possibilities for extracting rents; politicians can demand payment from givings recipients in exchange for granting them property or property amenities. Once givings enter the picture, a model of takings compensation must take account of three sets of actors: not merely politicians and property owners, but also potential property recipients (developers, in our shorthand). Thus, once developers enter the analysis, government rent extraction is no longer confined to interactions

[80] 545 U.S. 469 (2005) (finding that there was no basis for exempting economic development from the broad definition of "public purpose" and allowing a developer to acquire properties by eminent domain for the construction of a retail and residential complex).

[81] 304 N.W.2d 455 (Mich. 1981) (holding that the city did not abuse its discretion in condemning properties in order to convey the land to a private company for the creation of an industrial site that would create jobs and promote the public welfare).

[82] See Krier & Serkin, supra note 7, at 859–60. For views critical of the lax public use doctrine employed by courts in these cases to uphold the takings, see Epstein, supra note 2, at 161–81; Ilya Somin, Controlling the Grasping Hand: Economic Development Takings after *Kelo*, 15 S. Ct. Econ. Rev. 183 (2007).

[83] For a general discussion of the problems of givings, see Bell & Parchomovsky, supra note 40.

with property owners. The government can auction off its eminent domain and regulatory power to developers to facilitate various construction projects for them. Likewise, developers can initiate transactions with politicians to this end.

We include developers in our model alongside owners and politicians in the following manner: developers wish to have property that they do not currently own. One way of acquiring the property is straightforward. Developers may offer to purchase the property from the owners, and if they can agree on the price and terms of the sale, developers and owners can complete the transaction on their own. Alternatively, developers may attempt to utilize the politicians' coercive powers. Instead of paying owners to transfer the property, the developers can prevail upon politicians to force the transfer of the property in two steps: first, by taking the property by eminent domain and then by transferring it at less than market value (or even for free) to the developers. This latter method, of course, is ripe for rent-extraction. Before entering into a more precise analysis of the opportunities for corruption in a rent-seeking model with developers, we should emphasize again that a *formal* transfer of title to the developers is not necessary. For instance, when cities build stadiums for professional sports teams after taking properties by eminent domain, the city often retains title to the sports facility, while renting it to the sports team at an attractive price.[84] Indeed, for this reason, our model is able to treat property that continues to be held by the state as simply a variant of developer-motivated takings, at least in the eyes of the corrupt politician.

In our model, developers do not alter the takings compensation result because developers are in a very important sense irrelevant to the takings question. Developers are interested only in the giving; they are indifferent to the question of how the state acquires the property. Consequently, the existence of developers willing to

[84] See Philip Weinberg, Eminent Domain for Private Sports Stadiums: Fair Ball or Foul?, 35 Envtl. L. 311, 315 (2005) (explaining that the land needed for municipally-financed sports stadiums is often acquired through eminent domain); see also Roger G. Noll & Andrew Zimbalist, "Build the Stadium—Create the Jobs!," *in* Sports, Jobs, and Taxes: The Economic Impact of Sports Teams and Stadiums 1, 7–8 (Roger G. Noll & Andrew Zimbalist eds., 1997) (explaining that local government often pays for acquiring the land, most of the site preparation, and some of the stadium construction costs before leasing it to a sports team).

pay for property title or amenities affects the takings equation primarily in two ways: (a) by increasing politicians' abilities to extract rents from the property after the state acquires it; and (b) by altering the political costs associated with the taking. Neither effect should be exacerbated by a compensation requirement. Consequently, a compensation requirement should generally reduce rent-extracting activity, even in a world where givings are frequent and essentially unrestricted.[85]

Once we treat developers separately, we can see that developers' desire to obtain property in exchange for rents cannot be affected by takings compensation. Instead, developers will be affected solely by the charges assessed by the state in exchange for the givings. Where the givings charge equals the value that the developer attaches to the property, the politician's ability to extract rents will be reduced to a minimum. Any value less than the subjective value the developer attaches to the property will create a greater incentive for rent-motivated takings.

2. Clouted Properties

Until now we have presumed that there are no electability restraints on politicians' takings powers. This is doubtless true in some cases: there are many property owners who are politically powerless and may be easily preyed upon by corrupt politicians. It is obviously not true, however, that *all* owners are politically powerless. In some cases, the taking of a property may induce a political backlash. This backlash imposes an additional cost on corrupt politicians that may deter them from taking, even where compensation is lower than subjective value.

Unfortunately, our model shows that there is no way of knowing what the compensation policy should be for such clouted proper-

[85] Admittedly, were there absolute symmetry in transaction costs between property owners and developers, the existence of givings would eliminate the need for takings compensation. Property would be allocated optimally even without takings compensation and givings charges: any threat to take and give the property would result in an auction between equally situated owners and developers and result in a win for the superior property holder. Brennan and Boyd reached a similar result. Brennan & Boyd, supra note 45, at 191 (finding that where landowners and those in favor of land use regulations (e.g., environmentalists) have equal political influence, the social optimum is reached without a need for takings compensation). But transaction costs are almost never symmetric, and this result is not likely to ever occur in the real world.

ties. In some cases, the optimal compensation might be zero, as that number would produce a significant enough backlash to ensure no rent-induced takings threats. In other cases, the optimal compensation might be as high as subjective value, since the political backlash will never be enough to alter the usual rent-seeking calculus of the corrupt politician.

This finding—that there is no optimal amount of compensation for deterring rent-motivated takings and threats when properties are clouted—is identical to that of Paul Pecorino as described in Part I.[86] If there were a sound way to identify such clouted properties in advance, it might be possible to exempt them from the usual compensation requirements. However, it is difficult to imagine how such properties could be identified in advance, and it is yet more difficult to imagine what compensation policy the law should institute for such properties.

3. Findings Summarized

Takings compensation plays a vital role in deterring takings and takings threats motivated by corrupt politicians' desire to extract rents from property owners. Where owners of property lack political power to oppose takings, such rent-motivated takings and threats are most greatly reduced when owners are guaranteed compensation at the full subjective value of their property. Where owners have the political power to oppose takings, the effect of compensation on rent-motivated takings and threats is unpredictable.

Takings compensation does not affect politicians' rent-extracting activity vis-à-vis developers. Such rent-extracting activity is minimized where developers are required to pay a givings charge equal to the value the developer attaches to the property. However, the willingness of corrupt politicians to take property in order to satisfy the desires of developers does not alter the desirability of compensation at owners' subjective value.

[86] See supra Subsection I.B.3.

III. NORMATIVE IMPLICATIONS AND EXTENSIONS

In this Part, we explore some of the further normative implications of our model, as well as some of the limiting assumptions. We have already observed that as far as rent extraction from property owners is concerned, the optimal measure is subjective value. Further, we have seen that no compensation measure can effectively eliminate rents in interactions between politicians and developers. Rent seeking may only be ameliorated by a givings law that will impose a fair charge on developers commensurate with the gains they stand to receive from harnessing the government's eminent domain power to advance various development projects.

We now turn to three other sets of implications of our rent-extraction understanding of takings compensation. First, we further refine our discussion about takings compensation to identify cases where practical reasons dictate anchoring compensation at market value rather than subjective value. In such cases, we show that paying compensation at a fixed bonus above market value as a proxy for subjective value, as suggested by some commentators, can be counterproductive. Second, we offer some observations about how to frame the kinds of government actions that should be subjected to required compensation. Specifically, we show that suggestions that government actions should be aggregated over a long period of time to offset compensation are potentially very harmful in a rent-seeking world. Third, we show why a private takings insurance mechanism cannot be developed in a world of rent seeking. In offering this explanation, we seek to contribute to a small economic analysis of takings literature that explores the necessity of compensation as a publicly-provided insurance for private losses created by the exercise of eminent domain.[87]

[87] See Lawrence Blume & Daniel L. Rubinfeld, Compensation for Takings: An Economic Analysis, 72 Cal. L. Rev. 569 (1984) (evaluating the arguments for and against compensation as a form of insurance against regulatory takings); Lawrence Blume, Daniel L. Rubinfeld & Perry Shapiro, The Taking of Land: When Should Compensation Be Paid?, 99 Q.J. Econ. 71 (1984) (questioning whether compensation for eminent domain takings is efficient); William A. Fischel & Perry Shapiro, Takings, Insurance, and Michelman: Comments on Economic Interpretations of "Just Compensation" Law, 17 J. Legal Stud. 269 (1988) (exploring noncompensation and insurance models); Louis Kaplow, An Economic Analysis of Legal Transitions, 99 Harv. L. Rev. 509 (1986) (addressing the impact of transitional government policy in connection with takings and other economic reforms).

After exploring these three implications, we turn to two limiting assumptions within our model. These limiting assumptions concern the inability to craft a compensation policy to limit corrupt takings of clouted properties, as well as the costs of a compensation system as a mechanism for combating corruption.

A. Market Value Compensation and the Dangers of Overcompensation

In our model, we demonstrated that optimal compensation for takings is the subjective value of property to the owner. It is particularly worth noting that because this optimal compensation is at precisely subjective value, excessive compensation can be just as much a problem as insufficient compensation. When compensation is excessive, politicians will seek to take property in order to extract rents. In such cases, the primary rent-seeking activity is no longer the threat of inadequately compensated takings. Rather, the relevant activity is extracting rents from owners interested in having their properties taken in order to benefit from the inflated compensation package. In our rent-seeking model, there is no reason to believe that the one activity is any more harmful or distortive than the other.

This has important implications for the proposal that payment of fixed bonuses in addition to market value should be used as proxies for subjective value. Adding such bonuses is likely to create rents, and some scholars have suggested paying a fixed bonus over market value.[88] Indeed, as we noted, Richard Epstein suggested offering such bonuses as a solution to rent-seeking takings.[89] Additionally, a number of jurisdictions have done so in the past, and continue to do so today. In Indiana, for example, when an owner-occupied residence is taken, compensation must be paid at 150% of market value.[90] Missouri grants 125% of market value for compen-

[88] See, e.g., Lee Anne Fennell, Taking Eminent Domain Apart, 2004 Mich. St. L. Rev. 957, 958–59 (2004).
[89] See supra Subsection I.B.4.
[90] Ind. Code Ann. § 32-24-4.5-8(2)(A) (2006).

sation when a "homestead" is taken and 150% when a "heritage" property is taken.[91] In our model, such rules are gravely mistaken.

The dangers posed by such bonus compensation are in some ways even greater than those of undercompensation. As we have noted, one of the costs that politicians must take into account in extracting rents from properties is the cost of identifying candidates for takings. Under current law, in which compensation at market value for takings is guaranteed, politicians must identify properties for which such compensation is likely to be significantly less than subjective value, and then determine if a rent can be extracted, net of electability, legality, and transaction costs. Where takings are overcompensated, however, the politician's task is considerably eased. She need no longer invest much effort in identifying properties for takings. Instead, unscrupulous owners who are interested in exploiting the generous compensation scheme will themselves approach the politicians and identify their properties as candidates for takings.

But subjective value is not an easy standard for the law to realize. While owners know how much value they attach to their continued ownership of their properties, others do not. Generally, subjective value is neither observable nor readily ascertainable by third parties; only the aggrieved property owners know the true value of their property. In fact, the case law is quite explicit in acknowledging that eminent domain law has compromised its goal of full compensation and adopted a standard of market value compensation instead for purely practical reasons—that is, "[b]ecause of serious practical difficulties in assessing the worth an individual places on particular property at a given time . . . ."[92]

This gives rise to a danger that courts asked to determine subjective value may overestimate or underestimate subjective value. Like the dangers of overcompensation and undercompensation, systematic errors of the courts do not result in symmetric dangers.

[91] Mo. Ann. Stat. §§ 523.039(2)-(3) (2006). For further examples, see Daphna Lewinsohn-Zamir, Identifying Intense Preferences, 94 Cornell L. Rev. 1391, 1408–09 (2009).

[92] United States v. 564.54 Acres of Land, 441 U.S. 506, 511 (1979); see also United States v. Miller, 317 U.S. 369, 374 (1943) (explaining that, for practical reasons, "courts early adopted, and have retained, the concept of market value" in determining takings compensation).

If courts are known systematically to overcompensate, even for a certain class of properties, unscrupulous owners will put themselves forward as candidates for takings. This will, again, reduce the corrupt politician's cost of identifying a property to take, and increase the likelihood of a rent-seeking taking.

Liquidity concerns may be particularly important in this respect. It must be recognized that for many owners the home constitutes the most important potential source of funds, but one that is highly illiquid. Simply put, houses are not as easy to transform into cash as bank accounts. If courts are not inclined to include liquidity concerns in evaluating subjective value, this may lead to a serious danger of excessive takings in difficult financial times. When they experience insolvency or liquidity distress, a significant number of property owners will likely agree to receive less than what they would ordinarily consider the full subjective value when their property is taken, so long as they can receive the entire amount to be paid as quickly as possible. If courts are inclined to overestimate subjective value due to their ignoring liquidity distress, property owners who are pressed for liquidity will be able to receive a higher return on their property with a taking than they would in a voluntary market transaction. Realizing this, the government may auction off takings to owners with pressing liquidity needs in thin markets and extract rents from them in exchange for supplying them with liquidity. Since owners will receive a lesser amount in the open market—or may not be able to sell the property at all—they may prefer to forego a portion of their subjective value surplus and offer it to politicians to have their properties taken.

In light of all these dangers of overcompensation, an argument can be adduced in favor of market compensation as the best proxy for subjective value. While it is true that in most cases payment at market value will undercompensate owners, so long as the difference between subjective value and market value is small, this danger should be preferred to the danger of overcompensating owners. Simply put, when politicians and courts cannot readily identify the property owners who place a high subjective value on their properties, compensation at subjective value will create a situation in which all property owners will misrepresent themselves as owners with high subjective value. When this happens, the administrative costs of separating the owners who truly have large surplus subjective values from those who value their properties at close to market value will be significant.

Under this state of affairs, it will make sense to compensate at market value for two related reasons. First, since politicians cannot readily identify those owners with high subjective value, they cannot easily engage in rent extraction because they will not readily know which property owners to target. This means that the risk of rent extraction is likely to be very small in such a scenario. Second, the cost of screening for the owners with the high subjective value from the larger pool of owners is going to be significant. This means that the benefits derived from compensation at subjective value may be drowned out by the screening costs stemming from such a system. These two effects combine to establish a prima facie case for compensation at market value.

B. Framing Rent-Seeking Transactions

Our rent-minimization perspective also has important implications for the issue of "framing" the taking. There is an ongoing debate about what actions should be taken into account when deciding whether and how much to compensate. When the government takes away Bob's title to property *A*, but in doing so also creates benefits for Bob's property *B*, should compensation reflect only the effect on property *A*, or also on property *B*? What if today's regulatory taking results in the elimination of ninety percent of the value of *A*, but yesterday's government action created that same ninety percent due to a regulatory benefit? Should the taking be "framed" so as to allow the giving and taking to offset each other?

In a thought-provoking article, Daryl Levinson addressed the framing problem and its relation to the government's general practice of paying compensation for takings but not assessing charges for givings.[93] Levinson observed potential unfairness in forcing the government to pay compensation for actions and regulations that reduce property value, even though the government does not get to collect a corresponding payment whenever its actions increase property value.[94] Levinson argued that this asymmetry is problem-

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[93] Daryl J. Levinson, Framing Transactions in Constitutional Law, 111 Yale L.J. 1311 (2002).

[94] Id. at 1338.

atic because it is often prior government acts and planning that create much of the value the government is required to compensate property owners for when it subsequently takes or regulates certain properties.[95] Levinson therefore suggested that courts consider prior government acts within the same "frame" as the government taking and give the government "credit" for past, value-creating acts and regulations when considering the proper compensation to be paid for a taking.[96] More broadly, Levinson proposed that the legal system adopts a broad framing approach that will reduce the government's obligation to compensate.[97]

Our model demonstrates a significant danger in this proposed approach. Instead, our model supports a narrow framing of constitutional transactions. In our model, every moment represents a new opportunity to engage in rent-seeking takings or threats. Including multiple government actions in the "frame" of a taking for purposes of measuring compensation leaves intact all the rent-seeking opportunities for government givings, while increasing the rent-seeking opportunities associated with takings. Consider, for example, the following potential government actions that affect the value of a single property. In year one, politicians consider whether to approve a zoning variance permitting construction of multiple family homes in a protected wetlands area. In year fifty, politicians consider whether to nullify such variances in wetlands areas, and require that all such lands be returned to a pristine state. Under Levinson's approach, if the government were to first grant the variance and then cancel it, no compensation should be paid for the value of the homes since the hand that gave was the same hand that took away. However, an analysis that focuses on rent-creating activities notes that both the giving and taking decisions are separate opportunities to extract rents. In year one, the politician can extract payment from the owner in exchange for the variance. And in year fifty, the politician can demand payment in exchange for not taking the variance away. Indeed, if all takings transactions were framed broadly, as Levinson suggests, those who previously received government largesse would provide excellent targets for

[95] Id. at 1315.
[96] Id. at 1315–17.
[97] Id. at 1340.

extracting rents upon threat of taking back the previously bestowed largesse.

We may explain this result differently by returning more specifically to the findings of our model. As noted previously,[98] our model demonstrates that where the beneficiaries of givings are distinct from the victims of takings, there is no way to alter the compensation number so as to reduce corrupt activities associated with givings. Our model assumes that the takings and givings are disassociated because we examine physical takings, in which property is taken from one person and given to another. But even where the same person is the recipient of the giving and the victim of the taking, the disassociated approach used by our model is preferable, so long as the politician can disaggregate the results. This is because if the politician has distinct takings and givings choices to make, each one must be examined through its own utility calculus. Otherwise, the corruptions created by givings will increase. Each giving will provide an opportunity to extract rents while the politician creates a class of future victims for further rent extraction.

C. Takings Insurance

One way of analyzing takings compensation is through the prism of insurance, and our framework implicates this concept. In order to explain this implication, we first offer a preliminary review of the debate about private provision of takings insurance. In essence, by paying compensation to owners any time it takes their property, the government grants all property owners a publicly-provided insurance policy against the risk of future takings of their property. This analysis of the essence of takings compensation is at the heart of models offered by those such as Louis Kaplow[99] as well as Lawrence Blume, Daniel Rubinfeld, and Perry Shapiro.[100]

The harm of such state-provided insurance is obvious: it creates a moral hazard that encourages excessive development of property.[101] So too, the benefit of such insurance, like all insurance, is obvious. Takings insurance spreads risk and therefore reduces dis-

[98] See supra Section II.B.
[99] Kaplow, supra note 87.
[100] Blume, Rubinfeld & Shapiro, supra note 87.
[101] See id.

utilities associated with property owners' risk aversion.[102] As others have previously noted,[103] the risk-aversion justification for takings compensation suffers from serious flaws. If risk aversion is indeed a problem, why not allow the market to provide a solution in the form of private insurance, rather than government insurance?

Our rent minimization framework adds an additional argument against the adoption of private insurance against takings. To see why, it is crucial to understand that it is not only the power to take that enables rent extractions, but also information about the identity of the specific properties that may be taken. Once politicians identify the properties "to be taken," they can sell the information both to the relevant homeowners and the insurance companies. Clearly, advance information about planned takings is valuable for both groups. In the case of the homeowners, information about a planned taking will send them to buy insurance on their homes. In the case of the insurance companies, the information will have the opposite effect, inducing the insurance company to engage in price discrimination or turn the homeowners away.

In other words, the availability of a private insurance market against takings risk creates a new market in which rents may be extracted for takings threats. At the same time, if homeowners are compensated by insurance companies rather than the state, the salutary effects of state-provided compensation on reducing rent-seeking activities will be lost.

It is noteworthy that the ability of the government to trade in information about takings will exacerbate the adverse selection problem noted by William Fischel and is likely to cause the private insurance market against takings to unravel.[104] Our analysis, therefore, supports retention of the current system of government provided insurance against takings. When the government is at once the taker and the insurer, it dramatically reduces its ability to profit from selling information about its planned action.

[102] Blume & Rubinfeld, supra note 87, at 572.

[103] See, e.g., Kaplow, supra note 87, at 603.

[104] William Fischel, Regulatory Takings: Law, Economics and Politics 191 (1995); Fischel & Shapiro, supra note 87, at 286.

D. Limiting Assumptions

We conclude this Part by exploring the implications of several of the assumptions underlying our model.

1. Cloutedness

We begin with the sharp distinction our model draws between clouted and unclouted property. Our claim that takings compensation helps combat corruption is restricted to unclouted properties, that is, to properties whose taking would not arouse a significant political reaction. By contrast, our model is unable to predict how compensation would affect the motivation of corrupt politicians regarding clouted properties, that is, properties whose taking would arouse significant political reaction.[105]

Does this argue for a bifurcated takings rule in which only unclouted properties would have the right to full compensation, while owners of clouted properties would have to fend for themselves politically? We think not, for two reasons. By definition, the inability to set a compensation level that optimally reduces corrupt pressures regarding clouted properties can provide no stronger argument for zero compensation than full compensation. Any compensation level set for clouted properties would necessarily be arbitrary, and there is no good reason to believe that it would decrease incentives for corruption when compared to full compensation. Moreover, the very establishment of a bifurcated system, in which owners would have to prove lack of clout in order to enjoy full compensation, would create an unhealthy incentive for owners to invest in proving that their properties are unclouted or in trying to disguise clouted properties as unclouted. These expenditures would necessarily be wasteful and it is difficult to imagine that they would be entirely successful. After all, it is difficult to imagine how owners could definitively prove the lack of political power associated with ownership of their property.

2. Socially Desirable Givings

In our analysis, corrupt politicians evaluate separately the possibility of extracting rents from owners and from developers. In our

[105] See supra Section II.B.

model, the willingness of developers to pay bribes for givings of property will still encourage corrupt politicians to engage in rent-motivated takings, even if compensation policy is optimal. We suggest that incentives for rent-motivated givings can only be blunted where the state requires developers to pay a charge in the magnitude of the subjective value the developers attach to the property.[106]

We should recognize, however, that assessing charges at the developer's subjective value is not problem-free. If developers must pay the state the full value they attach to property given to them, they will be indifferent to the giving. Developers will no longer seek to pay bribes to corrupt politicians for givings. But they will also no longer seek any givings at all, whether motivated by corruption, or anything else. Any initiative for giving property in order to improve social welfare will have to come from publicly minded politicians.

Thus, if we believe that some givings are desirable, and we believe they will only come about if developers demand them, we should not rapidly embrace subjective-value charges. Rather, in setting the level of charges to be paid by the developers we must balance the desire to reduce corrupt givings on the one hand, with the need to encourage socially beneficial givings on the other. Unfortunately, since our model focuses on reducing corruption, it cannot specify the parameters for balancing good and bad givings. If we believe that publicly minded politicians will be good at seeking out opportunities for socially beneficial givings, this need not trouble us excessively.

3. Socially Desirable Takings

Assessing subjective value charges to developers threatens to eliminate even socially beneficial givings. The reason for this is that a developer who must pay a givings charge at the full subjective value of the given property will be indifferent to the giving. Consequently, developers will never go out of their way to encourage givings, even where the givings would benefit society at large. By contrast, within the parameters of our analysis, granting subjective value compensation to owners should not reduce socially beneficial takings. Subjective value compensation should make owners indif-

[106] See supra Section II.B.

ferent to takings. The beneficiaries, however, will not be indifferent to the takings. As our analysis of givings shows, the beneficiaries' interest in the taking will not be affected by compensation at all.[107] Additionally, publicly minded politicians should consider pursuing socially beneficial takings where they can be identified, irrespective of any beneficiary request.

This entire analysis, however, is premised on an assumption of cost-free transfer payments. That is to say, we have presumed that the act of compensating owners for the value of their taken properties does not entail any additional cost to society. In general, transfer payments do not, in and of themselves, affect total social welfare. Rather, they simply add welfare to one party in the same amount as they lower it to another. But transfer payments are rarely costless. Arranging for the transfer of funds from one person to another entails potentially significant administrative costs. Once we include these administrative costs in the picture, we must acknowledge that compensation decisions entail a balance between the reduction in corruption created by subjective value compensation and the costs of administering the payment of compensation to aggrieved owners. Corrupt rent-seeking activities are like other crimes. Given the costs of preventing crime, society may find it worthwhile to permit some crime to take place.

On a similar note, our model assumes a fixed background legal approach to corruption, encapsulated in the "legality cost" a politician expects to pay for corrupt activities. In real life, such legality costs can be altered by decisionmakers. Law enforcement officials may devote greater efforts to locating and capturing criminals. Lawmakers may refine the definition and scope of criminal offenses. The state may increase punishments and devote more resources to confining criminals. Thus, decisionmakers face an additional set of tradeoffs when considering compensation policy. If raising funds for government action is costly and entails deadweight loss, decisionmakers must not only consider the costs of administering compensation, they must also consider the possibility of earning a better return on corruption-reduction by investing in law enforcement and similar measures.

[107] See infra Appendix, Proposition 3.

These factors limit the scope of our model in some respects. Nonetheless, we argue that the model provides important insight into the utility of the compensation requirement and its ability to fight rent seeking. At the very least, we can say that when deciding on compensation policy, lawmakers must incorporate into their calculus the importance of compensation in reducing corruption.

CONCLUSION

In this Essay, we developed a rent-minimization justification for takings compensation. We showed that the compensation mandate in the Fifth Amendment reduces the potential rents extracted and sought by politicians, developers, and property owners. By reducing available rents, the compensation requirement mitigates the danger of inefficient intervention in real property markets and lowers wasteful expenditures on lobbying efforts.

We also examined the implications of our rent-minimization perspective for various policy issues such as optimal compensation awards, how to treat past government actions that affected the value of taken properties (an issue known in the literature as "framing"), and the desirability of adopting a givings law and instituting private insurance against takings. Our main findings were that the optimal compensation award for taken property should be between the market value and the subjective value to the owner. Another finding of our analysis was that a perfect solution that would fully eliminate all possible rents is unattainable in this context. As for the framing issue, our rent-minimization analysis clearly favors narrow framing that treats each government act on a stand-alone basis. Our analysis also supports the adoption of a givings law as a way of further reducing rents.

Finally, our analysis cautions against substituting government compensation with private insurance for takings. Although the discussion in the Essay is primarily theoretical, it has real world consequences in both the United States and elsewhere. The pursuit of rents by politicians and government actors may dramatically destabilize property regimes. This risk is especially acute in developing countries where private property is protected neither legally nor informally by norms or traditions. Our analysis teaches that the enactment and enforcement of a compensation requirement for takings can help discipline corrupt politicians and ameliorate the ill-effects of rent extraction and seeking.

APPENDIX: FORMAL MODEL

Our model proposes that a politician's utility calculus for taking any particular property can be represented by:

$$U_p = \alpha|V_o - P_o| + \beta|V_d - P_d| \tag{1}$$

In this equation, U_p represents the gross utility that the politician may realize; V_o and P_o the property's value to the owner and the compensation paid for taking, respectively; V_d and P_d the property's value to the developer and the charge paid by the developer for the grant of the property; and coefficients α and β, where $0 < \alpha < 1$ and $0 < \beta < 1$, each represent the inability of the politician to appropriate the full gain and/or loss to the owners and developers. This inability to estimate the full gain or loss is related, in large part, to the inability of a politician to credibly commit never to take a property after being bribed by an owner or never to fail to take property after granting it to a developer.

The politician's costs can be represented by:

$$\mathrm{C} = c_i + c_p + c_l + c_e \tag{2}$$

In this equation, costs are cumulative and consist of the costs of identifying properties to take (c_i), costs of processing rent extractions (c_p), costs of avoiding legal sanctions (c_l), and the electability costs of a taking, that is, the anticipated future losses as a result of reduced chances of being reelected to office due to the taking (c_e).[108]

The politician's net utility for taking any given property can therefore be represented by:

$$U_p - \mathrm{C} = \alpha|V_o - P_o| + \beta|V_d - P_d| - (c_i + c_p + c_l + c_e) \tag{3}$$

Formally, a politician will take a property when the politician's utility function for taking the property, net of costs, is positive, or when:

$$U_p(|V_o - P_o|, |V_d - P_d|) - \mathrm{C} > 0 \tag{4}$$

[108] Note that for unclouted properties, c_e will be zero.

Alternatively, when the return of this function is positive, the politician can credibly threaten to take property without actually carrying out the taking.

The utility function of extractable rents (U_p) for the politician is a function of the rents that can be extracted from each of the original owner, the developer (i.e., the potential recipient of the taken property), and the state (if the taken property remains under state ownership). For each of these actors, rents may only be extracted from net gain or loss. Thus, extractable rents from the owner are a function of the absolute value of the difference between value to the owner and compensation received ($\Delta_o = |V_o - P_o|$). Extractable rents from the developer are a function of the absolute value of the difference between the value to the developer and any payment rendered to the state for the property ($\Delta_d = |V_d - P_d|$). Extractable rents from the state are a function of the difference between the value to the users of the property (the developers) and any payment the users make to the state. Thus, extractable rents may be considered as similar to the extractable rents from developers, since ultimately such rents may only be taken from users of the property. We presume that the state will not itself pay rents.

We further presume that the extractable rents for each property (independent of costs) strictly increase as the total value to the developer and/or to the owner increase, such that $\partial U / \partial \Delta_o \geq 0$, $\partial U / \partial \Delta_d \geq 0$, and $\partial^2 U / \partial \Delta_o^2 \geq 0$, $\partial^2 U / \partial \Delta_d^2 \geq 0$. Our assumption here is based on the observation that there is no intrinsic reason why the politician's rent should diminish with the value realized or lost by the owner/developer, but there is strong reason to believe that it would. Setting aside the costs identified above, readiness to pay rents will increase as the value realized or lost by the owner/developer increases.

Potential costs in each case are represented by C, where $C = c_i + c_p + c_l + c_e$. We assume that c_i, c_p, and c_l are independent of the compensation paid, such that $\partial c_i / \partial P_o = 0$, $\partial c_p / \partial P_o = 0$ and $\partial c_d / \partial P_o = 0$. We make no similar assumption about the electability costs of takings. In other words, $\partial c_e / \partial P_o \leq 0$ and $\partial c_e / \partial P_o \geq 0$ are both possible.

Within these parameters, we now show that there is an optimal level of compensation that produces the minimum amount of rent-induced takings and threats of takings.

Proposition 1: *For unclouted properties, the closer the compensation approaches to subjective value, without exceeding it, the lower the likelihood of rent-extracting takings and rent-extracting threats.*

Proof: Under (4) above, politicians take when $U_p(|V_o - P_o|, |V_d - P_d|) - C > 0$. As we have defined the terms, for unclouted properties, the value of C should remain static with increases or decreases in P_o, i.e., $\partial C / \partial P_o = 0$.

At $P_o=0$, the politician will take when:

$$\alpha V_o + \beta|V_d - P_d| - C > 0 \qquad (5)$$

Imagine now that $P_o = \theta$, where $0 < \theta < V_o$. The politician will now take when:

$$\alpha V_o - \alpha\theta + \beta|V_d - P_d| - C > 0 \qquad (6)$$

Comparing (5) and (6), we can see that $\alpha V_o + \beta|V_d - P_d| - C > \alpha V_o - \alpha\theta + \beta|V_d - P_d| - C$ because $\alpha\theta > 0$. Thus, as P_o approaches V_o, the likelihood of the politician taking or threatening a rent-induced taking decreases.

Proposition 2: *For unclouted properties, the greater the compensation exceeds subjective value, the greater the likelihood of rent-extracting takings and rent-extracting threats.*

Proof: The proof is similar to that of proposition 1.

Here, imagine that $P_o = \gamma$, where $V_o < \gamma$. The politician will now take when:

$$\alpha\gamma - \alpha V_o + \beta|V_d - P_d| - C > 0 \qquad (7)$$

By contrast, if $P_o = V_o$, politicians will take when:

$$\beta|V_d - P_d| - C > 0 \qquad (8)$$

Comparing (7) and (8), we can see that $\alpha\gamma - \alpha V_o + \beta|V_d - P_d| - C > \beta|V_d - P_d| - C$ because $\alpha(\gamma - V_o) > 0$. Thus, as P_o exceeds V_o, the likelihood of the politician taking or threatening a rent-induced taking increases.

Proposition 3: *For unclouted properties, compensation at subjective value produces the minimum likelihood of rent-extracting takings and rent-extracting threats (although this likelihood need not be zero).*

Proof: Proposition 3 follows directly from propositions 1 and 2.

Comparing (6) and (8), we can see that $\alpha V_o - \alpha\theta + \beta|V_d - P_d| - C > \beta|V_d - P_d| - C$, since $\alpha(V_o - \theta) > 0$. Similarly, comparing (7) and (8), we can see that $\alpha\gamma - \alpha V_o + \beta|V_d - P_d| - C > \beta|V_d - P_d| - C$ because $\alpha(\gamma - V_o) > 0$. Thus, $U_p - C$ is at a minimum at $P_o = V_o$, and compensation at subjective level produces the minimum number of rent-induced takings or threats of takings.

The intuition behind these three propositions may be explained as follows. As noted above, politicians take when $U_p(|V_o - P_o|, |V_d - P_d|) - C > 0$, or when $U_p(|V_o - P_o|, |V_d - P_d|) > C$. By definition, when unclouted properties are taken, the net value of the taking to the owner (Δ_o) has no effect on the political cost to the politician of taking. Thus, the magnitude of P_o is irrelevant to c_p. Other elements of costs should not be affected by P_o: none of the cost of identifying properties, the likelihood of legal sanctions, or the cost of processing rents should be affected by compensation. The value of C should therefore remain static with increases in P_o. Similarly, compensation paid to the owner has no effect on the ability to realize rents from the developer. The net value of the giving to the developer (Δ_d) is affected only by the value of the property to the developer, and the charge the developer must pay to receive the property. Thus, the sole determinant of the attractiveness of a taking or threatened taking to the politician is the extractable net value of the taking to the owner ($\alpha\Delta_o$). This value is zero when the owner is fully compensated for the taking ($P_o = V_o$) and rises as the owner is either over-compensated or under-compensated.

Having demonstrated that optimal compensation is set at the subjective value of the property to the owner, we can now show that similarly, the optimal charge for giving property to developers should be set at the subjective value of the property to the developer.

Proposition 4: *For unclouted properties, the closer the givings charge approaches to subjective value to the developer, without exceeding it, the lower the likelihood of takings motivated by rent-extracting givings.*

Proof: We begin again with (4) above, under which politicians take when $U_p(|V_o - P_o|, |V_d - P_d|) - C > 0$.

At $P_d = 0$, the politician will take when:

$$\alpha|V_o - P_o| + \beta V_d - C > 0 \tag{9}$$

Imagine now that $P_d = \theta$, where $0 < \theta < V_d$. The politician will now take when:

$$\alpha|V_o - P_o| + \beta V_d - \beta\theta - C > 0 \tag{10}$$

Comparing (9) and (10), we can see that $\alpha|V_o - P_o| + \beta V_d - C > \alpha|V_o - P_o| + \beta V_d - \beta\theta - C$ because $\beta\theta > 0$. Thus, as P_d approaches V_d, the likelihood of the politician taking or threatening a rent-induced taking decreases.

It is worth observing here that givings charges are, for the most part, only a theoretical construct. As we have observed elsewhere,[109] it is possible to construct a givings law that would impose a "fair charge" requirement on developers. The "fair charge" requirement is the givings' analogue to the "just compensation" mandate in takings law. The "fair charge" requirement would force developers to pay for government conferrals of benefits and thus minimize their incentives to "buy" such services.[110]

We do not need to examine the effect of givings charges in excess of subjective value to the developer. This is because a developer would never willingly accept such a giving subject to such a

[109] Bell & Parchomovsky, supra note 40.
[110] See id. at 615–17.

charge, and, under current circumstances, it is difficult to envision forced givings on such terms. However, we can show that the optimal charge is at subjective value to the developer.

Proposition 5: *For unclouted properties, givings charges at subjective value to the developer produce the minimum likelihood of takings motivated by rent-extracting givings (although this likelihood need not be zero).*

Proof: The proof follows directly from the previous proposition.

First, let us note when the politician will take if $P_d = V_d$:

$$\alpha|V_o - P_o| - C > 0 \tag{11}$$

If we compare (10) and (11), we can see that $\alpha|V_o - P_o| + \beta V_d - \beta\theta - C > \alpha|V_o - P_o| - C$ because $\beta(V_d - \theta) > 0$. Thus, the minimum number of takings is reached as $P_d = V_d$.

Until now, we have examined only unclouted properties. For unclouted properties, C is unaffected by the amount of compensation paid or givings charge assessed. It is therefore possible to see that optimal compensation at subjective value (and optimal givings charges at subjective value to the developer) achieve minimum rent-seeking takings. However, matters change when property is clouted. In such cases, C is affected by the compensation decision. Quite simply, in such cases, the quantum of compensation paid to the owners (or givings charge taken from the developer) affects the electability cost to the politician (c_e).

In such cases, without knowing the effect of compensation on the electability cost to the politician, it is not possible to determine the optimal quantity of compensation. Optimal compensation may be zero, some number less than subjective value, some number greater than subjective value, or subjective value.

Proposition 6: *For clouted properties, compensation at any level produces unpredictable effects on rent-extracting takings, and it may reduce or increase likelihood of rent-extracting takings and rent-extracting threats, depending on the effects of compensation on the politician's electability.*

Proof: Once properties are clouted, the magnitude of P_o becomes relevant to c_e. Simply put, the likelihood that owners will seek to extract a political price from the politician will increase as Δ_o increases. The result is that the effects of compensation are unpredictable. While compensation reduces U_p as P_o approaches V_o, it also may decrease C, depending on the magnitude of the political effect of compensation. If the effect on C dominates, compensation will increase the likelihood of rent-seeking takings. If the effect on U_p dominates, compensation will decrease the likelihood of rent-seeking takings.

To see this, let us divide the cost function as follows:

$$C = C' + c_e \qquad (12)$$

Where

$$c_e = \varepsilon|V_o - P_o| \qquad (13)$$

and ε is a coefficient representing the political cost to be imposed on the politician as a result of the loss suffered by the owner. We should note that $\varepsilon > 0$, by assumption, but no upper bound of ε may be stated. It is possible that the political losses experienced by the politician may be greater or lesser than the value of the property to the owner. As a result, equation (3) above can be rewritten as follows:

$$U_p - C = \alpha|V_o - P_o| + \beta|V_d - P_d| - C' - \varepsilon|V_o - P_o| \qquad (14)$$

In turn, we may say that the politician will take when:

$$(\alpha - \varepsilon)|V_o - P_o| + \beta|V_d - P_d| - C' > 0 \qquad (15)$$

We may now return to our earlier proofs.

In proof 1, we were able to prove that $\alpha V_o + \beta|V_d - P_d| - C > \alpha V_o - \alpha\theta + \beta|V_d - P_d| - C$ because $\alpha\theta > 0$. However, we cannot prove that $(\alpha - \varepsilon)V_o + \beta|V_d - P_d| - C > (\alpha - \varepsilon)V_o - (\alpha - \varepsilon)\theta + \beta|V_d - P_d| - C$ because it is possible that $(\alpha - \varepsilon) > 0$ and that $(\alpha - \varepsilon) < 0$.

In proof 2, we were able to prove that $\alpha\gamma - \alpha V_o + \beta|V_d - P_d| - C > \beta|V_d - P_d| - C$ because $\alpha(\gamma - V_o) > 0$. However, we cannot prove that $(\alpha-\varepsilon)\gamma - (\alpha-\varepsilon)V_o + \beta|V_d - P_d| - C > \beta|V_d - P_d| - C$ because it is possible that $(\alpha-\varepsilon) > 0$ and that $(\alpha-\varepsilon) < 0$.

Our proof 3 depended on proofs 1 and 2, which is no longer valid, where the politician's decision is made according to (15), rather than (4). Where $\varepsilon > \alpha$, the likelihood of a rent-induced taking or threat may increase with compensation below subjective value or above subjective value. However, where $\alpha > \varepsilon$, proofs 1, 2, and 3 still hold.

Not knowing the magnitude of ε, it is not possible to know anything about the optimal level of compensation.