COMMENT ON FISCHEL'S *POLITICAL ECONOMY OF JUST COMPENSATION*

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Professor Fischel's Article[1] provides a different and fresh perspective on the issue of takings by analogizing the military draft—which is not only a taking of one's labor but a potential call on one's life—to the taking of land or property for regulatory purposes. At one level, the Article makes an obvious point: we abandoned the draft (in favor of a volunteer army, which effectively compensates individuals for their labor) when it became too unpopular or costly to sustain. Fischel reasons that, likewise, property owners will gain compensation for the takings that affect them when their opposition is equally strong.[2]

It is hard to quarrel with this line of reasoning. But, to be quite frank, it begs some of the more interesting normative questions that have swirled around the debate over "regulatory takings." In particular, what regulatory actions, if any, deserve compensation? Or, put differently, how does one draw the line between regulatory actions that deserve compensation and those that do not?

To answer these questions, it is helpful to distinguish between two types of regulatory situations. In one category are certain types of zoning or similar regulatory actions, which may diminish the value of property in order to achieve a larger public purpose, but where the property owner has caused no harm or imposed no "externality." This first category of actions may be analogous to eminent domain and can entail the arbitrariness that critics found so offensive about the military draft.

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1. William A. Fischel, *The Political Economy of Just Compensation: Lessons from the Military Draft for the Takings Issue*, 20 HARV. J.L. & PUB. POL'Y 23 (1996).

2. *See id.* at 60.

The second, and much broader, category of situations involves regulatory actions specifically designed to internalize an externality, such as environmental pollution. Compensation for these types of regulatory actions is much more controversial and would bring much, if not all, worthwhile regulation to a halt.

As it happens, the Congress has for the past year been considering legislative proposals that would trigger compensation in both of these categories. The House of Representatives passed the Private Property Protection Act of 1995 ("House Bill"),[3] which represents a relatively narrow approach to compensable takings. It would provide compensation to landowners affected by certain federal water programs and by federal actions protecting wetlands and endangered species. Compensation would be due when such actions effectively "take" at least twenty percent of a portion of the property.[4] This proposal is narrow in the sense that only specific types of regulatory action would trigger compensation.[5] Some of these actions, such as saving an endangered species, arguably are designed to produce larger public benefits without necessarily preventing or mitigating an externality, such as pollution.[6]

The Senate Judiciary Committee has approved the Omnibus Property Rights Act of 1995 ("Senate Bill"),[7] which takes a relatively broad approach to the regulatory takings issue. This bill provides compensation in cases where any federal regulatory action (and some state actions) affecting any type of property reduces the value of a portion of property by at least thirty-three percent.[8]

The Clinton Administration has strongly opposed both bills, for sound reasons. They are inconsistent with our constitutional traditions and would frustrate the implementation of worthy governmental policies. Nevertheless, in addressing the narrow and broad versions of compensable regulatory takings, I would like to make occasional references to these legislative proposals because they help illustrate the flaws inherent in trying to create

3. H.R. 925, 104th Cong., 1st Sess. (1995).

4. *See id.* § 3(a).

5. *See id.* § 10(5).

6. In contrast, other actions often are designed to prevent externalities. For example, wetlands protections prevent harm because wetlands provide essential flood control benefits and act as filters to screen pollutants from surface water runoff.

7. S. 605, 104th Cong., 1st Sess. (1995).

8. *See id.* § 204.

an automatic standard for compensation.

The constitutional basis for compensation, as we are all aware, is the Just Compensation Clause in the Fifth Amendment, which prohibits the government from taking private property for public use without compensation.[9] The compensation requirement is well established regarding condemnations of land for public purposes. In *Lucas v. South Carolina Coastal Council*,[10] the Supreme Court made clear that compensation also applies in cases where government regulation has effectively denied owners of all beneficial and productive use of their land, unless the prohibited use constitutes a nuisance as defined by basic principles of common law.[11]

Despite all of the controversy surrounding the *Lucas* decision—and the pre-decisional hype about what the case might portend—the case is really very straightforward. Regulation can be the equivalent of eminent domain. When 100% of the value of property is destroyed, compensation is due.[12]

Advocates from what I have called the narrow regulatory takings school want to extend *Lucas* even further, however. Rather than limiting compensation for regulatory actions not involving externalities to situations in which property has been reduced in value by 100%, these advocates want a considerably lower threshold. For example, the House Bill would lower the compensation threshold to just 20% and would involve only a portion of any property, rather than the entire property.[13]

To be sure, *Lucas* does not hold that less than 100% diminution in value is never compensable.[14] Future cases of diminution in value will continue to be considered on a case-by-case basis, although courts hitherto have rarely awarded compensation awards. There are good reasons why the *Lucas* approach is correct, especially in the regulatory context.

First, there is a measurement problem, especially when the threshold is applied automatically. Once the threshold is

9. The Just Compensation Clause provides: "[N]or shall private property be taken for public use, without just compensation." U.S. CONST. amend. V.

10. 505 U.S. 1003 (1992).

11. *See id.* at 1030-31.

12. *See id.* at 1019.

13. *See* H.R. 925, *supra* note 3, at § 3(a).

14. *See Lucas*, 505 U.S. at 1019.

lowered to something less than a complete inability to use one's property, what should the base be? Certainly not a percentage of the physical property, since all land is not equally productive. Should it be some percentage of the value of the property? If so, should it be the value of the initial investment, the current market value of the land, or the potential market value it would have had if (absent the regulation's application) it had been developed in a particular way?

Second, setting the threshold below 100% introduces a moral hazard and could easily create a new industry of "bounty hunting." Attracted by the potential compensation offered by a less-than-100% threshold—especially a threshold as low as 20%, as in the House Bill—individuals would feel encouraged to purchase property as they anticipated regulatory action, turning compensation into a matter of speculation rather than deliberation. The incentives for bounty hunting would be magnified by the provision in the House Bill that computes the 20% on *any portion* of a property. This provision would encourage owners to restructure their properties in ways that maximize their ability to receive compensation. In short, these new bounty hunters—most likely the growing class of attorneys with spare cash—would specialize in developing arguments for how government action has reduced their property's value rather than in actually developing the land itself.

The case for compensation, even where the threshold is 100%, is completely unfounded in the case of regulations imposed to correct negative externalities. In these situations, the government regulates to prevent harm to others; the fact that a regulation may diminish the value of the property held by those who cause the externality should not trigger compensation. Drawing on Ronald Coase's famous insight that the allocation of property rights has no effect on efficiency,[15] Coasians argue that compensation will not disturb the overall efficiency of the economy. This is incorrect. In a world of tight budget constraints, providing compensation to polluters and other harm-doers would effectively bring meritorious regulation of externalities to a halt, thereby reducing overall efficiency. Even if this were not the case, it is hard to defend the distributional consequences of having taxpayers fund polluters' losses.

15. *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

Moreover, any attempt to provide broad-based compensation for regulatory effects inevitably raises the thorny issue of "incidence"—that is, who actually suffers a loss when regulations take effect, and thus who "deserves" compensation. Consider, for example, a regulation requiring electric utilities to install scrubbers. Who actually bears the cost of this regulation? Is it the utility, its business customers, or the customers of those businesses? The answer depends on how much of the initial cost is passed forward at each stage of the economic food chain. Having courts sort out such issues would certainly be a boon to economists and lawyers, but would anyone else be comfortable with this further crowding of the courts?

Beyond these technical points, the fundamental fact is that we have no constitutional tradition that suggests that property owners have an absolute right to use their land in any manner that maximizes their profits. Even *Lucas* acknowledges that all citizens, in exchange for the protection of their private ownership, have a corresponding responsibility to refrain from doing things on their property that could harm others. In his opinion, Justice Scalia notes that the "understandings of our citizens" are such that "the property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police powers."[16]

Both the House Bill and the Senate Bill attempt to address this issue by carving out an exception for regulation of activities that constitute nuisances under state common law principles.[17] This exemption is a token attempt at best, however. State nuisance law is highly uneven and provides only a thin layer of protection against externalities, especially those with effects crossing state boundaries. Indeed, the lack of efficacy of state laws in this area is a principle reason we have federal environmental regulation, for example. In addition, a nuisance exemption would not necessarily exempt from a compensation requirement those socially beneficial federal regulations that protect human health or public safety.

Finally, by emphasizing only the negative effects of regulation on private property, proposals such as the Senate Bill ignore the

16. *Lucas*, 505 U.S. at 1027.

17. *See* H.R. 925, *supra* note 3, at § 4; S. 605, *supra* note 7, at § 204.

benefits that regulation can confer on private property owners. In testimony this summer, the Department of Justice quoted a survey that found that clean water and air ranked second and third in importance out of forty-three factors on which people rely in choosing a place to live—ahead of schools, low taxes and health care.[18] Property values reflect such preferences.

Similarly, the exclusive focus on the regulatory costs paid by polluters and other creators of negative externalities ignores the benefits that regulations confer on businesses. The fishing industry, for example, could hardly survive if our rivers, lakes, and coastal areas were polluted. The same is true for the recreation industry, and for others.

To be sure, some regulations may go further than necessary to undo negative externalities—causing their costs to outweigh their benefits. The solution is more effective regulation and executive branch oversight of the regulatory process. In January 1996, the American Enterprise Institute (AEI) held a highly stimulating conference dealing with that precise topic.[19] At that conference, I pointed out how the Clinton Administration under Sally Katzen's direction has taken its regulatory oversight responsibilities very seriously. For example, the Administration recently provided updated information for the agencies to help them perform their cost-benefit analyses.

The Administration has taken other steps, especially in the environmental area, to try to ensure that regulations are enforced in a way that minimizes the intrusion on private citizens, particularly small business and property owners. For example, the Administration is revamping its wetlands regulations. Many individuals and small businesses are already allowed to fill portions of certain wetlands without needing to get an individual permit. The new regulatory initiatives will give small landowners even more flexibility when modifying homes located on small wetlands.[20] In addition, the Department of

18. *See Environmental Regulations and Property Rights: Hearings on S. 605 Before the Comm. on the Environment and Public Works United States Senate Concerning Takings Legislation*, 104th Cong., 1st Sess. 18 (1995) (statement of John R. Schmidt, Associate Attorney General, Criminal Division).

19. This conference, "Revising Regulatory Reform," was held on January 17, 1996. Essays from the conference will be published in the summer of 1997. *See* REVISING REGULATORY REFORM (Robert Hahn ed., forthcoming 1997).

20. By "modifying," I mean modest additions such as adding extra rooms or building a garage.

Interior has reformed its permit procedure to give relief to small landowners.

Moreover, the Administration has promoted programs that compensate owners who voluntarily turn over their land to the government in order to promote larger social objectives. Under the Wetlands Reserve Program (WRP), the federal government pays willing sellers of agricultural wetlands the fair market value of their property. The WRP has been so popular that the government has had funds to buy only one-fifth of the acres offered by landowners. The Administration's 1997 budget proposes additional monies to continue this program. It is important to note that this compensation is a voluntary program whereby the government reclaims only that land that landowners willingly offer for sale.

Those who do not trust government regulators might argue that an automatic compensation requirement is necessary in order to impose discipline on the regulatory process. Adopting a compensation requirement for this purpose, however, would be overkill in the extreme. Frankly, one reason its advocates find the idea so attractive is probably its usefulness as a vehicle for broadly undoing regulation across the board.

The reason is straightforward. As anyone who has read the newspapers during the past year must certainly understand, the name of the game in Washington is how to reduce the federal deficit, not increase it. The Office of Management and Budget (OMB) estimated last year that the cost of the House Bill, the narrow regulatory bill, would be $28 billion.[21] OMB did not

21. To derive its estimate, OMB relied on agency estimates of claims exposure—the funds needed to satisfy all claims likely to be filed under the legislation. While doing so may overstate the cost (since actual expenditures would be lower than total claims exposure), any overstatement is offset because OMB did not include in its calculations the agency administrative costs to process the claims; the higher agency costs of managing the property that the federal government acquires under the mandated purchase program; the interest on any successful claims; and the costs to the judiciary when litigation was pursued.

OMB assumed a time lag between the passage of the House Bill and the date of estimated payouts, in order to account for the time necessary to allow claims to be filed, processed, and considered in court. OMB also assumed that the earliest year in which Congress could appropriate more funds for processing claims would be 1997. OMB then assumed that from fiscal year 1997 to fiscal year 2002, processing would begin on all claims in the year submitted, with no backlogs. Generally, OMB assumed a 24-month processing time between claim submittal and payment. OMB and the agencies did not assume that more citizens would seek to get benefits by being regulated. The agencies did assume, however, that citizens now being regulated would become more combative and less inclined to accept permit conditions.

estimate the cost of the Senate Bill. Such an estimate would be more difficult to do because that bill's compensation provisions are so broad. But certainly it is safe to assume that the costs of the Senate Bill would be several times larger than those of the House Bill. Further, both these bills provide that in some instances the federal government must pay compensation for state and local actions, even where state and local officials have the discretion to pursue another course of conduct. This requirement would also add to the federal tab for compensation.

Because these bills mandate compensation, yet do not make the federal obligation to pay clearly subject to advance congressional appropriation of funds for this purpose, the bills would fall under certain provisions of the Budget Enforcement Act. In order that the deficit not be increased by any decrease in revenues or increase in entitlement spending, this Act provides for certain actions to be taken if one funding program becomes too expensive.[22] Consequently, implementation of either bill could prompt a sequester of other mandatory programs, forcing automatic, across-the-board cuts in programs such as Medicare and veterans' readjustment benefits, to name but a few.[23] Raising the threshold, or applying the threshold to the entire parcel, would not substantially limit the cost because owners could still structure their land use in a way that maximizes compensation.

In short, the budgetary consequences alone of the regulatory takings bills would bring much worthy regulatory activity to a halt. That is an unacceptable result.[24]

The types of costs that would be imposed would include claims under the Endangered Species Act. Such claims could be filed when the Interior Department listed species, when it designated critical habitats, or when it either denied incidental "take permits" or conditioned their approval upon the landowner undertaking a habitat conservation plan. Claims could also be filed against the Wetlands Program, in which a landowner needs a permit to discharge dredged or fill material into "waters" of the U.S., which include wetlands. Compensation claims could potentially result when conditions were imposed on permits, when permits were denied, when enforcement actions were taken with regard to current permits, and when jurisdictional determinations were made that a particular parcel was a wetland.

22. *See* Budget Enforcement Act of 1990, 2 U.S.C. §§ 661, 665, 900, 907 (1996).

23. These bills would also circumvent the normal budget and appropriations process because they would elevate compensation in takings cases over all other activities of selected agencies. Agencies would be required to make compensation payments, to the exclusion of other equally legitimate activities that have been legislated by Congress.

24. *Cf.* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 413 (1922) (stressing that the government could not function were it to pay every owner of land for any decrease in value that resulted from an official action).

The issues at the heart of this discussion are fairness and balance. The bills before Congress attempt to legislate equity in favor of the property owner. But equity in these matters is not so simply defined. That is why the case-by-case approach that our judicial system has pursued on takings, as well as this Administration's efforts to temper the implementation of regulations with the interests of small individual landowners, is more likely than mandated compensation to achieve an outcome that reflects the public interest more accurately.

This leads me back to one of the basic points made in Fischel's Article. As summarized above, Fischel reasons that, as with the draft, property owners will achieve their goal of compensation when their opposition to the current takings regime becomes overwhelming.[25] This may be true, but I wonder if their opposition will ever reach the same fevered pitch. There is a crucial difference between the situations of those who opposed the draft and those who oppose uncompensated regulatory takings. In the regulatory takings context, there are two camps of property owners, on opposite sides of the fence: one man's inability to dump chemicals into a river is another man's opportunity to fish in untainted waters. In fact, one of the iron rules of Washington may apply here. When trying to make the difficult choices required to balance the budget, we are reminded that every check sent from Washington has a recipient. Similarly, property owners may soon confront the fact that many regulations contribute to the high standard of living that we have come to enjoy.

25. *See* Fischel, *supra* note 1, at 60.