§3.7 Trespass and Eminent Domain

The landowner's right to repel a physical intrusion in the form of engine sparks is only a qualified right. The intruder can defeat it by showing that his land use, which is incompatible with the injured landowner's, is more valuable. But if your neighbor parks his car in your garage, you have a right to eject him as a trespasser no matter how convincingly he can demonstrate to a court that the use of your garage to park his car is more valuable than your use of it.

The difference between the cases, at least on a first pass at the problem, is the difference between conflicting *claims* and conflicting uses. In general the proper

7. I am using "uncertainty" here in its broad, popular-usage sense. Later in this book I will distinguish between risk as a contingency to which a probability can be assigned, and uncertainty as a risk that cannot be quantified.

8. The farmer might not be in a position to eliminate the risk either by diversifying (e.g., by owning large amounts of railroad common stock) or by buying insurance. Insurance against a decline in land values that is due to changes in the definition of property rights would be difficult to buy because the appropriate premium, which depends on both the probability and the magnitude of the loss if the risk materializes, would be so difficult to compute (see §4.5 infra).

9. Another problem with a first-in-time, first-in-right rule — already examined — is that it can lead to a premature, or to an excessive, commitment of resources.

10. See Keith Burgess-Jackson, The Ethics and Economics of Right-to-Farm Statutes, 9 Harv. J. Law & Pub. Policy 481 (1986); Ji Kwong & John Baden, Comment: The Ethics and Economics of Right-to-Farm Statutes, 9 id. at 825.
method (because it is cheaper and more accurate) of resolving conflicting claims in the market, i.e., voluntary transacting. If your neighbor decides that your garage is worth more to him than to you, he can pay you to rent it to him. But if he merely claims that he can use your garage more productively and on that basis seizes it and challenges you to prove otherwise, he thrusts on the courts a difficult evidentiary question: Which of you would really be willing to pay more for the use of the garage? In the spark case, negotiation in advance may be infeasible because of the number of landowners potentially affected, so if courts want to encourage the most productive use of land they cannot avoid comparing the values of the competing uses. That is not necessary in the garage case, because transactions are feasible; and so the law forbids the taking, forcing a negotiation.

If the government wants my garage, however, it can seize it under the eminent domain power, paying me "just compensation" (=market value); it need not negotiate with me. This result is inconsistent with the distinction just suggested, because it is a case of competing claims rather than competing uses. The familiar argument that the eminent domain power is necessary to overcome the stubbornness of people who refuse to sell at a "reasonable" (that is, the market) price is bad economics. If I refuse to sell for less than $250,000 a house for which no one else would pay more than $200,000, it does not follow that I am irrational. A property is usually worth more to its owner than its market price—that's why it's owned by him rather than by someone else—because it fits his tastes or needs best as a consequence of its location or improvements or because relocation costs would be high. Real estate is a heterogeneous good and so a particular parcel in the hands of a particular owner will generally yield him an idiosyncratic value that is on top of the market value. Eminent domain operates to tax away that value; if market value is $X and total value (including idiosyncratic value) is $1.2X, then if the government takes property by eminent domain it pays for it in effect by spending $X out of the government's own coffers and $.2X out of the owner's pocket.

A good economic argument for eminent domain, although one with greater application to railroads and other right-of-way companies than to the government, is that it is an antimonopoly device. Once the railroad or pipeline has begun to build its line, the cost of abandoning it for an alternative route becomes very high. Knowing this, people owning land in the path of the advancing line will be tempted to hold out for a very high price—a price in excess of the opportunity cost of the land. (This is a problem of bilateral monopoly; see §3.8 infra.) Transaction costs will be high, land-acquisition costs high, and for both reasons the right-of-way company will have to raise the price of its services. The higher price will induce some consumers to shift to substitute services. Right-of-way companies will therefore have a smaller output; as a result they will need, and buy, less land than they would have bought at prices equal to the opportunity costs of the land. Higher land prices will also give the companies an incentive to substitute other inputs for some of the land they would have bought. As a result of all this, land that would have been more valuable to a right-of-way company than to its present owners will remain in its existing, less valuable uses, and this is inefficient. (What other inefficiency is created?) There are methods by which the right-of-way company may be able to negate the hold-up power of the landowners, as we shall see; but they are costly.

This analysis shows that the distinction between conflicting claims to a resource and conflicting or incompatible uses of resources is not fundamental. What is fundamental is the distinction between settings of low transaction costs and of high transaction costs. In the former, the law should require the parties to transact
in the market, which it can do by making the present owner's property right absolute (or nearly so), so that anyone who thinks the property worth more has to negotiate with the owner. But in settings of high transaction costs, people must be allowed to use the courts to shift resources to a more valuable use; the market is by definition unable to perform this function in those settings. This distinction is only imperfectly reflected in the law. While some government takings of land do occur in high-transaction-cost settings—taking land for a highway, or for an airport or military base that requires the assembly of a large number of contiguous parcels—many others do not (public schools, post offices; government office buildings).

In settings where transaction costs are low, the exercise of the eminent domain power is just a form of taxation; it taxes away subjective (what I called earlier idiosyncratic) values. It has this effect when transaction costs are high, too, because the government is required to compensate the owner only to the extent of the market value of the property, but in that setting it is an incident to an economically defensible use of the eminent domain power. Is it an efficient form of taxation? As we shall see in Chapter 17, the best tax is one that does not change the behavior of the people taxed; and since the exercise of the eminent domain power is difficult to predict, the eminent domain "tax" may be pretty good from this standpoint. But it is costly in another way. Unlike the usual tax, which takes a little bite out of many hides, the eminent domain "tax" takes a big bite out of a few. Subjective values associated with the ownership of a particular home could be a significant fraction of one's wealth, and its loss could not be insured against (why not?). For a person who is risk averse, as most of us are, the risk of losing a significant fraction of one's wealth will not be offset by the government's cost savings, even if those savings are passed on to the public in the form of lower taxes. The loss in utility to the risk-averse owner is a cost of the hypothetical eminent domain "tax" and could on balance make it inefficient. There would rarely be offsetting windfalls, since a person who values his property less than the market does will sell it rather than wait for the government to condemn it.

The Supreme Court's decision in the *Kelo* case raises the question whether it is ever proper for government to use the eminent domain power to take private property for transfer to another private entity, rather than keep it for some governmental use, such as a post office or an army base. The Fifth Amendment to the Constitution permits the government to take property only for a "public use." In *Kelo*, Pfizer, the pharmaceutical manufacturer, had decided to build a large research facility adjacent to a 90-acre stretch of downtown and waterfront property in New London. The city hoped that Pfizer's presence would attract other businesses to the neighborhood. The plaintiffs owned residential properties located on portions of the 90-acre tract that the city's redevelopment plan earmarked for office space and parking. It might have been impossible to develop those areas for these uses had the areas remained spotted with houses (the plaintiffs owned in the aggregate 15 houses in the 2 areas). The city called this the "spotted leopard" problem, and solved it by condemning the houses. But it did not defend its action by reference to the plaintiffs' hold-up power. (The analogy to condemnation by a right-of-way company is plain.) Instead it said that "the area [of the redevelopment project, a waterfront area in downtown New London, Connecticut] was sufficiently distressed to justify a

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program of economic rejuvenation.” But if “economic rejuvenation” is a public use, what is to prevent a city from condemning the homes of lower-middle-class families and giving them free of charge to multimillionaires, provided it could show that the new owners would be likely to pay enough for various local goods and services, and in property and other local taxes, to offset the expense of compensating the owners of the condemned properties at market value? In upholding the condemnation, the Supreme Court ignored the fact that private developers who want to assemble a large contiguous parcel of land are generally able to do so by employing “straw man” purchasers. The fact that it is difficult for government to operate with the secrecy required for the straw-man method to work is a bad argument for allowing government to use eminent domain on behalf of private developers rather than letting them fend for themselves.\(^5\)

A better argument for the Court’s result is that the more limitations that are placed on the private development of condemned land, the more active the government itself will become in development, and that would be inefficient. If the City of New London had built office space, parking, etc., on land condemned from private owners, a challenge based on the “public use” limitation would be unlikely to succeed — unless the Court strictly confined “public use” to hold-up situations and was prepared to try to determine, case by case, whether a genuine such situation existed.

A separate question from why eminent domain is why require compensation to the owner whose property is taken. Why not just let property owners insure the market value of their property against the risk of its being taken by eminent domain? That possibility undermines the argument that failure to compensate would demoralize condemnees or lead them to use resources less efficiently in the future, for example by always renting rather than buying property that might be condemned.\(^4\)

The risk of a taking (a risk measured by the cost of insurance against such a taking) would be reflected in lower property prices, so owners would be compensated.

Might the concern behind the requirement of just compensation be that the government might use the power of eminent domain to oppress its political enemies or vulnerable minority groups? Such conduct would violate the constitutional guarantees of free speech and equal protection of the laws, but those guarantees were not well developed in the eighteenth century, when the just-compensation clause was added to the Constitution as part of the Bill of Rights. Nor was insurance common.

What remains to justify the just-compensation requirement today is that without it government would have an incentive to substitute land for cheaper inputs. For that were, however, more expensive to the government. This assumes that it is impracticable for the government to seize, rather than to buy, the other inputs; clearly it would be impracticable to conscript labor without compensation, except in a slave state (or in the military—see below). Suppose the government has a choice between putting up a tall but narrow building on a small lot and a short but wide building on a large lot. The market value of the small lot is $1 million and of the

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4. As argued in Frank I. Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law, 80 Harv. L. Rev. 1165 (1967). Such insurance would be feasible. The government’s eminent domain takings vary less from year to year than the losses from earthquakes; and insurance can be bought against expropriation of property by foreign governments.
large lot $3 million. The tall narrow building would cost $10 million to build and the short wide one $9 million. The cheaper alternative from the standpoint of society as a whole is to build the tall building on the small lot (total cost: $11 million [$10 million + $1 million]) rather than the short building on the large lot ($12 million [$9 million + $3 million]). But if the land is free to the government, it will build the short building on the large lot, for then the net cost to it will be $1 million less ($10 million — $9 million). Of course, this assumes that the government makes its procurement decisions approximately as a private entrepreneur would do, that is, on the basis of private rather than social costs unless forced to take social costs into account. The assumption is realistic; government is highly sensitive to budgetary expense. Students of the military have long noted that a draft, by making labor inputs artificially cheap to the military, induces an excessive substitution of labor for capital in the military production function (see §17.2 infra). The same kind of distortion would occur in the use of land as an input into government services if there were no requirement of compensation for taking land.

The requirement of paying just compensation is not without problems. It entails higher taxes (or tax substitutes such as inflation or public debt) than if there were no such requirement; and taxes, as we shall see in Chapter 17, distort the allocation of resources. Also, just compensation in the legal sense is not full compensation in the economic sense. Yet full compensation might be a mistake even as subjective values could be determined accurately at low cost. It might induce overinvestment in property that the owner had reason to think was likely to be taken eventually by the government. The law tries to deal with this problem by denying compensation for any property improvements made after the announcement of the government’s intention to take the property. The problem is more serious, the more generous the minimum compensation deemed just.

A specific exclusion from the requirement of compensation that may make practical sense is the refusal to compensate for goodwill when business premises are taken. The problem is not measurement (though that is what the courts say it is) but uncertainty about whether the goodwill is really tied to the premises; if it can be transferred intact to other premises, it has not been taken with the land.

Difficult questions arise when market value is due in some sense to the government itself and the question is whether its contribution should be credited against the compensation due the owner. Suppose that in time of war the government requisitions a large fraction of the nation’s privately owned boats, and the tremendous reduction in the supply of boats to the private market causes the market price of the remaining boats, the ones that have not been requisitioned, to rise. Should the government have to pay the new market price for any further boats that it requisitions? If the answer is yes, the result is a capricious wealth distribution from taxpayers to boat owners. But answering no is problematic too; it will result in the government’s taking too many boats because it will not consider the competing needs of the remaining private boat users.

Should it make a difference whether the government requisitioned the boats from people who owned them before the market price began to rise, or from

5. Maybe they could be. Ancient Athens had a clever method of self-assessment of property for tax purposes: Anyone could force you to sell your property to him at your self-assessed valuation. Do you see any economic objections to such a system? A simple lower-bound measure of the total value (objective plus subjective) of property taken by eminent domain would be the author’s recent rejection of a bona fide offer at a price above the market price.

those who bought them from the previous owners at the current high price? This question brings out the administrative complexity of trying to base justcompensation law on an aversion to windfalls. Much, maybe most, of the property the government takes has benefited from government expenditures. A conspicuous example is land reclaimed from a lake or river by the Corps of Engineers (except in New Orleans!)—but all privately owned land benefits from public expenditures on maintaining law and order, a title-recording system, etc. The benefits may have been impounded in the price of the land long ago, however, so that payment of full compensation will confer no windfall on anyone. And why confiscate only condemnees’ windfalls?

It has been argued that if the just-compensation principle were founded on considerations of efficiency, then if the market value of my home fell by $10,000 as a result of some government regulation, I would be entitled to the same compensation as if the government had taken a corner of my property worth $10,000. But there are important economic differences between these cases. When a government regulation affecting property values is general in its application, as will normally be the case, the costs of compensation would be very high, especially if efforts were made, as in economic logic they should be (why?), to take account of people benefited by the regulation, by awarding them negative compensation (i.e., taxing away their windfalls). Imagine the difficulties involved in the government’s identifying, and then transacting with, everyone whose property values were raised or lowered by government regulation of the price of natural gas or heating oil. Moreover, a regulation, because it affects more people than a single taking, is more likely to mobilize effective political opposition. A political check is less likely even in the case of a random series of takings (as distinct from a single isolated taking), because the victims are less likely to constitute a homogenous group able effectively to mobilize for political action.

An additional consideration comes into play when the regulation affects interactive land uses. An example would be a zoning ordinance forbidding the development of land other than for residential use. Suppose such an ordinance is invoked to prevent a landowner from creating a pigsty on his land, the neighbors’ land being used exclusively for residential purposes. We cannot classify the ordinance as an infringement of the pig farmer’s property rights until we first decide that those rights include the right to harm one’s neighbors by means of a pigsty. And we cannot decide this prior question without evaluating the competing uses affected by the ordinance. Once that evaluation is made, however, and the property right assigned accordingly, no further economic function is served by forcing the gainers from the ordinance to compensate the losers.

The zoning case falls between the usual taking of land for a public use, in which just compensation must be paid, and the abatement of a nuisance, in which compensation need not be paid (for the excellent reason that to have to pay compensation for “taking” a nuisance would encourage the creation of nuisances). Consider the related example of statutes that empower the government to designate a building’s façade as a landmark; upon designation, the owner cannot alter the façade. An alternative to designation would be the purchase (possibly backed up by the threat of condemnation, subject to payment of just compensation) by the government of an easement in the façade. Does the government designate “too many” landmarks when the designation route rather than the purchase route is followed?

7. Bruce A. Ackerman, Private Property and the Constitution, ch. 6 (1977).
This is difficult to say. The fact that there is no compensation will cause designees to resist. The resistance of taxpayers might actually be less. Government tax-and-spend programs (agricultural subsidies, for example) are often as socially costly as regulatory programs, but the costs are spread so thinly over the taxpaying public that few taxpayers squawk.

Might the government, however, designate the “wrong” landmarks, that is, property that would be worth a lot more in an altered state? Possibly not, since the greater the alternative value the stronger the resistance to the designation. But there is a danger of reducing the supply of landmarks under the designation approach; building owners may rush to demolish potential landmark façades in advance of designation. Also, the social cost, as opposed to the financial cost to the government, of the designation route may be greater than if compensation is paid (why?).

The basic difficulty with compensation as the solution to the economic problems created by the government’s use of eminent domain is that the government is not an ordinary purchaser. It is meaningless to speak of making the government pay for the things it wants just like everybody else, when the government must resort to coercion to obtain the money it uses to pay for the things it wants. The money that the government uses to pay compensation comes from taxation, which is a taking of money without compensation.8

How well does just compensation work in practice? An empirical study of Chicago’s urban renewal program found that, under eminent domain, high-value parcels systematically receive more than fair market value and low-value parcels less.9 There are three reasons for this pattern. First, the government’s ability to vary its inputs of legal services according to the value of the parcel to be taken is severely limited by the regulations governing the prosecution of a condemnation case. The result is a tendency for the government to spend too much on the trial of a case involving a low-value parcel and too little on the trial of a case involving a high-value parcel. Second, the fixed costs of a trial are a larger share of total costs the less valuable the parcel; and their effect in encouraging plaintiffs to settle such cases cheaply is not completely offset by the government’s incentive to make generous settlement offers in order to avoid the fixed costs of litigation to it, because the government may be able to spread these costs over a number of parcels that it is seeking to acquire simultaneously. Third, there may be additional economies of scale for the government when the parcels that it is simultaneously acquiring are homogeneous. This permits effective consolidation of the government’s legal efforts—empirically, low-value parcels tend to be more homogeneous than high ones.