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EXPLORING THE KOZINSKI PARADOX: WHY IS MORE EFFICIENT REGULATION A TAKING OF PROPERTY?*

WILLIAM A. FISCHEL**

I. THE PARADOX OF EFFICIENCY IN *HALL V. CITY OF SANTA BARBARA*

Alex Kozinski is a Federal Judge for the Ninth Circuit Court of Appeals. He is among the Reagan judicial appointees who have been influenced by the law and economics movement. Unlike some others in the law and economics tradition, Kozinski retains a libertarian outlook on many issues. He has defended flag mutilation as a form of free speech both on the bench¹ and at gatherings of conservatives. At one of the latter, he dramatized his position by unfolding a flag he had obtained during a trip to his native Rumania. The Rumanian flag was defaced, its hammer-and-sickle center ripped out in protest during the revolution against the Communist Ceausescu regime.²

My text for this article is Judge Kozinski's 1986 opinion in *Hall v. City of Santa Barbara*.³ *Hall* held that a mobile home rent-control regulation could be a taking of property and hence require just compensation under the Fifth Amendment, seemingly contrary to a long line of precedents that have upheld rent control. The paradox to which the title of this article alludes appears in footnote 24 of the opinion.⁴

Citing economists of a variety of political persuasions (e.g., conservatives Alchian and Allen and liberals Nordhaus and Samuelson), Judge

* Revision of a draft presented at the Conference on Law and Economics of Local Government, University of Virginia Law School, Nov. 8-9, 1991, sponsored by the John M. Olin Foundation. The article was written while I was an Olin Fellow in Law and Economics at the Law School of the University of California at Berkeley. I wish to thank both the Foundation and the Law School for their support. My leave was supported in part by a Rockefeller Grant from Dartmouth College. Helpful comments on earlier drafts were received from Vicki Been, Richard Epstein, Daniel Farber, Saul Levmore, Edgar Olsen, Andrea Peterson, Daniel Rubinfeld, Joseph Sax, Stewart Sterk, and participants in seminars at Berkeley, Stanford, the University of British Columbia, and the University of Hawaii as well as the University of Virginia.

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1. See *McCalden v. California Library Ass'n*, 955 F.2d 1214, 1230 (9th Cir. 1992) (Kozinski, J., dissenting) ("The federal courts have a long and proud tradition of protecting the right of individuals with unpopular points of view to express themselves publicly even where this subjects onlookers to intense discomfort, even anger.") (citing *Texas v. Johnson*, 491 U.S. 397 (1989) (flag burning)).

2. Professor Daniel Rodriguez, who clerked for Judge Kozinski, told me this story.

3. 833 F.2d 1270 (9th Cir. 1986), *cert. denied*, 485 U.S. 940 (1988).

4. 833 F.2d at 1279 n.24.

Kozinski noted that the typical rent control ordinance creates inefficient incentives for tenants to overstay. Because tenants normally lose their right to a below-market rent when they move, they are apt to remain in their units longer than otherwise in order to have the advantage of low rents. The Santa Barbara mobile home rent control ordinance at issue in *Hall* cured such inefficient incentives because existing tenants could cash out future benefits when they moved. (The indirect method of the cash-out will be described presently.) In distinguishing Santa Barbara's ordinance from conventional rent control, Judge Kozinski noted that "the very fact of the inefficiency—that the tenant is not given too great a stake in the property—saves most rent control schemes from potential unconstitutionality. After all, efficiency would be maximized by giving the tenant a fee simple interest in the property."⁵

The paradox to be explored is why a judge versed in law and economics should regard improved efficiency as a reason to strike down a regulation as a taking. Note that this goes beyond what I believe most critics of law and economics would say about efficiency, that it is or should be irrelevant to judicial decisions.⁶ Judge Kozinski's dictum is used in this article to explain why inefficient regulatory transfers, as economists normally understand that term, should not usually be regarded as takings of property.

Conversely, it is argued here that certain efficient regulatory transfers,⁷ those that respond to the wishes of the majority of voters and

5. *Id.*

6. This position is taken most vigorously by the Critical Legal Studies school. See, e.g., Duncan Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387 (1981). One leading Crit, however, rationalizes normal rent control on the grounds that its inefficient inalienability serves the desirable goal of perpetuating a low income community in the face of gentrification. Mark Kelman, *On Democracy Bashing: A Skeptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement*, 74 VA. L. REV. 199, 271 (1988); see also William H. Simon, *Social Republican Property*, 38 UCLA L. REV. 1335, 1359-61 (1991). Neither Kelman nor Simon considers mobile home rent control of the type at issue in *Hall*, but presumably both would oppose it, since the ability of tenants to cash out their entitlement increases the original tenants' mobility and hence does nothing to perpetuate the original community and its communitarian values. Scholars who subscribe to the view that local politics especially advances communitarian values should be alarmed by the evidence that, when given the opportunity, prevailing local factions are inclined to take the money and run.

7. The term "regulatory transfer" is intended to exempt regulations that impose burdens proportionately among those who receive the benefits. The classic example is the zoning regulation imposed on people who have equal holdings of land to refrain from activities that may benefit one but devalue the property of others. Such zoning may be efficient if it is the least costly means of accomplishing mutually agreed upon goals. Robert Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines As Land Use Controls*, 40 U. CHI. L. REV. 681, 693 (1973). In many cases, however, zoning imposes burdens on one set of owners (e.g., owners of undeveloped land) to benefit another set of owners (e.g., owners of already-developed homes). WILLIAM A. FISCHER, *DO GROWTH CONTROLS MATTER?* 47 (1990). The type of ordinance considered in the present article is of the latter variety, in which there is a transfer of wealth from one group to another, but in which

which have little deadweight loss, are much stronger candidates for being regarded as takings. My position is not that inefficiency is desirable, but that in many contexts, inefficiency is evidence that political and economic processes are available to protect those burdened by excessive regulation, so that courts should not intervene on behalf of the aggrieved property owners. This approach finds jurisprudential virtue in two of the bugbears of economists, deadweight loss and special-interest legislation.⁸

Hall's footnote 24 is not a sport on Kozinski's part. I wrote to him about it on March 6, 1989. In his letter to me of March 20, 1989, he cited his opinion in another case in which he "espouses the advantages of inefficiency in running the government."⁹ I must add that this communication, our sole intellectual contact, should in no way suggest that Judge Kozinski agrees with what I have written here or elsewhere about the takings issue. Nor have I seen the efficiency dictum referred to in later opinions on rent control by Judge Kozinski.¹⁰

A brief description of my previous work on regulatory takings may help the reader grasp the thrust of my argument. Most of my economic research since the early 1970s has concerned government land use regulation, usually in an urban, local government context.¹¹ I came to the conclusion that the takings clause was an attractive means of disciplining the inefficient excesses of local government land use controls. With that in mind, I authored or coauthored several papers on economic aspects of the takings issue,¹² and I organized (with Richard Brooks) a conference

there is at least some color of public purpose. This article will not consider the question of the plausibility or efficiency of the public purpose.

8. I will proceed in this article on the pessimistic assumption that most state and federal regulations have much deadweight loss and are the product of special interest legislation. I half believe that, but the other half thinks that many regulations so characterized have subtle efficiency virtues and, more importantly, that a lot of regulatory legislation is passed by politicians who want to do good things for the general public. Among the reasons for my ambivalence is that it is empirically difficult to distinguish the special interest model from its supposed opposite, the public interest model. See Robert Plotnick, *Redistribution to the Poor: An Overheard Conversation*, 14 PUB. FIN. Q. 223 (1986). My reason for opting for what I suppose to be the pessimistic model in this article is that the main criticism of judicial laissez-faire comes from those who subscribe to the special interest model of politics. See, e.g., *infra* notes 85-86 and accompanying text.

9. Letter from Alex Kozinski, Judge, 9th Cir., to William A. Fischel, Professor of Economics, Dartmouth College (Mar. 20, 1989) (on file with author).

10. See *Sierra Lake Reserve v. City of Rocklin*, 938 F.2d 951 (9th Cir. 1991) (moving rent control cases into federal courts because the California courts had rejected the *Hall* possessory interest doctrine); *Azul Pacifico, Inc. v. City of Los Angeles*, 948 F.2d 575 (9th Cir. 1991) (upholding and providing guidelines for monetary damages to mobile home park owners who had sued under the *Hall* doctrine), *withdrawn*, 1992 U.S. App. LEXIS 17358 (9th Cir. 1992).

11. WILLIAM A. FISCHEL, *THE ECONOMICS OF ZONING LAWS* (1985), discusses takings in the zoning context in chapters 8 and 9.

12. William A. Fischel & Perry Shapiro, *Takings, Insurance and Michelman: Comments on Economic Interpretations of Just Compensation Law*, 17 J. LEGAL STUD. 269 (1988) [hereinafter Fischel & Shapiro, *Takings*]; William A. Fischel & Perry Shapiro, *A Constitutional Choice Model of*

of law and economics professors on the 1987 takings decisions.¹³ I also audited classes in property, contracts, constitutional law, and state and local government at Vermont Law School. Partly to get a first-hand look at local regulation, I volunteered to serve on a zoning board from 1987 until 1991.

My research and experience of the last five years have impressed me with the limitations of the judicial system as an economic policy maker. I have argued at some length, for example, that judge-ordered school finance reform in California had the unanticipated effect of triggering a major property tax revolt, which in turn has been detrimental to local government in general and education in particular.¹⁴ My growing skepticism of judicial capacity has caused me to reassess my 1985 position that takings jurisprudence offers much hope for relief from inefficient regulations.¹⁵ This essay is the beginning of that reassessment, which I plan to develop into a book in the next few years. (Having written one lengthy book, I know enough not to forecast when it will be published or even to hazard the eventual title.)

In my view, many acts by the government may qualify as takings of property, many more than courts of law should find to violate the Constitution. The point of this essay is not to describe what acts constitute regulatory takings. Professor Richard Epstein has undertaken the task,

Compensation for Takings, 9 INT'L REV. OF L. ECON. 115 (1989) [hereinafter Fischel & Shapiro, *Constitutional Choice Model*]; William A. Fischel, *The Economics of Land Use Exactions: A Property Rights Analysis*, 50 LAW & CONTEMP. PROBS. 101 (1987).

13. The conference papers were published as *The Jurisprudence of Takings*, 88 COLUM. L. REV. 1581 (1988), for which I wrote an introduction that summarizes my views, William A. Fischel, *Introduction: Utilitarian Balancing and Formalism in Takings*, 88 COLUM. L. REV. 1581 (1988).

14. See William A. Fischel, *Did Serrano Cause Proposition 13?*, 42 NAT'L TAX J. 465 (1989). To use the fiscal debacle caused by *Serrano* to condemn judicial activism in support of economic liberties may strike some readers to be as unfair as condemning the U.S. nuclear industry because of the Chernobyl disaster. *Serrano* was based on an application of the equal protection clause, not the takings or due process clause. See *Serrano v. Priest*, 487 P.2d 1241 (Cal. 1971). As Ralph Winter observed, however, *Serrano* was unconsciously in the tradition of economic due process, and he criticized it for that reason. Ralph Winter, *Poverty, Economic Equality, and the Equal Protection Clause*, 1972 SUP. CT. REV. 41, 58, 100-01. A theory that urges judges to broadly apply the takings clause cannot easily deny the same application of the equal protection clause.

15. My earlier discussions of takings law did express reservations about the capacity of judicial review. See FISCHEL, *supra* note 11, at 169. The present article offers what I hope are more convincing reasons for this skepticism as well as a perspective for deciding when judicial review is indispensable. The broader issue has been aired in an exchange between Richard Epstein and Antonin Scalia. Epstein urged active review, and Scalia wondered why public choice theorists, who are so skeptical of the motives of legislators, are so Pollyannish about judges. Richard A. Epstein, *Judicial Review: Reckoning on Two Kinds of Error*, in ECONOMIC LIBERTIES AND THE JUDICIARY (James A. Dorn & Henry G. Manne eds., 1987); Antonin Scalia, *Economic Affairs as Human Affairs*, in ECONOMIC LIBERTIES AND THE JUDICIARY, *supra*. Judge Alex Kozinski, writing a forward in the same volume, seems to support an intermediate position. See Alex Kozinski, *The Judiciary and the Constitution*, in ECONOMIC LIBERTIES AND THE JUDICIARY, *supra*.

and the list is enormous.¹⁶ The purpose of my essay is to ask when *judges* should invoke the takings clause and order the government to pay the party who is burdened. My perspective is that of an economist and social observer who regards judges as only a part, but a still necessary part, of the enterprise of protecting individuals from the excesses of the state. The Kozinski paradox illustrates one of those instances in which it is necessary for judges to act under the takings clause to forestall unfair behavior by the government.

Near the conclusion of his famous 1967 analysis of the takings issue, Frank Michelman pauses and notes that his analysis comes down to the "unamazing proposition that the true purpose of the just compensation rule is to forestall evils associated with unfair treatment"¹⁷ In her exhaustive 1990 analysis of the Supreme Court cases and legal commentary on takings jurisprudence in the decades since Michelman's article, Andrea Peterson distills nearly the same conclusion.¹⁸ The takings issue is about fairness. The question is how to make this "unamazing" principle operational. The present essay will show that economic inefficiency provides a means by which judges can identify a class of controversies in which fairness considerations demand that they, rather than political and economic processes, have to act to ensure fairness. I do not claim that this guide itself is a fairness test; Michelman's test is still the class in this area, and it will be reviewed presently. My claim is that the Kozinski paradox provides an important insight about where and when judges must act if the words of the takings clause are to mean anything at all.

A. *The Inefficiency of Rent Control and How Mobile Homes Are Different*

Although rent control is hardly a ubiquitous phenomenon in the United States, its adoption has increased in recent years,¹⁹ especially in

16. RICHARD A. EPSTEIN, *TAKINGS* (1985). He has since taken progressive income taxation off his list of actions that constitute takings. Richard A. Epstein, *Property, Speech, and Politics of Distrust*, 59 U. CHI. L. REV. 41, 43 (1992).

17. Frank I. Michelman, *Property, Utility and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1226 (1967).

18. "[T]he Justices evidently are deciding these cases according to their sense of when it is fair for the government to take something of economic value from a private party without paying for it." Andrea L. Peterson, *The Takings Clause: In Search of Underlying Principles Part II—Takings as Intentional Deprivations of Property Without Moral Justification*, 78 CAL. L. REV. 53, 162 (1990).

19. See Kenneth Baar, *Guidelines for Drafting Rent Control Laws: Lessons of a Decade*, 35 RUTGERS L. REV. 725 (1983). There is now a substantial literature by economists on conventional (meaning apartments, not mobile homes) rent control. Edgar Olsen is the economists' dean of these studies, in part because he lacks the partisanship that characterizes most commentators on rent control. Edgar O. Olsen, *An Econometric Analysis of Rent Control*, 80 J. POL. ECON. 93 (1972); Edgar O. Olsen, *What Do Economists Know about the Effect of Rent Control on Housing Maintenance*

California since the passage of Proposition 13 in 1978.²⁰ By 1988, more than a quarter of all rental units in California were covered by rent control.²¹ Among the tenants most successful in obtaining rent control regulations were residents of mobile home parks.²² By the middle 1980s, more than a third of all mobile home units in California were in mobile home parks subject to local rent control. Mobile home rent control presents different issues than most apartment rent controls because of the nature of the market.

Most mobile home coaches (as trailers and manufactured housing units will be referred to here) are purchased by their occupants, not rented. If the coach is brand new, it is usually transported to a rented "pad" in a mobile home park. The move to the park is usually the last time a coach is moved until it is scrapped. Immobility is especially obvious for the popular "double-wides," which are actually two units joined along their length. When owners of a coach in a mobile home park want to relocate their household, they usually sell the coach and move themselves and their furniture to a different housing unit, which may, of course, be a "stick-built" home or apartment. The coach stays in place, and its new owner moves in. The turnover in tenants of the mobile home park is referred to as a vacancy, even though the coach itself does not relocate.²³

One anxiety of tenants of mobile home parks is the possibility of

nance?, 1 J. REAL EST. FIN. & ECON. 295 (1988). Olsen was also a contributor to the excellent survey by the U.S. Department of Housing & Urban Development. U.S. DEP'T OF HOUS. AND URBAN DEV., REPORT TO CONGRESS ON RENT CONTROL (Sept. 1991).

20. W. DENNIS KEATING, RENT CONTROL IN CALIFORNIA: RESPONDING TO THE HOUSING CRISIS 3 (1983). Proposition 13 was said to have encouraged rent control because landlords did not reduce rents in response to the deep cuts in property taxes. An explanation more consistent with economic theory is that Proposition 13 reduced the cost of rent control to homeowners. One argument against rent control is that homeowners end up shouldering more of the property tax burden if apartments are devalued. This argument became less persuasive after Proposition 13 because homeowners' tax burdens essentially became fixed at one percent of 1975 or subsequent sale values. As a result, California homeowners became less opposed to tenant demands for rent control.

21. Studies of the experience of cities with moderate rent controls suggest that there is little distortion from controls that adjust regularly for inflation and permit vacancy decontrol. Michael Murray et al., *Analyzing Rent Control: The Case of Los Angeles*, 29 ECON. INQUIRY 601 (1991). An excellent study of the unusually stringent rent controls in Berkeley, California, demonstrates substantial reductions in the rental housing stock and on the value of remaining apartment building normally predicted by elementary economic theory. Michael St. John, *The Impact of Rent Control on Property Values* (1989) (unpublished Ph.D. dissertation, University of California, Berkeley).

22. On mobile home rent control and *Hall*, see Werner Z. Hirsch, *An Inquiry into the Effects of Mobile Home Park Rent Controls*, 24 J. URB. ECON. 212 (1988); Joel G. Hirsch & Werner Z. Hirsch, *Legal-Economic Analysis of Rent Controls in a Mobile Home Context: Placement Values and Vacancy Decontrols*, 35 UCLA L. REV. 399 (1988); Mary E. McAlister, *Hall v. City of Santa Barbara: A New Look at California Rent Controls and the Takings Clause*, 17 ECOLOGY L.Q. 179 (1990).

23. The separation of ownership of the structure from the land makes mobile home parks unusual but not unique. Many homes in Hawaii are owned by residents who have long-term leases on the land, as described in *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229 (1984). The Hawaiian land

eviction. Eviction imposes larger costs on mobile home tenants because they not only must find another place themselves, as would regular apartment dwellers, they may have to remove their coaches, too. Even neglecting the nonpecuniary costs of changing homes and neighborhoods, eviction looms larger for mobile home park tenants than for most other tenants. The value of a used mobile home detached from its site is much lower than those in place. (This may be because coaches are seldom moved until they are old, but it also reflects the moving costs and the value of an established tenancy even in the absence of government regulations.)

California responded to tenant-coach owners' concerns legislatively in the 1970s by adopting just-cause eviction laws that made it nearly impossible for a park owner to evict well-behaved tenants who pay their rent.²⁴ This by itself would not seem to be a burden on landlords, though, since they normally had little desire to get rid of good tenants who paid their rent regularly.²⁵ The landlord's position is changed, however, under rent control.

When real returns on apartment housing rentals are reduced by rent control, landlords have an incentive to reduce prior investment in housing as well as forgo future investment in rental housing. Withdrawing prior investment can be done by reducing maintenance of the unit or by converting it to alternative uses such as offices or condominiums. In response to this, both the state of California and local rent control jurisdictions have adopted habitability laws and other regulations designed to penalize undermaintenance,²⁶ and they have passed anti-conversion laws

leases also present rent-control problems. See *Richardson v. City & County of Honolulu*, 759 F. Supp. 1477 (D. Haw. 1991).

24. A wealth of legal sources on mobile home legislation has been created as a result of litigation subsequent to *Hall*. The U.S. Supreme Court has affirmed a California case that upheld mobile home rent control, including the retention of controls upon vacancy, explicitly rejecting the analogy of mobile-home rent control to physical invasion of *Hall*. *Yee v. City of Escondido*, 112 S. Ct. 1522 (1992), *aff'g* 274 Cal. Rptr. 551 (Ct. App. 1990) (discussed *infra* notes 115-32 and accompanying text). *Hall* and the California *Yee* opinion review the relevant state legislation, and for purposes of this article I will not list statutes except when one is specifically mentioned.

25. An important exception arises when park owners seek to change their land to another use. According to Paul Deffebach, Bay Area Regional Director for Local Government and Community Relations of the Western Mobilehome Association (which represents park owners), some landowners regarded the mobile home park as an interim land use, preferable to holding the land in its unimproved state until such time as a commercial development became profitable. Interview with Paul Deffebach (Dec. 16, 1991). Anti-eviction regulations have effectively frustrated the plans of many owners who, in retrospect, probably would have been better off leaving the land vacant. See also CALIFORNIA DEP'T OF HOUS. & COMMUNITY DEV., ORDINANCES AND LAWS REGULATING CHANGE OF USE OF MOBILEHOME PARKS (May 1987) (summarizing local ordinances, many of which require park owner to pay each tenant relocation fees and costs, as well as extensive and easily-challenged notice and procedural requirements).

26. The habitability and maintenance laws were adopted in part as common law changes rather

intended to stem the flow of rental units to other uses. Enforcement of maintenance and habitability laws is problematical for traditional apartments. For apartments, common areas are normally maintained by the owner, and remedies for an accumulation of minor infractions are hard to obtain. It is possible to get an order to fix broken plumbing, but seldom to paint the outside of the apartment, sweep the walks, or combat general dinginess. Laws that prevent the conversion of rental units to other uses can sometimes be evaded by the owner's reoccupying the unit himself or withdrawing it from the market by demolition. Landlords can also increase their rate of return under rent control by selecting what they regard as high quality tenants, or they can indulge in personal preferences that would be costly under normal market conditions. Harold Demsetz found that during wartime rent control in Chicago, overt racial discrimination appeared in newspaper ads for apartments, a practice that had previously been rare.²⁷

Another inefficiency remains even if the maintenance and anti- eviction police can do their job, or even if vacancy decontrol is permitted. Tenants are apt to hold onto rent controlled apartments too long. For example, parents may stay in a spacious apartment long after their children have left home and a smaller unit would be more appropriate. Tenants of rent-controlled apartments may be reluctant to take jobs in other places because it means giving up the advantages of rent control. This is true even if the other location has rent control, since the newcomer will have higher search costs or will have to pay finders' fees to locate a unit.

Mobile home parks are a different story. Santa Barbara and many other California communities adopted the panoply of rent control regulations for their mobile home parks. But the usual inefficiencies that accompany such regulations were greatly mitigated by the tenant's ownership of their coaches. It was primarily land rent, not capital returns, that was regulated. Of course, the landlord in this case had provided much capital, including utility connections and a road network, as well as the spot for the pad itself. But these required relatively little maintenance, and some routine maintenance could be done by the tenant coach-owners themselves.

A crucial feature of mobile home rent control is whether it has va-

than legislation, and they apply to all jurisdictions not just those with rent control. Edward H. Rabin, *The Revolution in Residential Landlord-Tenant Law: Causes and Consequences*, 69 CORNELL L. REV. 517, 521-27 (1984). "Failure to maintain" suits have been used extensively by California mobile home park tenants to prevent park owners subject to rent control from reducing services.

27. Reported by Walter Block in William A. Fischel, *Panel Discussion: Redistribution and Regulation of Housing*, 32 EMORY L.J. 767, 791 (1983).

cancy decontrol. If pad rents continue to be controlled after the coach is sold (recall that the coach remains on the pad), the buyer of the coach will continue to get the benefits of rent control. Because the buyers know this, they will be willing to pay more for coaches located in mobile home parks in communities that impose rent control without vacancy decontrol. Vacancy control thus enables sellers of coaches to capitalize the value of rent control in the sale of their coaches. For example, if the market rents for a mobile home pad would have been \$3000 per year, but regulated rents are only \$2000 per year for both the existing and future tenants, the capitalized value of the \$1000 subsidy will be incorporated in the price of the coach that the new tenant would pay for the coach.

The hypothetical \$1000 annual subsidy would be secure for future tenants, since only coach owners could select buyers, and park owners could not under California law deny occupation by any creditworthy prospective tenant. Unlike the owners of apartment buildings who could repossess rent-controlled units for their own use, an exception that is usually allowed under anti-eviction statutes, the park owners would not have the option of occupying the coaches for themselves, since the coaches were the property of their occupants. (Park owners could, of course, purchase the coaches when they came up for sale, but they would then have to pay for the capitalized value of rent control on their own land.)

Capitalization of the future benefits of rent control in coach sales would depend both on how much rents were held below market values and on buyers' estimates of how long rents would remain low under the law. Rents were permitted to increase under Santa Barbara's ordinance by the greater of three percent or three-quarters of the rise in the Consumer Price Index. Thus if inflation were zero, in a few years the park owners could charge market rents, though the permitted increase would probably be reduced if inflation fell that much.²⁸ Upon vacancy, the park owner could also raise rents by ten percent. (Recall that "vacancy" in the mobile home park context usually means sale of the coach in place; it does not require removal of the coach as an eviction usually would.) Further rent increases were allowed only by arbitration. Each of these concessions to the landlord would reduce the capitalization of rent controls in coaches.

We do not have to speculate about capitalization, though. In a coin-

28. Los Angeles rent control had in the 1970s permitted a maximum of 7.6 percent rent increases for apartments. When inflation dipped below 7.6 percent in the 1980s, the Los Angeles city council reduced the allowable increases to the rate of inflation. Murray et al., *supra* note 21, at 624.

cidence of economic research with legal action, UCLA Economics Professor Werner Hirsch and his son, attorney Joel Hirsch, were undertaking a study of the effect of California mobile home rent controls on the price of coaches at the very time that *Hall v. City of Santa Barbara* was being litigated.²⁹ Hirsch and Hirsch estimated by regression analysis that the value of coaches sold in rent-controlled communities was one-third higher than that of coaches sold in other communities. (Most other communities that had mobile home rent controls had the same features as that of Santa Barbara, the most important being that pad rents did not return to market rates when a vacancy occurred.) It was clear that a large fraction of the rental value of the land had been transferred to the owners of the coach by the combination of local rent control (including especially the absence of vacancy decontrol) and state and local laws that prevented park owners from selecting succeeding tenants or otherwise controlling the use of their pads.

Because of the transferability of rent control (by not permitting vacancy decontrol or park owner repossession), some of the major inefficiencies that plague rent control in stick-built apartments were substantially mitigated. Owners of mobile home coaches had incentives to perform maintenance to make their units more saleable, so the most visible and depreciable capital in the park would not become unduly run down under rent control. Coach owners did not suffer the lock-in effect that rent control imposes on tenants of most apartments. They had no incentive to remain in their units once jobs or family situations had changed, since they could take the financial benefit of rent control with them in the form of a lump sum payment from the buyer of their coach. It is the latter efficiency improvement that Judge Kozinski noted as emblematic of the unconstitutional takings aspect of the ordinance.

I originally suspected that this is an instance in which rent control might create overmaintenance of the units. Tenant coach-owners in rent-controlled parks might overmaintain their coaches to make them last longer if, when the unit was worn out, it had to be replaced and the park owner could then repossess the literally vacant space. I had underestimated the creativeness of the mobile home tenants' lobby. State legislation prevents a park owner from interfering with tenants' ability to replace their coaches. This law in conjunction with other tenant rights laws effectively permits tenants to market the value of their low-rent leaseholds even if they have run-down coaches. In an instance cited by Judge Kozinski's opinion in a later mobile home takings case, a new ten-

29. Hirsch, *supra* note 22, at 213; Hirsch & Hirsch, *supra* note 22, at 400.

ant reported that she paid \$77,000 for a coach in a Los Angeles mobile home park.³⁰ She sold the old coach for \$5000 to someone who would remove it and installed a new unit, candidly explaining that she paid mainly for the value of the space.

Other inefficiencies, however, persisted under mobile home rent control. The number of new mobile home parks opened in California dropped precipitously after mobile home rent control became widespread in the early 1980s.³¹ But that drop would probably have occurred even under milder forms of rent control in which there was no capitalization. As Professor Avinash Dixit argues in a recent issue of the *Journal of Political Economy*, commitment of resources into an irreversible investment requires an above-average rate of return, and the required rate of return increases substantially as the probability of a legal ceiling being imposed increases.³²

The important point of Dixit's article for the present issue is that *any* rate of return below market rates will discourage entry. According to Dixit's model, entry into the mobile home park business would have been deterred even without the capitalization of rent control in the coach market. Thus the long-run inefficiencies of rent control are not worsened by Santa Barbara's ordinance, and several of the short-run inefficiencies are mitigated by it. Moreover, the lack of new parks was mitigated by California state legislation in 1980 and 1981 that limited the ability of local governments to restrict placement of mobile homes on foundations in regular residential zones.³³ In such instances, the coach owner is also the land owner, and none of the rent control issues applies. The only obvious efficiency problem is that new owners must now pay for both land and capital costs, and the higher down payment may deter some potential residents, especially if banks are reluctant to accept as security the capitalized value of rent control.

30. *Azul Pacifico, Inc. v. City of Los Angeles*, 948 F.2d 575, 578 (9th Cir. 1991), *withdrawn*, 1992 U.S. App. LEXIS 17358 (9th Cir. 1992).

31. Hirsch & Hirsch, *supra* note 22, at 463; CALIFORNIA DEP'T OF HOUS. & COMMUNITY DEV., MOBILEHOME PARKS IN CALIFORNIA: A SURVEY OF MOBILEHOME PARK OWNERS 4 (Feb. 1986) [hereinafter OWNER SURVEY].

32. Avinash K. Dixit, *Irreversible Investment with Price Ceilings*, 99 J. POL. ECON. 541 (1991).

33. These are described in CALIFORNIA DEP'T OF HOUS. & COMMUNITY DEV., LOCAL GOVERNMENT MOBILEHOME AND MOBILEHOME PARK POLICIES IN CALIFORNIA: A SURVEY OF CITY AND COUNTY PLANNING DIRECTORS (June 1986) [hereinafter PLANNERS SURVEY]. The survey indicated general compliance with the law that local zoning not impede placement of mobile homes in general residential districts (CAL. GOV'T CODE §§ 65852.3, .7 (Deering 1992)). A law passed in 1989 implicitly conceded the supply retardation effects of rent control by disallowing rent control on new mobile home parks built in California. CAL. CIV. CODE §§ 798.45, .7 (Deering 1992). The effect of this law will depend on whether potential park developers believe it will not be changed to their detriment sometime in the future.

The Pareto-superiority criterion for efficiency requires that someone be made better off and no one else be made worse off by a proposed policy. Adoption of rent control itself does not meet that criterion, since landlords are almost always made worse off. The efficiency superiority of mobile home rent control is solely in comparison to rent control of regular apartments. In regular apartment rent control, the owner's rate of return is diminished, and the tenant gets lower rents. But because she has no market in which to sell her right to a low-rent apartment, the tenant's advantage is gradually diminished. (I assume that subletting is illegal, as it normally is in conventional rent control, and that it is costly to evade the law.) The sitting tenant forgoes a job in another city, she forgoes an apartment in a better neighborhood, all to keep the low-rent apartment.

Now plug the same set of controls into the mobile home case, and we see that the landlord (in this case, the mobile home park owner) is, on the assumption that both rent-control ordinances are equally durable,³⁴ no worse off than his counterpart in the apartment house business, while his tenant is better off: she can capitalize the value of rent control when she sells the coach. If the coach owner wants to take a job elsewhere or move to another park, she can in effect take her rent control with her, since she can sell her old coach at a higher value. It is in this comparative sense that mobile home rent control represents an efficiency gain over the same regulations applied to apartment-house rent control.

The legal basis for Judge Kozinski's decision was not formally based on the efficiency criterion. Instead, he argued that the combined effect of the state and local regulations was to transfer a possessory interest from park owner to coach owner. This new possessory interest constituted a permanent physical invasion of the park owner's property, which is almost always a *per se* taking under the *Loretto* test.³⁵ As I indicated above, this characterization is plausible. Under the web of state and local regulations, a park owner has no reasonable expectation of ever being able to occupy the pads in his park without the leave of his tenants. This does not mean that the park owner is bereft of any economic value from his land; he still is entitled to the controlled rent, and this stream is valuable. Hence Judge Kozinski did not base his decision on loss of value,

34. The qualification about equal durability is necessary because, as I argue below, efficient rent control is apt to last longer than inefficient rent control. Because of this, the apartment landlord is apt to feel less demoralized about his loss than the mobile home park owner. See *infra* note 56 and accompanying text for a discussion of demoralization costs.

35. See *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), discussed *infra* notes 108-14 and accompanying text. See also my discussion of "regulation chopping" *infra* text accompanying notes 124-28, which indicates the importance of Kozinski's looking at the entire effect of the web of regulation rather than at each regulation by itself.

since loss of some value as the result of regulation is usually not by itself regarded as a compensable taking.

The two other judges on the panel hearing the *Hall* appeal agreed with Kozinski, and the Ninth Circuit declined to set up a nine-judge en banc rehearing of the case.³⁶ The dissent to the decision not to rehear *Hall* en banc pointed out that the holding goes against almost all precedents regarding rent control in that circuit as well as those of the U.S. Supreme Court.³⁷ The reasoning closest to that in *Hall* was a dissent by Chief Justice Rehnquist from a decision not to grant certiorari to a Cambridge, Massachusetts, rent control/just-cause eviction appeal.³⁸ Justice Rehnquist sought to extend the physical invasion standard to what is regarded by the state court as a noncompensable regulation.

The physical invasion/regulation distinction is venerable in takings jurisprudence. It supposedly creates a bright-line test for determining the sufficient conditions for a compensable taking of property. The government lays a finger on your land (or causes someone else to), and it has to pay. "Mere" regulation, however, is not usually a taking unless the value of the property is reduced to zero, and even then some regulations will be upheld.³⁹ While courts ritually invoke Justice Holmes's words in *Pennsylvania Coal* to the effect that a regulation that "goes too far" requires compensation,⁴⁰ few display much inclination to actually award compensation.

B. *Kozinski's Paradox and Economic Policy*

This section has two related objectives in exploring Kozinski's paradox. The first is to show that the paradox does not necessarily arise from the cashing out of regulations, even rent control regulations. Second, I show by reference to the economics of taxation that the paradox is not simply about transferring land rents; lots of land rent could be trans-

36. *Hall v. City of Santa Barbara*, 813 F.2d 198, 209 (9th Cir. 1987).

37. 813 F.2d at 209 (Schroder, J., dissenting). One other circuit had relied on the *Hall* reasoning to hold a New Jersey community's mobile home rent control a taking without just compensation. *Pinewood Estates v. Barnegat Township Leveling Bd.*, 898 F.2d 347, 354-55 (3d Cir. 1990).

38. *Fresh Pond Shopping Center v. Callahan*, 464 U.S. 875 (1983). Massachusetts courts had previously upheld a Cambridge ordinance that prevented an owner from evicting a tenant in order to occupy it himself. *Flynn v. Cambridge*, 418 N.E.2d 335 (Mass. 1981).

39. I do not here explore the conditions in which a regulation might be regarded as a taking except to note that the landowner has a severe legal burden to overcome to collect damages, a burden almost as severe as that in which the government must bear to argue that a physical invasion does not require compensation. For a review of the current state of U.S. Supreme Court doctrine on this, see Peterson, *supra* note 18. A recent takings case, *Lucas v. South Carolina Coastal Council*, discussed *infra* at text accompanying notes 133-38, discusses the conditions under which regulations that leave property with no economic use must be compensated.

40. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

ferred from the private to the public sector without invoking a taking. In the following section, I show that the paradoxical efficiency reason for invoking the takings clause in *Hall* is consistent with Frank Michelman's utilitarian-economic theory of when compensation should be paid.

1. Cashing Out Regulations

As I noted in the first section of this article, my research on land use controls has led me to the conclusion that they are inefficiently restrictive. One road to efficiency is to apply the takings clause more vigorously to local regulations. But even this remedy would leave in place many zoning regulations of dubious efficiency, and an additional remedy is necessary. The second half of my proposed cure for zoning's excesses is to take a cue from Professor Coase and acknowledge that local governments possess such entitlements and promote free trade in zoning. To be specific, let communities, or, as Robert Nelson suggests, neighborhoods, sell exceptions to zoning restrictions that they collectively value less than developers.⁴¹ The analogous method for dealing with rent control is to permit tenants to sell the right to decontrol their apartments. Fungible rent control is in fact advanced by economist Michael Wolkoff without apparent concern over its constitutionality.⁴²

The problem that Kozinski's paradox presents to the foregoing policies is that the clear efficiency gain from the exchange seems to suggest that cashing out regulations itself is a taking. This would surely be the case if the regulation were passed solely for the purpose of raising revenue by selling exceptions to it.⁴³ There are two ways to deter such opportunism. One would be to more closely scrutinize police power regulations on a "harm-prevention" standard.⁴⁴ If we were confident that all regulations were legitimate, we would have little reason to object if the government decided to endure some harms in exchange for cash. (If this seems crass, think of the uses of the cash to reduce some other harm that can-

41. ROBERT NELSON, ZONING AND PROPERTY RIGHTS 21 (1977).

42. See Michael Wolkoff, *Property Rights to Rent Regulated Apartments: A Path Towards Decontrol*, 9 J. POL. ANALYSIS & MGMT. 260 (1990). I have argued elsewhere that the *Nollan* decision's insistence on a "nexus" between a regulation's stated purpose and its actual impact makes trade more difficult. See Fischel, *supra* note 13 (commenting on the 1987 takings decisions, including *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987)). Kozinski's paradox is, I argue in the present article, more insightful as to the source of anxiety about uncompensated regulatory transfers of wealth than Justice Scalia's nexus test.

43. The anxiety about such opportunistic use of regulation is explored in Stewart Sterk, *Nollan, Henry George, and Exactions*, 88 COLUM. L. REV. 1731 (1988).

44. For an explication of a modern version of the harm-prevention standard, see Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385, 405 (1977).

not be prevented by regulation, such as providing schools to reduce illiteracy.)

The other way to forestall opportunism is to require the government to wait a long time before accepting cash for rescinding the regulation. Those who would benefit from the money would be removed by time from those who adopted the regulation. The case for cashing out by negotiation New York City's rent controls, which were the object of Michael Wolkoff's proposal, is more compelling because New York has had rent controls continuously for more than fifty years. Whatever the rationale for adopting and maintaining rent controls, it cannot have been simply as a scheme by which the city could raise money.⁴⁵

The primary difference between California mobile home tenants and New York City apartment tenants is that mobile home regulation is relatively new, and its constitutionality was unsettled from the beginning. Although city attorneys might have regarded California's state constitutional holdings as providing security for almost any rent-control regulation, the federal courts' decisions were more problematical. Because of the youth of such regulations, devices that cash them out, such as in the market for coaches, are automatically suspect, especially if the beneficiaries are identical to those who urged passage of the regulation.

2. Taxation and Rent Transfer

To explore another aspect of Kozinski's paradox, consider another situation in which land rents are transferred efficiently. The economic theory of efficient taxation requires that taxes be levied in such a way that private economic behavior is not altered. This does not mean that an efficient tax is a painless tax. It still transfers resources from an individual's control to the government's control, often to the considerable disappointment of the individual. (Cartoon depicting one prosperous eighteenth century American saying to another, "You know, taxation *with* representation isn't so great, either.")

The classic example of the efficient tax is a tax on land rent. This insight was the basis for Henry George's single-tax movement.⁴⁶ George's idea lives on in modern optimal tax theory, which attempts a

45. The newness of the regulation may distinguish the *Municipal Art Society* case, in which the New York courts overturned a deal by the city to give a developer more favorable zoning in exchange for the builder's paying a higher price for the city's land. *Municipal Art Society v. City of New York*, 522 N.Y.S.2d 800 (Sup. Ct. 1987). See Jerold Kayden, *Zoning for Dollars: New Rules for an Old Game? Comments on the Municipal Art Society and Nollan Cases*, 39 WASH. U. J. URB. & CONTEMP. L. 3 (1991).

46. See HENRY GEORGE, *PROGRESS AND POVERTY* (1879).

kind of second-best Georgist rule by, roughly speaking, taxing commodities in proportion to how inelastic their demand or supply schedules are.⁴⁷ George's land tax has also been applied to urban economics to show that it is the optimal tax for an urban area.⁴⁸ If we take Kozinski's paradox literally, a lot of economic policy would be in trouble.

An obvious and important difference between land taxes and Santa Barbara's mobile home regulation is that, in most instances, taxes apply to a large number of people, while mobile home rent control requires a very small number of persons to bear its burden. Had the city taxed the land rents of every resident to subsidize the well-being of mobile home coach owners, we would be much less upset about the policy, even though the source of revenue was land rent. It seems also a good deal less likely that the ordinance would have passed, although there is no reason for a judge to presume this.

The obvious reason why we economists believe there is a difference between Santa Barbara's mobile home rent control scheme and an efficient tax is that the burden is spread out more under the tax, so no individual feels quite as bad. But this challenges our utilitarian calculus. If we didn't like a tax of amount X when one person of population N bears it, why should we prefer it when the amount is written $(X/N)N$?

One response is the declining marginal utility of income and its corollary, risk aversion.⁴⁹ If people are risk averse, then, *ceteris paribus*, tax burdens should be spread more widely. We could frame this as a choice between a lottery as to who provides X versus a uniform assessment of each person of X/N to pay for X .

But risk aversion does not, I submit, cover all of the cases in which we would think that the mobile home park rent transfer is economically questionable. To get at this, assume that the Halls are risk neutral, or that they have had an opportunity to spread their assets enough to self insure, or even that they purchased insurance from a third party not worried about moral hazard and adverse selection. Even in this case, I submit, there is a case against imposing the burden on the Halls. What I want to argue in the following section is that the Kozinski paradox

47. RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 291 (5th ed. 1989).

48. The modern progenitor of the "Henry George theorem" is Joseph E. Stiglitz, *The Theory of Local Public Goods*, in *ECONOMICS OF PUBLIC SERVICES* (Martin S. Feldstein & Robert P. Inman eds., 1977).

49. On risk aversion as a reason for compensation, see Lawrence Blume & Daniel Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 *CAL. L. REV.* 569 (1984). An economic model that generates a just compensation rule without risk aversion is Fischel & Shapiro, *Constitutional Choice Model*, *supra* note 12.

points to a type of cost often neglected by economists. There is a good reason for the neglect, of course, since most economic policies, such as taxation and most national regulations, spread their burdens widely if not evenly.

To further motivate this inquiry, I report the results of a presentation I made in 1987 at the National Tax Association's Committee on Local Nonproperty Taxation. (This committee covers all local taxes except the property tax.) Attending were about twenty practitioners and scholars of public finance. I presented evidence that many communities were using land use exactions to finance local expenditures that were only distantly related to the project that occasioned the exaction. I argued that exactions could at least in principle be efficient insofar as they represented increments to land value from rezoning the property.⁵⁰ The Committee members seemed to grasp the logic of this argument.

They didn't like it at all. Even when I pointed out the similarity of such exactions to a land tax, with which most were comfortable in principle, no one in the room regarded this as an improvement in public finance. This leads me to believe that economists do not themselves accept a version of efficiency that takes no account of distributional fairness. Rather than just say that fairness is something economists don't have to think about, I want to argue here that fairness can be integrated into economics. This will not require a great adjustment in economic analysis, since most economic policies still involve situations in which the question of concentrated individual burdens does not arise. But integration of fairness into the notion of efficiency will help evaluate the regulatory takings question.

C. *Michelman's Two Demoralization Costs and Land Rent Transfers*

Frank Michelman's article⁵¹ is twenty-five years old and, if citations are any indication, still highly influential.⁵² I recapitulate some of its analysis here because I have noticed that being widely-cited does not necessarily mean that it is widely read. I should also point out that the utilitarian balancing approach that Michelman articulated has, even when it is not patently misunderstood, most often been invoked to buttress the

50. The argument is presented in Fischel, *supra* note 12. I had presented the same argument to groups of lawyers and of planners, who had the same reaction as the economists and tax experts, but I attributed their negative reaction partly to not grasping the efficiency of a tax on land rent.

51. Michelman, *supra* note 17.

52. It is the eighth most cited law journal article on any subject. Fred R. Shapiro, *The Most Cited Law Review Articles*, 73 CAL. L. REV. 1540, 1550 (1985).

finding of no compensation in regulatory takings litigation.⁵³

Michelmann's utilitarian approach to takings is in form very much like the simple economic rule of public investment. For any given project, minimize the net costs. Michelmann's principal variation is that he thought of a type of cost that economists and others still have a hard time grasping. I will explain the formula first, because it is so easy, and then the nature of the peculiar cost term.

Any public measure, whether it is construction of a highway or adoption of a zoning regulation, will create some benefits, B , and require some inputs, whose cost is C . For highways, the inputs are land, labor and capital, and they are normally paid without a second thought. For a regulation, the chief "input" is the opportunity cost of the resources that are either withheld from alternative uses or compelled to be supplied by the regulation.

If the government decided to go through with a project, Michelmann's working assumption was that $B > C$, no more than that. It was not necessarily the best project, but it was not irrational, either. His heuristic focus for the just compensation question was not on forcing the government to calculate immediate benefits and costs correctly, but to see why a "rational" government should actually pay the costs once they became apparent.⁵⁴ This led to defining and then choosing the lesser of two different costs.

The first of the two is settlement costs, S . These are simply all the costs that the government endures if it does decide to pay C (or, one presumes, any fraction of C). S does not include the dollar value of C itself, an exclusion that has confused generations of readers, including at one time this author. Settlement costs are rather all of the bad things that happen if the government *does* decide to pay.

One obvious interpretation of S is the transaction cost of making the payment: the agency must identify who is eligible for the payment, winnow out those who are not, negotiate with owners, try an eminent domain case if negotiations fail, do the paper work of authorizing payment, and transfer whatever legal titles are required. The deadweight loss of additional taxes needed to finance the compensation should also be in-

53. The opinion most consciously derived from Michelmann is *Penn Cent. Transp. v. City of New York*, 438 U.S. 104 (1978), which invoked his "investment backed expectations" phrase to help determine whether the city's preventing the use of air rights over Grand Central Terminal was a taking. It was held not to be. *Id.* at 138.

54. *But see* Saul Levmore, *Takings, Torts, and Special Interests*, 77 VA. L. REV. 1333 (1991), in which he cautions against the risk of political forces shifting private activities to the government if the government is not required to compensate. *See also* Louis De Alessi, *Implications of Property Rights for Government Investment Choices*, 59 AM. ECON. REV. 13 (1969).

cluded in S , though the amount of tax revenue itself would not, since that is itself equal to C plus other kinds of S for which direct cash outlays are necessary. (Deadweight loss of taxation is the value of product sacrificed by the private sector that the public sector is unable to appropriate for itself.)

A less obvious component of settlement costs, recently pointed out by several economists, is the moral hazard implicit in paying just compensation.⁵⁵ If compensation is always made for roads, landowners are apt to not account for the impending taking and erect buildings that will shortly have to be demolished. Such wasted investment is socially costly, and a rational government would want to take it into account in deciding on compensation rules.

Settlement costs include some subtleties, but their nature is at least familiar to the tribe that brandishes the term "cost" most often. The other side of Michelman's utilitarian calculus is demoralization cost, which contains two aspects, one of which is less familiar to economists. Demoralization costs are all of the bad things that occur when the government chooses not to compensate. To complete the formula before exploring the nature of demoralization, the utilitarian (and economic) rule is for the government to endure the lesser of settlement costs and demoralization costs. If the social costs of not paying (=demoralization) are greater than the social costs of paying (=settlement), then pay. If demoralization costs are low and settlement costs are high, don't pay.

What are the bad consequences, the demoralization costs, of not paying? An obvious one is that if government does not pay for resources it appropriates, people in the future will be reluctant to expose their resources to the risk of being appropriated by the government. A common scenario is that a record of not compensating will cut investment, since investors will add the risk of uncompensated expropriation (including cost increases due to uncompensated regulations) to the natural deterrents to committing resources for future use.⁵⁶

This is a close calculation, since, as previously mentioned, one does not want property owners to risk too much investment, lest it be wasted when the government does take it.⁵⁷ Moreover, under the invasion/regu-

55. Lawrence Blume, et al., *The Taking of Land: When Should Compensation Be Paid?*, 99 Q.J. ECON. 71 (1984); Robert Cooter, *Unity in Tort, Contract and Property: The Model of Precaution*, 73 CAL. L. REV. 1 (1985). The moral hazard principle was cited by Justice Stevens in dissent in *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2922 n.5 (1992) (citing Daniel Farber, *Economic Analysis and Just Compensation*, 12 INT'L REV. L. & ECON. 125 (1992)).

56. Michelman, *supra* note 17, at 1214-18.

57. See William Fisher, *The Significance of Public Perceptions of the Takings Doctrine*, 88 COLUM. L. REV. 1774, 1779 n.25 (1988).

lation distinction, too *much* investment might occur if landowners anticipate adoption of more restrictive regulations. They may rush to complete buildings they otherwise would have waited to do, knowing that once they are complete they are usually safe from uncompensated removal. Thus the better term for the result of this kind of demoralization cost is "suboptimal" investment rather than "too little" investment.

While economists are comfortable with the suboptimal investment scenario, another component of demoralization cost is less familiar to them. This component is the disutility arising from having your property taken by someone else, even if your economic behavior is unaltered by the taking. Such disutility is the feeling of being had, analogous to the incremental disutility of having a possession stolen rather than simply losing it. It is what makes the question of just compensation different from the question of damages for accidents.⁵⁸ Such unfairness demoralization is the essence of the problem in *Hall*, since, as I have argued, the mobile home park owners' economic behavior is not significantly altered by Santa Barbara's rent control ordinance.

There is an incongruity of the "unfairness" aspect of demoralization costs with economic theory as it is usually applied in a policy context. The "disinvestment" aspect of demoralization costs is clearly identified with economic inefficiency. But the unfairness aspect of demoralization is invisible. Behavior of the victim is not changed. This is not to say that I think that the behavior of plaintiffs in *Hall* was not changed by the ordinance. It is only that this particular rent regulation induced much less inefficient behavioral changes than other rent control laws, or other regulations in general. *Hall* thus becomes a loose paradigm of the pure unfairness aspect of demoralization cost.

I emphasize the difference between the two types of demoralization costs because it is important to my theory of an appropriate judicial role in enforcing the takings clause. The *disinvestment* aspect of demoralization reduces future production and so imposes a cost on some other people. *If* those on whom the cost falls have some influence on the question of whether to compensate or not, something is apt to be done to mitigate the economic consequences. The anticipation of this possibility reduces the unfairness aspect of demoralization cost. Shirking, after all, is one response to the taking of one's labor without sufficient compensation, as Vietnam-era draftees knew and the U.S. government eventually

58. Michelman is explicit about the difference between a taking by the government and the loss of something by accident, the latter having been addressed by Calabresi's economic analysis of tort law. Michelman, *supra* note 17, at 1169 n.5 and 1216-17. The accident/taking distinction is explained in Fischel & Shapiro, *Takings*, *supra* note 12, at 282.

learned.⁵⁹

The inability of governments to deal with shirking and other manifestations of elastic supply such as emigration is one reason that governments everywhere usually compensate people for their labor services. But when no shirking is possible so that the lost production aspect is nil, I submit that the unfairness aspect of demoralization is actually increased. This is one interpretation of why surveys consistently find that people regard price increases during periods of extraordinary demand increases as unfair.⁶⁰ The short-run demand curve is nearly vertical so that there is virtually no opportunity to avoid the price increase.

It is the unavoidability of pure land rent transfers that forms one of two necessary conditions for judicial intervention in my analysis. Demoralization costs that reduce current or future production are more likely to be subject to legislative correction, since some rational group of people will perceive that this is a bad idea and sooner or later form a coalition to defeat or at least mitigate the cause of their misery. (This assumes the second necessary condition, which I discuss in more detail later, that those who bear the burden of lost production have meaningful access to the political process that makes the decision.)

It is important to recall that Michelman described his settlement and demoralization cost framework as a general rule, not one that necessarily compelled courts to act. It is consistent with his framework to ask when a judge should compel compensation, and when the logic of utilitarian calculus is sufficient to compel a government to offer compensation (which may be implicit or in-kind) without the prod of a judicial decision. The pure rent transfer coupled with a political process that affords no hope of relief is a taking that only an independent judiciary can cure.

The distinction that I draw here is similar to that which Michelman drew between the confidence that the political process operates as a "fairness machine," whose self-interested structural characteristics assure fairness, and the lack of such confidence, which requires a "fairness discipline" extrinsic to the political process.⁶¹ This interpretation of

59. P. J. O'ROURKE, *GIVE WAR A CHANCE* 215 (1991), remarked on the upbeat, highly motivated attitude of (professional) U.S. troops during the Persian Gulf war, in distinct contrast to the (mostly conscripted) soldiers who served in Vietnam.

60. Daniel Kahneman et al., *Fairness as a Constraint on Profit Seeking*, 76 *AM. ECON. REV.* 728 (1986). In a letter to me, Daniel Farber added two examples of direct conflict between efficiency and fairness: the English poll tax and monopoly price discrimination. Both are more efficient than their alternatives (general property taxes and nondiscriminating monopoly, respectively), but both are despised all the more for their efficiency. Letter from Daniel Farber to William A. Fischel (Apr. 17, 1992) (on file with author).

61. Michelman, *supra* note 17, at 1246.

Michelman's article resolves a much misunderstood comment in it. Michelman said that the takings question often should be resolved by parties other than judges, which, I submit, will normally be the case for demoralizations that give rise to visible inefficiency borne by the electorate.

My contribution to the question of reliance on the "fairness machine" is that its operation is less likely to work at the local government level. Local government involves less log rolling and less deliberation than state or national governments.⁶² Local governments typically have only a single legislative chamber, of which the executive is either an integral part or a civil-service agent. The three political examinations—lower house, upper house, and executive—that a measure must get at the federal level and in all states except Nebraska are collapsed into one at the local level.

The discipline that local governments are apt to respond to is the threat of relocation to more favorable jurisdictions. Thus excessive local regulation of portable assets is largely self-restraining. But the crucial aspect of this mechanism is that the asset be removable.⁶³ The economic consequences of higher prices, local inconvenience, and lost jobs are not present for locally determined redistributions of land rent or of assets made immobile by regulation. This is why the "efficient" mobile home regulation of *Hall* fails Michelman's utilitarian test and why courts must exert the fairness discipline in such instances.

Pure rent capture does not, I should add, necessarily give rise to the unfairness aspect of demoralization cost. It might be reduced by moral education. My friend Nic Tideman has long been dedicated to the principles of Henry George, and he consistently advances the moral case against private ownership of natural resources.⁶⁴ To the extent that people are persuaded by this, a transfer of pure land rent, which derives from a natural resource, will not be regarded as demoralizing. A great deal of

62. This is a matter of political theory, and other situations may be argued to require a fairness discipline. Perhaps a most dramatic instance occurs when the Endangered Species Act imposes substantial burdens on only a few landowners. Here the level of government is national, so that when a large number of landowners and sympathizers are burdened, as in the spotted owl controversy, there is an impetus to a political settlement. When only a small group of landowners is affected, though, a fairness discipline may be necessary even when the regulations are adopted by the national government. See Geoffrey Harrison, *The Endangered Species Act and Ursine Usurpations: A Grizzly Tale of Two Takings*, 58 U. CHI. L. REV. 1101 (1991).

63. The immobility of assets at the local level is the key to an innovative theory of takings advanced in a preliminary manuscript by attorney George B. Wyeth. George B. Wyeth, *Takings and Exploitation* (unpublished manuscript, on file with author).

64. See, e.g., Nicolaus Tideman, *Takings, Moral Evolution, and Justice*, 88 COLUM. L. REV. 1714 (1988).

environmental education seems to be an attempt to convince people that ownership of many natural resources ought not to be privately appropriated. To the extent that these social movements succeed, forced transfers are less demoralizing. But it must be clear that this new consciousness does not arise simply because public officials assert that that is how people should feel. The best test is that normal people do not in fact object to land rent transfers, a proposition apparently denied by the volume of litigation on the takings issue even when the prospect of financial gain by the plaintiff seems slim.

I have in this section suggested that there is a difference between demoralization costs that manifest themselves as suboptimal investment and those that result in feelings of being unfairly put upon. I suggested that the unfairness form of demoralization is the one appropriate for judges to focus on. For many people, this will seem too narrow. Rent control for regular housing gives rise to demoralization costs of the more familiar disinvestment incentives and suboptimal tenures. Why shouldn't this be called a taking, too?

Now, it may be that Judge Kozinski would like to find the ordinary rent control ordinance a taking, too, as Professor Epstein does.⁶⁵ I would also like to discourage rent control, but I am a little more reluctant to suggest that judges do so. The reason is that the disinvestment aspect of regular rent control along with the political participation mitigation of fairness costs sows the seeds to get rid of or to substantially mitigate rent control without the help of judges. I think that judges normally ought not to hold that a regulatory transfer is a taking unless the regulation is too efficient (i.e., it is a transfer of pure rents), and it is adopted outside of the give-and-take of pluralistic politics. This derives from my view of the role of judges in constitutional theory, and so I must digress to that subject.

D. Exit and Voice as Protectors of Constitutional Liberty

I take as given the idea that the takings clause was adopted, in John Hart Ely's words, as "yet another protection of the few against the many."⁶⁶ Evidence that this idea retains its appeal is the succinct and often quoted statement by Justice Hugo Black that

The Fifth Amendment's guarantee . . . [is] designed to bar Govern-

65. Richard A. Epstein, *Rent Control and the Theory of Efficient Regulation*, 54 BROOK. L. REV. 741, 758 (1988) ("Hall reaches the right result because all rent controls are unconstitutional, not because this statute is worse than others.").

66. JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW* 97 (1980).

ment from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.⁶⁷

As I mentioned in the first section, academic writers have often noted the importance of fairness in broadly explaining takings doctrines.

Revealed preference for the vitality of this idea is that at least half of the state constitutions strengthened the language of their takings clauses in the late nineteenth century. This was a popular reaction to compensation practices by the railroads, which were granted the power of eminent domain by the states. Railroad developers would often take part of a parcel of land and point out in court that the remaining property had risen in value, thereby often reducing "just compensation" to zero.⁶⁸ Even though this practice may actually have been efficiency enhancing in many cases (amounting to a "windfalls for wipeouts" arrangement proposed by the late Don Hagman⁶⁹), the perceived unfairness of a burden on particular individuals made it unacceptable in the long run.⁷⁰

Richard Epstein has argued in his 1985 book, *Takings*, that the takings clause requires the courts to overrule a great deal of regulation at all levels of government. Rent control, most zoning, the NLRB, and minimum wages would all fall to the judicial ax. Epstein's book has been harshly criticized by other scholars because they regard the result of a libertarian system as a plutocratic rule by the rich.⁷¹ This criticism seems to overlook the extent to which the existing knot of regulation that Epstein would cut preserves the privileges of the affluent against the onslaught of unfettered capitalism. Suburban exclusionary zoning comes to mind.⁷²

67. *Armstrong v. United States*, 364 U.S. 40, 49 (1960), *quoted in* *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 835 n.4 (1987) (Scalia, J.); *see also* *San Diego Gas & Elec. Co. v. City of San Diego*, 450 U.S. 621, 656 (1981) (Brennan, J., dissenting).

68. Harry Scheiber, *Property Law, Expropriation and Resource Allocation by Government, 1789-1910*, in *AMERICAN LAW AND CONSTITUTIONAL ORDER: HISTORICAL PERSPECTIVES* 132, 140 (Lawrence M. Friedman & Harry N. Scheiber eds., 1988).

69. Donald G. Hagman, *Compensable Regulations*, in *WINDFALLS FOR WIPEOUTS* (Donald G. Hagman & Dean Miszczynski eds., 1978).

70. The unfairness was not that the landowner was worse off than before, but that he was worse off relative to his neighbors, who gained from the public project without any loss at all. This is explained in *Prudential Ins. v. Central Nebraska Pub. Power & Irrigation Dist.*, 296 N.W. 752 (Neb. 1941).

71. *See, e.g.*, Thomas Grey, *The Malthusian Constitution*, 41 U. MIAMI L. REV. 21, 47 (1986).

72. For some reason, exclusionary zoning fails to come to Frank Michelman's mind when he defends deferential judicial review of takings as allowing a desirable means of redistributing income. *See* Frank L. Michelman, *Liberties, Fair Values, and Constitutional Method*, 59 U. CHI. L. REV. 91, 99-105 (1992). Michelman was responding to Epstein's revision of his original theory, which disallowed the welfare state entirely. EPSTEIN, *supra* note 16, at 281. The revised Epstein would allow systematic redistributions of income from rich to poor under the Takings Clause, but only if financed by general taxation. *See* Epstein, *supra* note 16, at 43, which further advances judicial activism on behalf of property by analogy to judicial activism on behalf of the First Amendment.

My problem with Epstein's remedy is that I hesitate to assign to the courts such an encompassing role in enforcing the takings clause. It is not just the limited capacities of judges that disturbs me, though that is surely important in an operational sense. The more fundamental reason is my belief that in the long run, democratic political processes are firmer guarantees of individual freedoms, including economic freedoms, than any intellectual apparatus imposed upon them.

Perhaps what convinced me most of this was the prescient forecast by the Marxist economist, John Roemer, in 1980. John was a colleague when I was visiting the University of California at Davis in that academic year. He is a highly respected economic theorist and a personally dedicated Marxist, a rare combination even back then. At a department seminar, Roemer was asked what he thought of the Soviet-required suppression of the Solidarity movement in Poland that was going on at the time. He said something to the effect that it was unfortunately necessary to tolerate such oppressive moves to preserve the long-run evolutionary path of socialism. After all, he said, if they bring back democracy, they'll bring back capitalism.

They did, and they did.

My more immediate task is to explain why judicial review of most economic regulations adopted in a democratic society should not be held by judges to require just compensation and why a few others should. A theory of takings has to fit into a more general theory of constitutional interpretation. For this purpose, I subscribe to the general approach of John Hart Ely's "process" theory.⁷³ Its key to the interpretation of the "open-ended" clauses, such as the due process and takings clauses, is that courts should inquire as to whether the democratic process is functioning properly. Constitutional courts are thus most concerned with enfranchisement, voting rules, and discrimination against "discrete and insular minorities," to borrow Justice Stone's famous phrase from footnote four of *Caroline Products*, who are easily discounted in some democratic processes.⁷⁴

The scholarly criticism of Ely's work has pointed out that there are many substantive parts of the Constitution, so a process theory is incomplete.⁷⁵ Whatever the validity of such criticism—it does not seem to me

73. ELY, *supra* note 66. An especially able and appealing defense of Ely's approach is Michael J. Klarman, *The Puzzling Resistance to Political Process Theory*, 77 VA. L. REV. 747 (1991).

74. *United States v. Carolene Products*, 304 U.S. 144, 152 n.4 (1938).

75. See, e.g., Laurence H. Tribe, *The Puzzling Persistence of Process-Based Constitutional Theories*, 89 YALE L.J. 1063 (1980). Tribe invoked the takings clause in passing as an example of substantive rights guaranteed by the Constitution. *Id.* at 1065.

that process theory denies the explicit substantive values. The major Constitutional issues have been about clauses like the takings clause that are in fact open to interpretation. The definitions of property, taking, just compensation, and public use are all matters that leave more than a little latitude for disagreement. A related criticism by Professor Paul Brest emphasizes the difficulty a process theory has in selecting which categories require protection from procedural defects.⁷⁶ Is that not a substantive question?

My employment of Ely's approach for takings analysis suffers less from Brest's objection because there is a standard by which victims of democratic excess can be identified: they are a minority⁷⁷ in a jurisdiction in which the usual minoritarian political protections are attenuated—that is, they are subject to local governments or to politically insulated special commissions, and they possess assets whose regulation cannot be escaped by moving them to other jurisdictions or other employments. Moreover, the remedy to be followed does not require that judges actually substitute their policies for those of elected officials. The government can continue its policies as long as it pays. The takings clause is a right to a remedy—just compensation—not a substantive right to noninterference by the government.

The appeal of Ely's approach is that it regards the Supreme Court as one of several institutions that protect constitutional liberty. The existence of three separate branches of government, the pluralistic nature of politics, and the difficulty of granting effect to laws that constrain liberty in a nation in which people can move about are at least as important guarantors of liberty as the pronouncements of judges. Legal centralism—the assumption that legal rules determine conduct—is as questionable a source of Constitutional liberty as Robert Ellickson found it was in

76. Paul Brest, *The Substance of Process*, 42 OHIO ST. L.J. 131 (1981). In a similar vein, Justice Lewis Powell asked how courts are to know what substantive outcome would have been achieved had the "discrete and insular" group not been effectively disfranchised. See Lewis Powell, *Carolene Products Revisited*, 82 COLUM. L. REV. 1087 (1982).

77. The special minority protection of Ely's theory and *Carolene's* Footnote Four troubles both Ely and Klarman because of the "burglar exception": burglars are a despised minority, but surely the Constitution should not protect them. ELY, *supra* note 66, at 154; Klarman, *supra* note 73, at 787. I would define a minority that is "discrete and insular" to be one whose condition is effectively immutable in order to avoid this difficulty and to get to the heart of Footnote Four's distinction. Burglars can refrain from stealing, and penalties on burgling are designed to deter potential thieves, not extract a tax from them. (Indeed, in the absence of any penalties, burglars might not be a minority.) Race, on the other hand, is an immutable characteristic. Ancestry, national origin, and, for the most part, religion, are also, to use the economist's term, almost perfectly inelastic in supply. Possessing XY chromosomes is, too, but, as Ely points out, it does not make women a political minority in need of special judicial protection after suffrage. ELY, *supra* note 66, at 164-70.

establishing order among rural neighbors in Shasta County, California.⁷⁸

Because of this, an economical judiciary—one that rationally responds to its limited ability to analyze issues and enforce its results—will want to use its resources where they will do the most good. Making sure that people can in fact move from one jurisdiction to another is one example, since mobility facilitates liberty by making it difficult for one jurisdiction to reap the fruits of oppression. Assuring that political participation is open to all is another low-cost, highly effective means of assuring that governments will respond to citizens. It is not a coincidence that these help assure the viability of Albert Hirschman's "exit and voice" modes of individual response to conflict in political, social, and economic organizations.⁷⁹

My view that the court is only one member of a broad set of protections for constitutional liberties makes me agree that the 1937 court revolution that *Carolene Products* epitomized was correct in abandoning close review of business regulation.⁸⁰ Businesses can normally protect themselves through the political process and by the self-help remedy of relocation and reallocation.⁸¹ At the state level, most businesses can threaten to exit, a threat that might even be credible at the national level for some firms.⁸² (The term exit includes downsizing and other elastic supply responses, not just physically leaving the jurisdiction.)

That self-protective activities in the political arena are called by the pejorative term "rent seeking" by public choice theorists is not persuasive.⁸³ Unless the critics of rent seeking have in mind a world that lacks transaction costs as a comparison, the relevant question is whether imposition of judicial review is apt to reduce the sum of error and transaction costs. My view of the analytical capacity of judges (discussed in a later

78. ROBERT ELLICKSON, *ORDER WITHOUT LAW* (1991) (describing cattle fencing and trespass disputes resolved efficiently without reference to the law).

79. ALBERT O. HIRSCHMAN, *EXIT, VOICE AND LOYALTY* (1970). Hirschman is actually ambivalent about the threat of exit in disciplining bad governments, recognizing that it may impede redistribution of wealth. Albert O. Hirschman, *Exit, Voice and the State*, 31 *WORLD POL.* 90 (1978).

80. *See, e.g., United States v. Carolene Products*, 304 U.S. 144 (1938).

81. Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 *Q.J. ECON.* 371 (1983), presents an optimistic view of the economic outcomes of pluralistic politics, in conscious contrast to majority-rule systems.

82. Economists have assembled evidence that taxes and regulations do indeed affect business location, implying that relocation is not an empty threat. *See* Robert Newman & Dennis Sullivan, *Econometric Analysis of Business Tax Impacts on Industrial Location: Who Do We Know, and How Do We Know It?*, 23 *J. URB. ECON.* 215 (1988).

83. Gordon Tullock, *The Welfare Cost of Tariffs, Monopolies, and Theft*, 5 *W. ECON. J.* 224 (1967), is the seminal work on rent seeking. A tongue-in-cheek review of estimates of its impact by a sympathizer is William R. Dougan, *The Cost of Rent Seeking: Is GNP Negative?*, 99 *J. POL. ECON.* 660 (1991).

section of this essay) and the inventiveness of lawyers (which needs no discussion) leads me to doubt it.

What of that parade of economic regulatory horrors that almost anyone can throw out in retort? My reluctance to advocate aggressive judicial action to correct them is that in a democracy, people learn chiefly by experience. Experience is not the only teacher, but it is usually the most convincing, and it is always more convincing than judicial pronouncements. The effects of farm price supports, wage and price controls, airline regulation, minimum wage laws, and conventional rent controls cannot be appreciated without some experience with them or at least observing someone else's experience with them.⁸⁴ Critics of regulation have eagerly pointed out the evils of excessive state control as the veils of socialism have dropped around the world. As a more prosaic example, the nonsensical special interest legislation upheld in *Carolene Products* has long since been vitiated, even before we learned that "filled" milk is probably more wholesome as well as cheaper than the real thing.⁸⁵

The reference to Professor Miller's study of *Carolene Products* is ironic because he and many other law and economics scholars have argued that the real problem with economic legislation is that it responds to a minority of special interests to the detriment of the majority.⁸⁶ This has led several commentators to advocate closer judicial scrutiny of special interest legislation. Bruce Ackerman has written that "[o]ther things being equal, 'discreteness and insularity' will normally be a source of enormous bargaining advantage, not disadvantage, for a group engaged in pluralist American politics."⁸⁷

84. As an example, Berkeley economist Michael Teitz, who has consulted frequently on rent control, told me in conversation that Los Angeles rent control advocates cannot convince the city council to engage in truly stringent rent control. Los Angeles council members look at the rancor of neighboring Santa Monica, which is one of the few California cities with rigorous rent controls, and always step back from the abyss. In a similar vein, the San Francisco Examiner editorialized against an initiative that would have made that city's rent control ordinance more stringent by holding up nearby Berkeley as a bad example of what would happen under stringent rent control. *No on Vacancy Control*, S.F. EXAMINER, Oct. 27, 1991, at A16:1. The voters apparently agreed, and the vacancy control initiative was defeated.

85. Geoffrey P. Miller, *The True Story of Carolene Products*, 1987 SUP. CT. REV. 397, 419-20.

86. See, e.g., RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 495 (2d ed. 1977); Carol Rose, *The Ancient Constitution vs. the Federalist Empire: Anti-Federalism from the Attack on "Monarchism" to Modern Localism*, 84 NW. U. L. REV. 74 (1989); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 3 (1971).

87. Bruce A. Ackerman, *Beyond Carolene Products*, 98 HARV. L. REV. 713, 723-24 (1985) (emphasis added). See also Peter Aronson, *Calhoun's Constitutional Economics*, 2 CONST. POL. ECON. 31 (1991). Ackerman's thesis is criticized on grounds other than those in the text by Daniel Farber & Philip Fricky, *Is Carolene Products Dead? Reflections on Affirmative Action and the Dynamics of Civil Rights Legislation*, 79 CAL. L. REV. 685, 701-08 (1991), and Einer Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 YALE L.J. 31 (1991).

I italicized the last condition because, regardless of the overall merits of Ackerman's thesis, its premise applies only where there is pluralistic politics, not majoritarian politics. Local governments, particularly the suburbs and small cities, are not governed by special interest politics. Robert Ellickson regards suburban growth controls as the product of the majoritarian factionalism that Madison worried about in the Tenth Federalist.⁸⁸ Economists' empirical studies of local government spending and taxing indicate that the median voter (i.e., majority rule) model, not the special interest (i.e., pluralist) model, works best.⁸⁹

The *Hall* case is a paradigm of effective majoritarianism. Santa Barbara's mobile home rent control was a regulatory transfer that was more efficient and more responsive to the will of a majority than most other regulations adopted at the state level. It is precisely because the local transfer had so little deadweight loss and because it responded to majority preferences to the detriment of a clearly defined minority, mobile home park owners, that its unfairness costs are so high. Lack of deadweight loss means that no other voters except personal sympathizers with the mobile home park owners felt any ill effects of the regulation. The usual majoritarian or, as economists say it, median voter dominance of local politics makes it clear that any hope of political influence to recoup some reciprocal gains in the future would be vain. The Halls were victims of the success of a parochial democracy.⁹⁰

When we economists condemn the absurd system of farm subsidies,

88. Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385, 405 (1977). See also FISCHER, *supra* note 11, at 209; Note, *City Government in the State Courts*, 78 HARV. L. REV. 1596, 1597 (1965).

89. See Thomas E. Borcherding & Robert Deacon, *The Demand for the Services of Non-Federal Governments: An Econometric Approach to Collective Choice*, 62 AM. ECON. REV. 891 (1972); Randall G. Holcombe, *The Median Voter Model in Public Choice Theory*, 61 PUB. CHOICE 115 (1989); Robert P. Inman, *Testing Political Economy's "As If" Proposition: Is the Median Income Voter Really Decisive?*, 33 PUB. CHOICE 45 (1979). I should not leave the impression that this topic is entirely settled among economists. Thomas Romer & Howard Rosenthal, *The Elusive Median Voter*, 12 J. PUB. ECON. 143 (1979), question the evidence, but they do not distinguish between large and small units of government or present empirical evidence. Evidence that the median voter model works best for small units of government (suburbs and small cities rather than central cities) is in Douglas Holtz-Eakin & Harvey S. Rosen, *The "Rationality" of Municipal Capital Spending: Evidence from New Jersey*, 19 REGIONAL SCI. & URB. ECON. 517 (1989); see also Howard S. Bloom & Helen Ladd, *Property Tax Revaluation and Tax Levy Growth*, 11 J. URB. ECON. 73 (1982).

90. A similar argument is advanced by Saul Levmore, *Just Compensation and Just Politics*, 22 CONN. L. REV. 285, 309 (1990). He argues that logrolling generally assures that benefits and burdens are spread out, so that compensation is required only when "majorities may mistreat minorities." For a similar view, see Daniel A. Farber, *Economic Analysis and Just Compensation: An Anti-Discrimination Theory of Takings*, 12 INT'L REV. L. & ECON. 125 (1992). The difference in our views is that Levmore and Farber make no distinction between small local governments and large state and national governments. They thus regard landlords as effective a political force as tenants so that no compensation is required. Nor does Levmore identify deadweight loss as a factor in disciplining excessive regulation.

for example, we should recall that a true majority rule vote might leave us, at least temporarily, with farm-price ceilings, whose shortage effects would be even worse than the present system. Direct democracy⁹¹ at the state or national level could involve costs similar to the majoritarian excesses that induced the anxieties that gave rise to the U.S. Constitutional Convention. It is worth remembering that James Madison sought to lodge power in a "large republic" to offset the excesses of smaller governments.⁹²

It is true that the states under the Articles of Confederation were what Madison had in mind as small republics. But most states at the time were not much larger in population than present day medium sized cities, and several states now exceed the population of the U.S. in 1790.⁹³ The quintessential small republics of today are the suburbs and small cities. That special interest, rather than majoritarian, legislation is most common in the present states and the national government is a tribute to the success of Madison's design to guard against government by majoritarian factions, not an indicator of its failure.

E. Mobile Home Rent Control and Politics

Because my analysis hinges on the majoritarian character of local rather than state government, the reader may ask at this point whether California's mobile home rent control statutes are purely local government phenomena. The answer is no. At the most general level, all local regulation can be superseded by state regulation. Although rent control was regarded by the California courts as an inherent property of local police powers,⁹⁴ it is clear that the state legislature can overrule its localities. For example, shortly after the city of Berkeley adopted commercial rent control, the legislature banned such regulation statewide.⁹⁵ At a

91. For a critique of judicial deference to initiatives and referenda as the equal of legislative enactments at the state level, see Julian Eule, *Judicial Review of Direct Democracy*, 99 YALE L.J. 1503 (1990). Eule does not treat takings in this context, but I would have courts look more critically at regulations adopted by initiative than by other means. FISCHER, *supra* note 11, at 222-23.

92. THE FEDERALIST NOS. 10, 51 (James Madison). Cass Sunstein, *Interest Groups in American Public Law*, 38 STAN. L. REV. 29, 40-45 (1985), points this out, but neglects the issue of local regulation. Thomas Merrill, in a largely sympathetic review of Epstein's *Takings*, adverts to the "large republic" defense of property, but notes in passing that this does not help with most local land use regulations. Thomas W. Merrill, *Rent Seeking and the Compensation Principle*, 80 NW. U. L. REV. 1561, 1590 (1986).

93. Half the states in 1790 had fewer than 100,000 people. U.S. population was about 4 million in 1790, about the size of present-day Washington State or Maryland. The two largest states in 1790 were Virginia, 692,000, and Pennsylvania, 434,000.

94. *Birkinfeld v. City of Berkeley*, 550 P.2d 1001, 1023 (Cal. 1976).

95. 1987 Cal. Stat. ch. 824, § 2 (codified at CAL. CIV. CODE § 1954.27 (Deering 1992)). A federal judge had, prior to the legislature's sweeping action, found that Berkeley's statute violated the Contract Clause and, under an analysis that relied heavily on *Hall*, possibly also the Takings

more particular level, it is clear that several strands of the web of mobile home rent regulation are created by the state legislature. The anti- eviction laws are products of the state legislature, while the decisions to adopt rent control and permit or deny vacancy decontrol are left to local governments.

My investigation into the politics of mobile home rent control revealed that there are two opposing lobbying organizations that operate both at the state and the local level.⁹⁶ The Western Mobilehome Association (WMA) represents park owners,⁹⁷ and the Golden State Mobilhome Owners League (GSMOL) is an organization of tenant-coach owners. (Among their differences is the way they spell mobile home.) GSMOL has been instrumental in adopting the state enabling legislation and local rent controls, and WMA has combatted GSMOL consistently on these issues. Given this situation, it seems to be a closer question as to whether park owners are truly the victims of majoritarian legislation, or whether they are just the current losers in the pluralistic, logrolling politics that surely characterizes the legislature of a large state like California. If the latter characterization is more apt, my normative model would offer a weaker case for judicial intervention on behalf of park owners.

The tenants' organization, GSMOL, has about 200,000 members,⁹⁸ while WMA has only about 2000.⁹⁹ But the theory of public choice tells us that counting voters does not dispose of the issue, since politicians respond to monetary support as well as votes. If WMA owners spend more than the GSMOL to influence legislation (which both sides seem to concede), they should sometimes prevail even when directly opposed by GSMOL. The apparent reasons for WMA's failure to do so on the criti-

Clause. *Ross v. City of Berkeley*, 655 F. Supp. 820, 836-41 (N.D. Cal. 1987). The legal victory by owners may have taken the wind out of the sails of commercial rent control advocates, so the legislative victory by landlords cannot be taken as unambiguous evidence that commercial landlords can protect their assets solely through the political process.

96. My knowledge of the politics of this issue is largely from interviews with Paul Deffebach, Regional Director for Local Government and Community Relations of the Western Mobilehome Association (WMA), San Mateo, California, and Gerry McLeish, of the firm of Craig and Biddle, Sacramento, which represents WMA in Sacramento. I have also perused a year's issues of the monthly newspaper of the Golden State Mobilhome Owners League, *THE CALIFORNIAN*, which gives detailed accounts of GSMOL's legislative activities.

97. A small group of park owners is represented by the Mobile Home Park Owners Alliance, which apparently split from WMA, but which largely works in concert with it.

98. Brief of Golden State Mobilhome Owners League, Inc., National Foundation of Manufactured Homeowners, and Designated Mobilhome Owners Associations as Amici Curiae in Support of Respondent at 1, *Yee v. City of Escondido*, 112 S. Ct. 1522 (1992) (No. 90-1947). The pro-tenant policies are presumably favored by many mobile home park tenants who do not belong to the GSMOL.

99. Brief of Amicus Curiae of Western Mobilehome Association in Support of Petitioners at 1, *Yee v. City of Escondido*, 112 S. Ct. 1522 (1992) (No. 90-1947).

cal issue of rent control, however, are instructive.¹⁰⁰

Mobile home parks are not randomly distributed across the state. Some places have a large number of them, and tenants constitute a large voting block in such districts. One such district is Escondido, represented in the state senate by Bill Craven. Mr. Craven is a Republican whose voting record receives large approval ratings by the state chamber of commerce and developer organizations. Mr. Craven has been, however, the author of numerous mobile home tenant protection bills. The reason is simple: there are more than 10,000 mobile home coaches in his district, and their owners make it clear to him, through GSMOL, how they think he should vote.

That GSMOL even exists seems unusual; the free-rider problem of tenants' organizations would seem to work against it. But mobile home coach owners are easier to organize than other tenants. Unlike most apartment tenants, they have a long-run financial stake in legislation, since they own their coaches. Mobile home owners are also a more homogenous group; most are white retired people who are conservative on most issues.¹⁰¹ They live in close-knit neighborhoods and meet in park community activities, and they have plenty of time to devote to politics.

One might think that the park owners, the WMA, would have some allies in other industry groups, such as apartment owners, realtors, developers, and mobile home manufacturers, to combat GSMOL on an issue as important as rent control at the state level. While there is a loose alliance in Sacramento called the "shelter group," mobile home park owners are easily carved out of it. When the shelter group sought (unsuccessfully) statewide legislation eliminating all forms of rent control, mobile homes were quickly eliminated as an exception to the proposed rule. The reason was that GSMOL quickly objected and it became apparent that the legislation could not move forward unless an exception were made for mobile homes, permitting localities to adopt rent control as before. Because of the distinctiveness of the market, the usual line-drawing distinctions that would arise, say, between owners of small apartment houses and large units did not arise. It became easy for other members of

100. That GSMOL almost always wins against the WMA on rent control and tenant-rights issues is proclaimed by GSMOL in its newspaper. *WMA Must Really be Worried*, THE CALIFORNIAN (Golden State Mobilhome Owners League, Inc., Garden Grove, Cal.), Apr. 1991, at 4. This was confirmed orally to me in separate interviews with Paul Deffebach and Gerry McLeish, who, as paid lobbyists for WMA, have little incentive to understate the political success of the organization.

101. I cannot help observing that the frequent claim that these retired people live on a "fixed income" cannot be true in the usual sense of fixed income, which refers to nominal incomes. Social Security undoubtedly forms most of their retirement income, and Social Security has for years been indexed to keep up with inflation.

the forces opposed to rent control to set the mobile home park owners adrift.

Realtors, apartment house owners, and developers of other housing often have interests contrary to that of park owners. For realtors, the relative efficiency of the regulatory transfer makes some of them favorably disposed towards mobile home rent control. A realtor's commission on selling a coach is enhanced if the sale price also includes the discounted value of rent control. Developers and owners of conventional apartments are perhaps more wary of the naked transfer effected by mobile home rent control, but, after all, mobile home parks are low-cost competitors for their products, and they may secretly be pleased to see park expansion stymied. None of the briefs for the park owners in the *Yee* appeal to the United States Supreme Court was joined by apartment owners, developers, or realtors. The tenants' organization, GSMOL, appears to have isolated its opponent at the state level in much the same way that it succeeds at the local level.¹⁰²

GSMOL's success is not just the result of clever politics; it is as much the result of the nature of the mobile home park market. The subjection of park owners to majoritarian preferences at the local level is the result of their political isolation at the state level. This isolation would not amount to much if the park owners could vote with their feet or otherwise withdraw from the market, but the transfer of land rent effected by the web of regulations prevents that as well. Hence the theory of regulatory takings advanced in this article, which limits judicial intervention to instances in which the political and economic markets offer no hope of respite, supports the *Hall* decision and Judge Kozinski's paradox of efficiency.

The immobility of land also makes me skeptical of Vicki Been's otherwise convincing articulation of the "exit/voice" model for not supervising local land use exactions.¹⁰³ She correctly notes that developers can choose among jurisdictions, so that if one community imposes exactions that unreasonably increase developers' costs, they will head for other places. In support of Professor Been's approach, I note that it is not a coincidence that local governments seldom attempt to regulate the price of groceries, an issue surely as important to their constituents as housing prices. Even if grocers are caught entirely by surprise by such a regulation, the immediate threat will be to suspend business in the juris-

102. WMA Amicus Brief at 8, *Yee* (No. 90-1947), indicates that of the 87 local jurisdictions that have mobile home rent control, only 13 also apply rent control to apartments.

103. Vicki Been, "Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 COLUM. L. REV. 473 (1991).

diction. Even under "moderate" price regulation, the quality of service is likely to decline. Because local voters will bear at least some of these costs, they are likely to urge errant city council members to rescind or modify the regulations.

The problem with Been's theory for land use exactions is that the landowner is the person who is bearing the costs, and landowners cannot move their assets. It is easy to suppose that it is the itinerant developer who bears the costs because in most situations the developer has to take an equity position in land in order to get his plans going. But the developer's willingness to pay for the land depends on anticipated regulatory burdens, so that the effect of regulations or anticipated exactions rounds upon the party who owns the land when the regulatory scheme is adopted.¹⁰⁴ "Exit" has a hollow meaning for people with immovable assets.

F. *The Elusive Physical Invasion/Regulation Distinction*

So far this article has argued that Judge Kozinski's paradox—that the inefficiency of regular rent control saves it from being a taking—can be expanded to a general rule for identifying regulatory transfers whose unfairness only judges can cure. The prospect of deadweight loss of an inefficient regulatory transfer means that there are people harmed by it who will politically attempt to modify it. The special interest legislation that emerges from pluralistic politics, whose results are often condemned as inefficient, enables potential victims of regulatory burdens to protect themselves politically by coalitions and vote trading. When neither of these conditions is present, as in California mobile home rent control laws, judges acting under the takings clause are the only bulwark against unfair regulatory takings of property.

As was noted, however, Judge Kozinski did not base his legal decision on this idea. He instead stretched the physical invasion standard from *Loretto* to include the dispossession of the landlord's interest in *Hall*. The reason for his doing so is that under California law, a regulatory taking requires showing a much greater burden than that borne by mobile home park owners. There was no evidence that their property had been devalued more than the typical land use control would devalue other forms of property.

104. Several economic studies indicate that land use regulations are capitalized in the price of raw land, so that the original land owner, not the subsequent buyer, bears the burden. For a review of the evidence, see FISCHER, *supra* note 7, at 21-27. See also Stewart E. Sterk, *Competition Among Municipalities as a Constraint on Land Use Exactions*, 45 VAND. L. REV. 831, 867 (1992) (agreeing that landowners are vulnerable to exactions).

My purpose in this section is to show that Kozinski's clever legal maneuver illustrates the vacuousness of the physical invasion/regulation distinction. This is not a criticism of Judge Kozinski. I think he is correct in his conclusion that local mobile home rent controls (at least those with vacancy controls), coupled with state and local tenant-rights legislation, does effect a transfer of a possessory interest. Moreover, I think that this analogy was the best that an intermediate-level appellate court judge could do given the precedents. By showing the impossibility of maintaining a neat distinction between regulation and physical invasion, Kozinski's maneuver points to the necessity of a better way to judge regulatory takings. It is Kozinski's paradox that points to that better way.

Stretching the boundaries of the physical invasion standard to include what in common language would be called regulatory burdens can be criticized as defeating one aspect of Michelman's half-hearted defense of the physical invasion/regulation distinction.¹⁰⁵ The advantage of the distinction is that it lowers transaction costs; it is a "bright line rule" that is easily understood and that might keep down settlement costs. Economists might further defend it or any other easily ascertained rule as providing a pole around which parties can bargain successfully.¹⁰⁶ Even though bargaining is costly, it is presumably easier to do so if there is no ambiguity in the initial entitlement.

The merit of the bright-line argument hinges on physical invasion being easily separated from regulation. If regulation shades imperceptibly into invasion, as Judge Kozinski pointed out in *Hall*, even the slight merit of a bright-line distinction evaporates. I will explore instances of blurriness other than that indirectly indicated by Judge Kozinski.

One instance arises when government wishes to acquire property, that is, physically occupy it, that is heavily regulated. What should the government pay for it? If advocates of the invasion/regulation distinction were truly committed to the rule, they would not inquire at all into the motives of a government that, just before condemnation proceedings had begun, had adopted a highly restrictive zoning classification on the property to be condemned. If this were permitted, the physical invasion standard would in fact be moot. While the owner would receive "just compensation" for that which she lost by the physical invasion, what she lost would be trivial if the regulation were unimpeachable.

No state court in fact would countenance the previous scenario.

105. Michelman, *supra* note 17, at 1227-29.

106. Susan Rose-Ackerman, *Against Ad Hocery: A Comment on Michelman*, 88 COLUM. L. REV. 1697, 1702-07 (1988).

Even the California courts, which seem dedicated to preserving the invasion/regulation distinction, will inquire into motives if a recently adopted regulation has an opportunistic air about it.¹⁰⁷ I take this as evidence that the invasion/regulation line is not all that bright.

To further show the invasion/regulation line's blurriness, let me offer a puzzle that I read about in the *New York Times*.¹⁰⁸ The City of New York sought to condemn some rent controlled buildings in order to expand Brooklyn Borough Hall. There was no hint that rent control and the project had anything to do with one another. The question was whether the tenants should be compensated for the loss of rent controlled apartments, not just for the usual moving costs that eminent domain implementation statutes often require.

Let's suppose that the tenants were not compensated. The market value of the building was probably substantially less under rent control than otherwise. In making plans for city projects, I presume that city planners have at least a rough idea of what buildings will cost to condemn. At some margin of decision, it could appear more rational to undertake a condemnation of a rent controlled building than one that was not. Hence in this situation, rent control leads to a physical invasion that would not otherwise have occurred, even though the government has not acted opportunistically in any way.

The cure for the excess condemnation in this instance would be to pay tenants for their putative estate. As I mentioned earlier in discussing rent control and expectations, tenants in New York City, which has had rent control for over fifty years, may well have acquired an entitlement for which they should be compensated. But a court considering condemnation awards for apartment buildings in cities that have more youthful, less settled rent control policies should not assign much weight to such arguments, especially since landlords could argue that the rent controls were only temporary measures in response to an unusual situation, a rationale historically used in defense of rent controls. The main point here is that there are plausible margins at which regulation induces physical invasion even when the condemnor is not behaving opportunistically.

107. See *Peacock v. County of Sacramento*, 77 Cal. Rptr. 391, 403 (Ct. App. 1969) (downzoning land for airport acquisition held a taking). *But see* *People v. Talleur*, 145 Cal. Rptr. 150, 154 (Ct. App. 1978) (indicating that coastal land acquired by eminent domain should reflect the market devaluation by the regulations of the California Coastal Commission). These may be distinguishable on the grounds that the Coastal Commission was created by statewide, not local, initiative, and the act was not obviously aimed at any particular owner's property. But adoption by initiative does raise additional political process questions. See *Eule*, *supra* note 91.

108. Nadine Brozan, *Brooklynites Balk at Relocation Deal*, *N.Y. TIMES*, Aug. 20, 1989, § 1, at 36.

My last example is more speculative. I suspect that the physical invasion of the cable TV box that was held a compensable taking in *Loretto* was in part occasioned by attempts to rationalize rent control regulation. Jurisdictions that adopt rent control typically find that they must keep the landlord from collecting on the side what he cannot collect up front. One of the latter devices is "key money" or "finder's fees," in which new tenants pay someone to get access to a rent controlled apartment.¹⁰⁹ Key money does not necessarily find its way to the landlord's pocket. The outgoing tenant, the neighbors, or building superintendents may get some or all of it.

An alternative to key money that would work more in the landlord's interest would be to charge above-market prices for some service connected with the building. Hence it might be in the landlord's interest to charge tenants for access to cable TV, electricity, or water, knowing that the tenant will be willing to pay some extra amount rather than move to another building. This scheme has the advantage to landlords and disadvantage to tenants of collecting payments from current as well as prospective tenants. Since most buildings caught in rent control already have electricity and water, the landlord could not impose charges for installing them. Cable TV, which arrived after most rent-controlled buildings were built, might offer a lever to recoup for the landlord some of the gap between rent control and market rent.

In order to foil this avenue for collecting side payments, the government would want to regulate the terms by which access to cable TV was permitted. Such a regulation was what gave rise to the *Loretto* case. The trivial physical invasion by the cable TV company that was held to be a taking was a necessary concomitant of the regulation, which was in turn, if my speculation is correct, logically compelled by rent regulation.

The New York Court of Appeals provided some evidence in support of my theory of the origins of the cable TV regulation. (The New York court had ruled that no taking had occurred.) Its opinion quoted from a New York State Public Service Commission (PSC) report: "In the electronic age, the landlord should not be able to preclude a tenant from obtaining CATV service (or to exact a surcharge for allowing the service) any more than he could preclude a tenant from receiving mail or telegrams directed to him." The opinion then quoted from the PSC Chairman's testimony, which concluded that "*Legislation is necessary,*

109. For a rueful personal story about how key money works in New York City apartments, see Epstein, *supra* note 65, at 741.

however, to prohibit gouging and arbitrary action."¹¹⁰

I do not want to oversell this proposition. Cable TV access legislation might well be warranted even without rent control. There may be network externalities to having universal access to cable TV. But it is interesting that the case itself arose in New York City, which has some of the most intractable rent controls in the country. Most landlords in cities without rent control would not feel burdened by the cable TV access regulation, since it simply compelled them to accept something that was in their own financial interest to have. In a free market for apartments, only idiosyncratic or short-sighted owners would want to withhold a service that made the rent and value of their apartment houses higher. I hope that I have at least planted a germ of doubt as to the viability of a neat separation of regulation from physical invasion from the case in which the distinction seems so important.

Attacks on the physical invasion/regulation distinction run the risk of being too persuasive. Michael Berger pointed out that a recent California rent control opinion cited arguments against the distinction in support of not paying compensation even for physical invasions.¹¹¹ It is rather like the story of the fascist general who, persuaded by onlookers that his original revenge on a rebellious village of shooting every tenth man was unfair, proceeded to shoot them all. The question remains, why compensate for physical invasions?

The answer would, of course, require another article at the least. One obvious beginning is that the demoralization costs of not paying are so high and settlement costs of paying are so low in the physical invasion cases. The small insight that I would add is that compensation for physical takings is a nearly universal policy among the nations of the world.¹¹² I find it interesting that compensation for regulatory takings is almost as universally absent among the rest of the world.¹¹³ The U.S. is nearly alone in this regard, but we are almost as nearly alone with regard to the extent to which we rely on local governments to autonomously decide on regulations.¹¹⁴ The highly regulated cities of Europe take their orders

110. *Loretto v. Teleprompter Manhattan CATV Corp.*, 423 N.E.2d 320, 328 (N.Y. 1981), *rev'd*, 458 U.S. 419 (1982).

111. Michael M. Berger, *6th District Flip-Flops on Vacancy Decontrol*, L.A. DAILY J., May 31, 1991 (describing *Casella v. City of Morgan Hill*, 280 Cal. Rptr. 876 (Ct. App. 1991)).

112. COMPENSATION FOR COMPULSORY PURCHASE: A COMPARATIVE STUDY (J.F. Garner ed. 1975).

113. Anthony Ogus, *Property Rights and Freedom of Economic Activity*, in CONSTITUTIONALISM AND RIGHTS: THE INFLUENCE OF THE UNITED STATES CONSTITUTION ABROAD (Louise Henkin & Albert J. Rosenthal eds., 1990).

114. An interesting exception is Switzerland, which also has strong local governments and does recognize the concept of regulatory takings. Its courts have had no more success than those of the

from national parliaments, in which pluralistic politics is the rule. This is not to say that some regulatory takings doctrines might not be a good idea for other countries. It is only to suggest that the politics of regulation is often different in the United States, and that may offer another reason for paying special attention in regulatory takings to that uniquely American phenomenon, independent local government.

G. *Judging and Economic Reasoning*

This section illustrates by example the hazards of relying on judges to apply economic principles. Its purpose is to combat the hopeful idea that if only the judges would pay attention to economic principles, the takings issue could be settled. The text for my claim is Judge Howard Wiener's opinion in *Yee v. City of Escondido*, a California appellate case that specifically rejected the reasoning in *Hall* and went to the trouble of explaining why.¹¹⁵

Judge Wiener in *Yee* asserts that mobile home parks are a "quasi-monopoly" without ever defining the term, let alone providing any evidence for the allegation. Nonetheless, he is right in suggesting that there are probably barriers to entry for someone who wants to set up a mobile home park in a given community. Entry into the mobile home business is not free because at one time many local land use controls sought to ban them altogether.¹¹⁶ For the government that creates a shortage of mobile home parks to turn around and accuse those who overcame the regulatory hurdles of charging unfairly high rents seems bizarrely unfair. If any remedy were due for monopoly, it should be against the local government that hindered the development.

In any event, though, looking at mobile home parks within a single community as a monopoly overlooks the numerous substitutes for housing, including mobile home sites outside of parks, apartments, other homes, and similar accommodations in nearby communities. Even with the local government hostility to mobile home parks, they are remarkably numerous in California. By no stretch of the imagination of the most eager antitrust economist could mobile home parks in California be regarded as having monopoly power.¹¹⁷

U.S. in resolving when a regulation becomes a taking, however. Enrico Riva, *Regulatory Takings in American Law and "Material Expropriation" in Swiss Law: A Comparison of the Applicable Standards*, 16 URB. L. 425, 425, 429-34 (1984).

115. *Yee v. City of Escondido*, 274 Cal. Rptr. 551 (Ct. App. 1990), *aff'd*, 112 S. Ct 1522 (1991).

116. This was prior to 1981 legislation that required local governments to reduce barriers to mobile home placement. Compliance with this law seems widespread. PLANNERS SURVEY, *supra* note 33, at 1.

117. In 1984 there were 5812 mobile home parks in California, containing 432,066 spaces.

The more novel sophistry in *Yee* is Judge Wiener's attempt to use elementary economic theory to justify the transfer of value from park owner to coach owner, which he concedes has occurred. He asserts that mobile home pads and the coaches that sit upon them are complements; you can't have a mobile home without a place to park it.¹¹⁸ When the price of an item declines, economists teach that the price of goods complementary to the item are apt to rise, unless they are in perfectly elastic supply. Judge Wiener uses the pithy example of popcorn: its price goes down, the price of popcorn poppers will rise. Hence, Judge Wiener implies, the capitalization of the rent control into the price of coaches is the free market at work, not some conspiracy to dispossess the owner. Take that, you law-and-economics judges, is the subtext.

The fallacies of his argument are at least three, one of which Judge Wiener soon owns up to. The one he admits is that if the rise in coach values were just the law of demand for complementary goods, one would see the value of all coaches rise.¹¹⁹ This did not happen; only the coaches that were actually in place in mobile home parks that were subject to rent control rose in value. Having admitted this rather special application, Judge Wiener goes on to claim that it is acceptable for only some to benefit. This manifestation of a naked transfer is exactly what Judge Kozinski finds so offensive, but Judge Wiener, having arrived at it as a special case of natural economic response to regulation, finds it no more bothersome than the typical regulation.

The second problem with Judge Wiener's complementary goods model is that the normal, though often implicit, assumption embedded in the economic analysis of complementary goods is that the price reduction in popcorn, for instance, is the result of popcorn having become more plentiful. That is, there has been an outward shift in supply (e.g., an unexpectedly large corn crop), which reduces prices and induces consumers to buy more corn, which in turn shifts out the demand for popcorn poppers. The pedagogical reason for leaving the supply-shift assumption unstated is, in my experience, that teachers do not want to confuse

OWNER SURVEY, *supra* note 31, at 4. The survey indicated that 92 percent of all spaces are located in parks with fewer than 400 spaces, and that the largest one percent of parks in the sample accounted for no more than 8 percent of all spaces. *Id.* at 14. It is possible that Judge Wiener's reference to monopoly refers to the bilateral bargaining situation that arises when there is a surplus that can be divided between two parties. In this situation, each party has a "monopoly" in the sense of having a strategic holdout position vis-a-vis the other. See generally Robert Cooter, *The Cost of Coase*, 11 J. LEG. STUD. 1 (1982).

118. *Yee*, 274 Cal. Rptr. at 553.

119. "The complementary good effect will be substantially limited to those mobilehomes currently occupying rent-controlled spaces." *Id.*

beginning students with supply considerations while talking about demand theory. Maybe we should risk some confusion.

If popcorn were reduced in price by a price control but no more corn were available, so that cheap corn was rationed and black markets suppressed, it is hard to imagine why holders of the "cheap" corn would want more poppers than they had before. The analogy of ordinary complementary goods markets to the mobile home rent control cases is inappropriate because what reduced the price of pads was not an increase in the supply of pads. Exactly the opposite was true, most probably because of the regulatory climate.¹²⁰

The third economic fallacy in *Yee* is that pads and coaches are necessarily complements. In an open market, the economic theory of cities teaches that land and capital (buildings) are substitutes.¹²¹ The reason houses in the suburbs are one or two stories is because land is cheaper than in the big city, where high land prices induce developers to put large amounts of capital on small lots. Suburban builders and consumers, on the other hand, substitute relatively cheap land for capital.

The alleged complementarity of land and capital in mobile home parks is only because park owners decided on a particular configuration in the past, not anticipating the adoption of rent controls. It is the adoption of the controls themselves, which with their usual tenant rights provisions retard any reconfiguration, that made for the apparent complementarity of the pads and the coaches. Shoes and bananas are not complementary goods (except in Buster Keaton movies), but if the government ruled that shoe sellers had to sell a banana to every customer, the market for shoes and bananas would look as if they were complements.

Another economic argument, though it does not seem that Judge Wiener was aware that economists have used it, is also advanced in *Yee*. He says that mobile home parks voluntarily got into the business and thus implicitly accepted the risk of regulation.¹²² This invokes a notice or rational expectations argument. It strikes me as being as disingenuous as the judge's assertion that mobile home owners are free to exit the business, when just-cause eviction laws could delay such a shutdown indefinitely. Does anyone really believe that the park owners would have gone into the business in the past had they anticipated the regulations that were adopted?

120. See Hirsch & Hirsch, *supra* note 22, at 463.

121. EDWIN MILLS & BRUCE HAMILTON, *URBAN ECONOMICS* 97 (4th ed. 1989).

122. *Yee*, 274 Cal. Rptr. at 557.

The notice argument might be applicable, though I would reserve judgment on it, to steely-eyed owners who established parks after the first rent controls were adopted. (It would not apply to someone who bought a pre-existing mobile home park, since what the purchaser bought included all of the legal rights that the previous owner had, which included any right to just compensation for a taking or other legal remedy.¹²³) For a judge to dismiss a complaint by saying, in effect, you should have seen it coming, is to avoid being a judge. An economist or a business advisor might use the rational expectations argument to explain in a positive way what will happen as a result of political decisions and in anticipation of a judge's decision, but what constitutes a reasonable expectation in the present context is for a judge to decide.

H. Entitlement Chopping and Regulation Chopping

The practice of dividing takings into physical invasions and regulations has been criticized as an unproductive formalism.¹²⁴ This section identifies another kind of formalism that is not widely recognized, but which the California *Yee* opinion epitomizes. I dub the new formalism "regulation chopping."

"Regulation chopping" is analogous to "entitlement chopping," a term coined by Frank Michelman to disparage one approach to the takings issue.¹²⁵ Entitlement chopping would almost always yield a decision that a regulation is a taking. A judge on an entitlement chopping spree would divide the bundle of property rights into their component sticks and see if one of the sticks were gone entirely as a result of the regulation. It is alleged by Judge Wiener in *Yee* that Justice Holmes did exactly that in *Pennsylvania Coal* when he held that the Pennsylvania ordinance that required that coal be mined underground without causing subsidence was an unconstitutional taking of the contractually reserved right to be free of liability for surface subsidence.¹²⁶

My reading of that difficult case does not hinge on regarding Holmes as a protector of specific types of property rights, in part because in other instances he had no trouble with burdensome regulations that

123. The reasons are explained in Fischel & Shapiro, *Takings*, *supra* note 12, at 287.

124. Frank Michelman, *Takings*, 1987, 88 COLUM. L. REV. 1600, 1625 (1988).

125. *Id.* at 1601. Michelman quickly reverts to Margaret Radin's term, "conceptual severance," to describe the idea that each stick from the bundle of property rights should be examined and protected separately. Margaret Jane Radin, *The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings*, 88 COLUM. L. REV. 1667, 1676 (1988).

126. Judge Wiener attributes this characterization of *Pennsylvania Coal* to Karl Manheim, *Tenant Eviction and the Takings Clause*, 1989 WIS. L. REV. 925, 968. See *Yee v. City of Escondido*, 274 Cal. Rptr. 551, 555 n.7 (Ct. App. 1990).

would clearly have run afoul of an entitlement chopping analysis.¹²⁷ But I agree that entitlement chopping is an unsatisfactory way of resolving takings. A creative conveyancer could chop out almost any right to property that might then be subject to complete abrogation by even the most reasonable regulation. For example, an owner anticipating a suburban housing height limitation of forty feet might convey to another the air rights above the limit, whose property would be rendered valueless and thus compensable by the subsequent regulation.

The inverse of entitlement chopping is what I call regulation chopping. This approach to the police power takes each government regulation by itself and sees if it, on its own merits and by itself, would amount to a taking. Since none is likely to do so, the sum of the government regulations must not amount to a taking, according to this approach. This is the approach of *Yee* and its brethren. Regular rent control is constitutional. Eviction control laws are constitutional. Hence the sum of these two (and others necessary to effect the wealth transfer) are constitutional. In this way, courts can avoid looking at the stark, demoralizing transfer that the combination effected.¹²⁸

My interpretation of *Hall* is that it attempts to confront the basic fairness issue in a context that has been thoroughly muddled by the Supreme Court's attempt to formalize takings law. *Hall* is as much a balancing decision as is permitted in the current Constitutional climate about takings. It is hung on the convenient though slippery hook of *Loretto*, but it at least adverts to the meager dialog that *Loretto* raised about the essential aspects of property.

It is *Yee* and its ubiquitous cohorts, which reflexively pigeonhole the case as nonreviewable economic regulation, that are the modern examples of formalism. Judge Kozinski's opinion is actually more faithful to a fairness test, or at least as faithful as an intermediate-level appellate judge can be in a judicial world rife with per se rules.

127. *Block v. Hirsch*, 256 U.S. 135, 156 (1921) (upholding a rent control law that prevented the owner from repossessing his own apartment without the owner's giving 30 days notice). A scholar who has reexamined *Pennsylvania Coal* does not indicate that Holmes's opinion rested on anything like entitlement chopping. Carol M. Rose, Mahon *Reconstructed: Why the Takings Issue Is Still a Muddle*, 57 S. CAL. L. REV. 561 (1984). To my mind, the key words of Holmes's opinion are these: "In general it is not plain that a man's misfortunes or necessities will justify his shifting the damages to his neighbor's shoulders. . . . [T]he question at bottom is upon whom the loss of the changes desired should fall." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416 (1922).

128. Scholars are not immune from the same sophistry. See, e.g., Karl Manheim, *supra* note 126, at 968, who examines tenant protection laws in isolation from rent control with vacancy controls and concludes for that reason that *Hall* was wrongly decided.

I. *The Kozinski Paradox After the Supreme Court's Yee Decision*

The basic content of the previous nine sections was composed prior to the United States Supreme Court's decision affirming, more or less, *Yee v. City of Escondido*.¹²⁹ The Court's *Yee* decision explicitly rejected what I referred to as the Kozinski maneuver, which shoehorned the mobile home rent control cases into the physical invasion category expressed by *Loretto*. The United States Supreme Court's decision does not change my analysis of the Kozinski paradox even though it does change the precedential value of *Hall v. City of Santa Barbara*.

The United States Supreme Court decision did not, however, endorse the California *Yee* decision that no regulatory taking had occurred. The Court instead held that the plaintiffs in *Yee* had relied wrongly on the reasoning of *Hall*, and, for that reason, the regulatory takings issue was not sufficiently briefed for them. Justice O'Connor's opinion in effect remanded the mobile home rent control controversy to the lower courts for argument strictly on the regulatory takings doctrine, no physical invasion references allowed.

It is rare for a decision to make everyone a loser, but the Court's *Yee* decision seems to have done that. The mobile home park owners lost their best attempt to get out from under rent control. But the tenant coach owners did not get rent control affirmed as not being a taking, either, and they must wait for another round of litigation before they know to what extent their regulatory rights are secure. Judge Wiener's complementary goods analysis was ignored, and Judge Kozinski's physical invasion analogy was rejected.

I have it on the oral authority of Henry Manne, whose program educates federal judges about economics, that judges really hate to be reversed. Although I doubt it is much comfort to Judge Kozinski, I think the Kozinski maneuver was in an important sense a success. The Supreme Court had in the 1980s seemingly embarked on an attempt to erect a formalistic set of criteria by which even the most obtuse judge could identify when a taking had occurred.¹³⁰ First and foremost was the regulation that effected a permanent physical invasion.

One way—maybe the only way—to talk unelected judges out of bad ideas is to show them the consequences of applying them. Judge Kozinski showed in *Hall v. City of Santa Barbara* that a rent control ordinance, coupled with a background of tenant protections and continuing vacancy controls, could have all of the characteristics of a physical invasion by a

129. *Yee v. City of Escondido*, 274 Cal. Rptr. 551 (Ct. App. 1990), *aff'd*, 112 S. Ct. 1522 (1991).

130. See Michelman, *supra* note 124, at 1622.

third party. Under the web of regulations examined in that case, the park owner had virtually no prospect of recovering the right to occupy his own land by the tenant of his choice or even by himself.¹³¹ But calling rent control a physical invasion obviously stretches the plain meaning of the language. What *Hall* showed was the difficulty, perhaps even the impossibility, of constructing a formalistic set of rules to define what constitutes a taking and still remain faithful to the concerns underlying the Takings Clause.

Justice O'Connor's distinction between an invasion by strangers and occupancy by tenants whom the land owner had invited prior to the adoption of rent control is unconvincing.¹³² Within my experience as a hiker, I know that many owners of land had voluntarily permitted the Appalachian Trail to cross their land. Did that acquiescence mean that no taking had occurred when the U.S. subsequently established permanent hiking easements for the Trail? Aside from the illogic of such an argument, there would be an enormous unfairness in penalizing landowners for having been generous with their land in the past, much as those mobile home park owners who had charitably (or recklessly, as it turned out) left rents low were disproportionately penalized when rent controls were adopted. The same might be said of owners of property whose developers hired good architects and built nice buildings, only to find that they were rewarded some years later with uncompensated restrictions on demolition from historic preservation ordinances, while owners of schlock had no such difficulties.

If the United States Supreme Court learned anything from *Yee* about the perils of formalism, it did not show in the more recent takings case, *Lucas v. South Carolina Coastal Council*.¹³³ A coastal regulation adopted in 1988, two years after Mr. Lucas had bought two appropriately zoned building lots for almost one million dollars, forbade any permanent dwellings. The state trial court held, incredibly, that the lots had been rendered "valueless" and, for that reason, a taking had occurred.¹³⁴ The South Carolina Supreme Court, accepting the trial court's facts, held nonetheless that such a devaluation was not a taking because of the

131. Justice O'Connor noted that California law allows the park owner to remove the tenant after several months' notice, but she does not deal with the numerous roadblocks that local governments can throw in the way of an owner who seeks to evict a tenant even to leave the business. *Yee*, 112 S. Ct. at 1528. For examples of such ordinances, see *Hall v. City of Santa Barbara*, 833 F.2d 1270, 1276 n.16 (9th Cir. 1986) (citing local ordinance creating indefinite lease), and, generally, CALIFORNIA DEP'T OF HOUS. & COMMUNITY DEV., *supra* note 25.

132. *Yee*, 112 S. Ct. at 1528.

133. 112 S. Ct. 2886 (1992).

134. *Id.* at 2889.

harm-prevention language of the Coastal Zone statute.¹³⁵ Harm-prevention invokes the so-called "nuisance exception" that the Court has often invoked in upholding land use regulations.

The United States Supreme Court reversed, creating a new formal exception to the nuisance exception. What might be called the "valueless" corollary holds that a regulation disallowing all economic use is always compensable, even if it is justified in harm-prevention language, unless the harm to be prevented is discernible in historical understandings of property, such as those embodied in the common law.¹³⁶ Legislative declarations that an activity is a nuisance are not, without more, presumed to remove the regulation from the reach of the takings clause in instances in which no economic value remains.

The admirable part of *Lucas* is its recognition that legislatures might, if the nuisance exception were absolute, salt all regulatory bills with antinuisance language to keep them clear of the takings issue. Indeed, any categorical rule that deferred to legislative pronouncements invites legislatures to evade the demands of the Fifth Amendment or any other Constitutional command. Courts that suspect regulatory takings must engage in independent inquiry into provenance of legislative action.

But, for the most part, *Lucas* misses the fairness issue. Not that fairness is easy in this case. On the one hand, owners of coastal land and their allies are probably well represented in the South Carolina legislature. One might even speculate that the delay between South Carolina's first foray into coastal protection in 1977 and the stringent regulation adopted in 1988 was due to the influence of such interests.¹³⁷ In any case, there would seem to be little process-theory justification for judicial intervention. This is unlike the situation of having the same legislation emerge from a local government, where owners of previously developed lots might easily gang up on owners of undeveloped lots to create a viewscape without having to pay for it.

On the other hand, the fairness infirmity of the state legislation challenged in *Lucas* is the disproportionate impact on an owner in a subdivision in which all neighboring lots had already been developed and were thus grandfathered by the legislation. The cost of granting Mr. Lucas an exception or of paying him for his land seems small compared to the

135. *Lucas v. South Carolina Coastal Comm'n*, 404 S.E.2d 895, 899 (S.C. 1991), *rev'd*, 112 S. Ct. 2886 (1992).

136. *Lucas*, 112 S. Ct. at 2889.

137. Beachfront landowners recently exhibited substantial political strength in resisting legislation that would limit federal flood insurance protection in flood-prone areas. Cornelia Dean, *Beachfront Owners Face Possible Insurance Cuts*, N.Y. TIMES, May 27, 1992, at A1. However, this group mainly represented the more numerous owners of developed lots, not people in Mr. Lucas' position.

alleged benefits of the bill. Indeed, as the record indicates, the South Carolina legislature took the former remedy by amending their law to permit discretionary exceptions for owners caught in Mr. Lucas's situation.

The legislature acted after the state trial court's takings decision but before the South Carolina Supreme Court's decision. One cannot know if the legislature would have acted to provide an avenue of redress for Lucas and others in the absence of the trial court's takings decision, but that fact did not require the United States Supreme Court to fall back on formalistic rules to justify reexamination of the case. The wrong to be righted in *Lucas* is the apparent disproportionate burden on a single owner. It is no less a wrong if a trial court finds that the land has some residual economic value as a tent site¹³⁸ than if no such value can be found.

II. CONCLUSION

The regulatory takings issue is primarily about fairness, not efficiency. Efficiency can nonetheless be used as a guide to detecting instances of unfairness. Judge Kozinski's passing note that the greater efficiency of regulation of mobile home parks makes them stronger candidates for takings was expanded in this article to show that it embodies more general principles of where to look for regulatory takings. The primary candidates are regulation of immovable assets (or assets made immovable by regulation) by majoritarian units of government.

The adoption of or changes in such regulations, such as local zoning and rent controls, does not mean they are unreasonable. Balancing factors such as reciprocity, disproportionate impact, and the harm-prevention test are appropriate in such instances. My primary novelty is to suggest that courts can save some of their scarce political capital by ignoring all but the most extreme regulations enacted by larger units of governments, such as the United States Congress, most states, and some large cities and counties. In these places, economic and political science research provides reason to believe that pluralistic politics will give those

138. Tenting seems popular with judges. *First English Evangelical Lutheran Church* was the remand of the famous Supreme Court case that told the California Courts that monetary damages, not injunctions, are the required remedy for regulatory takings. *First English Evangelical Lutheran Church v. County of Los Angeles*, 258 Cal. Rptr. 893 (Ct. App. 1989), *remanded from* 482 U.S. 304 (1987). The California appellate judge found that the county's ban on rebuilding the camp buildings destroyed by a flood was not a taking largely because the ban paternalistically removed campers from the risk of flooding. 258 Cal. Rptr. at 902. But when examining whether any economic value remained to the property after its inclusion in a flood plain zone, Judge Johnson noted that the area could be used for tents, *id.*, in which campers might be even more exposed to the risk of flooding than in restored buildings. Justice Blackmun, dissenting in *Lucas*, also mentions tenting as something Mr. Lucas can do on his beachfront property. 112 S. Ct. at 2908.

subject to regulation a realistic opportunity to politically protect themselves. And the pluralistic democratic political process is, in the long run, the more secure protection of property.