

Washington University Journal of Law & Policy

Volume 3 *Evolving Voices in Land Use Law: A Festschrift in Honor of Daniel R. Mandelker*

January 2000

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Recommended Citation

Jeffry A. Frieden, *Toward a Political Economy of Takings*, 3 WASH. U. J. L. & POL'Y 137 (2000),
https://openscholarship.wustl.edu/law_journal_law_policy/vol3/iss1/6

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Towards a Political Economy of Takings

Jeffrey A. Frieden*

I am a complete outsider to the enormous and excellent literature on takings, and my only qualification to consider it is my consanguinity with a leading contributor to this body of knowledge. In this article, I offer the musings of one whose own work is of political economy and an area of political economy far removed from the issues typically raised by takings.¹

To a neophyte, the most striking characteristic of takings is the privileged position accorded landed property. Although I have had great difficulty finding detailed information, it appears that every law-governed society, including the centrally planned economies before their demise, treats governmental policies that involve the physical taking of land very differently from policies that affect other assets.²

In this article, I address why land is different. First, I consider some potential answers to this puzzle. Most have merit, but none explain why land is treated so distinctly from other assets. Every purported explanation for the differential treatment of land should also apply to some other class of assets, but they do not.

Next, I conjecture about the reasons for the privileged status of land, emphasizing the role of politicians. I argue that policymakers have strong reasons to delegate decisions regarding the taking of land to other agencies, reasons that grow out of the extreme specificity of land as an asset. Given this specificity, the taking of land gives rise to extremely thorny valuation problems, as well as to very strong

* Department of Government, Harvard University. The author acknowledges, without implicating, extremely useful comments and suggestions from James Alt, Rachele Alterman, Benjamin Davy, Dhammika Dharmapala, William Fischel, Michael Levine, Daniel Mandelker, Mark Ramseyer, Kenneth Shepsle, and Dan Tarlock.

1. I am Daniel Mandelker's nephew and my work is on the political economy of international monetary and financial relations.

2. For a useful if somewhat dated treatment of this topic, see U.K. NATIONAL COMMISSION OF COMPARATIVE LAW, COMPENSATION FOR COMPULSORY PURCHASE (John Francis Garner ed., 1975).

incentives for the exertion of political pressure. It is politically efficient for policymakers to delegate the problem to an administrative body that is better insulated from lobbying. While there are similar incentives in other policy realms, they are nowhere as strong as with land.

I. THE PUZZLE AND SOME POTENTIAL EXPLANATIONS

In the United States and elsewhere, governments compensate landowners with the “fair” value of property that is taken in pursuit of a public purpose. Although this may seem uncontroversial and unproblematic, there is no reason why it should be the case, or why it should only be the case for land. Government policies affect the value of many private assets, and it is not uncommon for government policies to make some private assets worthless. The removal of trade protection can turn a factory into scrap and make employees’ human capital useless, at least in the employees’ current location. Changes in regulations can make financial institutions unviable. Inflation or devaluation reduce (although they usually do not destroy) the real value of nominal assets, including government bonds and private contracts.³

One common explanation as to why land is treated differently is the uncertainty of being compensated for improved property.⁴ If a piece of land could be taken without “fair” compensation, its owner would have little motive to invest in improvements. However, this is simply one of many conceivable examples of time inconsistency in

3. Penetrating explorations of these issues, which have helped me to clarify my understanding of current scholarship, include RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985); Richard A. Epstein, *Takings*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 561-69 (1998); WILLIAM A. FISCHEL, *REGULATORY TAKINGS: LAW, ECONOMICS, AND POLITICS* (1995); William A. Fischel, *The Political Economy of Just Compensation: Lessons from the Military Draft for the Takings Issue*, 20 *HARV. J.L. PUB. POL’Y* 24, 24-63 (Fall 1996). Another way of posing the question, as Epstein suggests, is to ask why owners are not similarly compensated for other (non-takings) governmental policies that affect the value of assets. Epstein. More finely, we might ask why “physical invasions” are treated differently than regulations that may have equal or greater effects on asset values.

4. See Robert Ellickson, *Property in Land*, 102 *YALE L.J.* 1315, 1315-1400 (1993) (developing this and related points). See Lawrence Blume & Daniel Rubenfield, *Compensation for Takings: An Economic Analysis*, 72 *CAL. L. REV.* 569 (1984).

policy, the fact that governments have incentives to renege on prior promises—such as a promise to subsidize an industry, provide price stability, or service government debt.⁵ Generations of political economists have analyzed this class of problems and have shown how governments can attempt to mitigate them with devices to improve their ability to keep their promises. Such “commitment technologies” are not perfect, but they can reduce the difficulty inherent in the many policy areas beset by time inconsistency. Perhaps the best-known argument has been made with regard to monetary policy. It is often argued that the establishment of an independent central bank can mitigate government’s temptations to inflate. The broader point is that the incentive problems associated with potential governmental takings of land are no different than those that confront a very wide variety of other assets. Yet, the solution to such problems, a promise to compensate for the government’s physical impairment of landed property, is found almost nowhere else. We can generalize from this to all arguments based on economic efficiency: inasmuch as they should apply to a wide variety of assets, they cannot explain the privileged position of land.

Another common explanation for the protection of landed property is tradition. During the early transition from feudalism to capitalism, powerful local nobles extracted royal promises to respect their property, which was primarily land. This commitment was enshrined in formal and informal constitutions, and has remained in place.⁶ This sort of path-dependent argument cannot be refuted directly, for one can always find a point at which governments agree to treat property differently—every such policy must have a beginning. The royal-noble story does not explain why similar commitments are just as common in countries without a real feudal past as they are elsewhere. Nor does it explain why the norms are as strong as, or stronger, in countries that violently overthrew monarchical rule, such as in the New World, as they are in former or continuing monarchies.

5. See Finn E. Kydland & Edward C. Prescott, *Rules Rather than Discretion: The Inconsistency of Optimal Plans*, 85 J. POL. ECON. 473 (1977) (providing the classic statement).

6. The argument reminds one of the old British music-hall line, “Does the name *Magna Carta* mean nothing to you? Did she die in vain?”

The path-dependent approach also does not explain why the former centrally planned economies had a different set of policies for property in land than for all other forms of private property. Therefore, whatever merit there may be in these explanations, they do not directly address the problem that interests me: why land is treated differently from other assets in every law-governed society.

II. A POLITICAL ECONOMY CONJECTURE

The secret of the distinctive treatment of land must reside in one or more of its characteristics as an asset. I suggest that the crucial characteristic may be the extremely high level of *specificity* of landed assets. In this setting, the specificity of an asset refers to the difference between the value of the asset in its current use and its value in its best alternative use. The concept is central to modern analyses of industrial organization, contractual relationships, and other contexts in which it is common to find non-market exchanges. Indeed, the point of departure in influential literature on transactions costs is asset specificity, which makes arms-length market-based interactions difficult if not impossible.⁷

The specificity of an asset to a particular use creates two interrelated problems: valuation and opportunism. It is extremely difficult to put a market value on an asset when the asset's value is highly dependent on context. For example, it is hard to imagine how to determine the value of a one-of-a-kind machine that is essential to producing Ford Escorts, but useless in any other role. By the same token, the owner or producer of such a machine would be able to "hold up" Ford opportunistically for more money (and Ford could do the same to the owner or producer) assuming no substitutes were available. As a result, no feasible contract could be written to overcome all of the problems associated with the great specificity of this asset. The difficulties inherent in such circumstances explain why

7. OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION* (1975) (providing the canonical starting points). See OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985); WILLIAM BAUMOL ET AL., *CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE* (1982) (noting that asset specificity is related (and opposite) to the idea of the "contestability" of markets).

firms *internalize* many parts of the production process, that is, they do not carry them out on the open market. Similar circumstances are often presented as the reason for the organization of many political “exchanges.”⁸

Although some land is undifferentiated and standardized, the value of most land is highly specific to its location, owner, and its current use. The owner of a parcel of land usually has accumulated it in its present form for a reason—it can be cropped in line with the family’s resources, it can be divided for inheritance, or it makes aesthetic or economic sense. The location of the property itself is often of value (as in the standard broker’s line about the three important factors in determining property value: location, location, and location) whether for reasons of sentiment or tradition, or because of intangible local externalities such as family and friends. In addition, improvements are often custom-built and may be difficult to replicate or disaggregate. Thus, losing some or all of a plot of land often involves damages that cannot be repaired, as centuries of literary encomiums to lost homesteads and places attest.

Without going into more depth, to add the requisite cautionary notes,⁹ let me simply posit that land is unusually specific as an asset.¹⁰ The next step is recognizing that there are circumstances when public purpose requires that privately owned land be taken or otherwise physically invaded. This is precisely due to specificity. Some lands are close to essential for the provision of legitimate public goods, including passage for roads or rivers, flood control, construction of public amenities.

Of course, provision of public goods can involve government policies that reduce or eliminate the value of private assets other than

8. For a good survey, see AVINASH DIXIT, *THE MAKING OF ECONOMIC POLICY: A TRANSACTION-COST POLITICS PERSPECTIVE* (1996).

9. These include the fact that specificity is on a continuum; that some lands are more specific than other lands, some not at all; that entire professions are based on coming up with pecuniary equivalents for assets that are difficult to value, such as good will; that land may be extreme in its specificity but is by no means unique; and that we expect individuals and societies to adjust in ways that mitigate the costs of this specificity. However, I believe that the general point holds: land is generally highly specific as to its site, use, and improvement.

10. Both Dan Tarlock and Michael Levine have pointed out to me that this is indicated by the common-law doctrine that land is unique, as reflected in the use of forced transfer (“specific performance”) rather than money damages as a remedy.

land. A provision of public education or transportation has an impact on private schools and transport companies, even when the government does not simply take over private firms. Here, too, valuation problems can be very difficult. Whether or not their taking is for public purposes that would be widely recognized as desirable, many private firms have been nationalized by governments around the world. Two points are worth making in this regard. First, the taking of land is far more common than the taking of other assets. Second, the validity of the argument made here should apply to other assets in proportion to their specificity: the more specific the asset, all else being equal, the more its treatment will be like that of land. But let me first develop the argument with regard to land.

The great specificity of landed property leads to two predictable responses to a taking. The first is that the value of the property may be hotly contested. The value of a piece of property as a private homestead or part of a farm may be very different from its value as roadbed for a railroad. Even if the full impact of the parcel's contribution to society as a railroad could be measured and all externalities thus internalized, the property may have intangible components of significance to its owner that complicate the calculation of the appropriate Pareto-improving compensation. As long experience demonstrates, it is easy to predict the price to be paid for taken property will be particularly controversial. This is not just because owners always believe that "fair" compensation involves more money, but also because the actual value of the property to the owner may be impossible to measure, thus leaving "fairness" impossible to assess.¹¹

The second implication of great asset specificity, in land as elsewhere, is that it increases the incentive to engage in political action to affect outcomes. This can be seen in two closely related ways. First, the more specific an asset is, the greater the quasi-rents associated with its use, making the asset more valuable to its owner. This in and of itself would, all else being equal, increase the owner's

11. Indeed, and in line with my discussion here, because it is so difficult to calculate the value of land to its owner, Pareto improvements may not in fact be attainable. It is theoretically possible that the difference between the market value of the land and its value to its current owner is larger than the welfare improvements that would result from the taking.

incentive to protect the asset. Second, asset specificity usually means that “sunk costs are not sunk,” so that it is rational for owners to take into account their current holdings to determine future actions. This is because the value of assets is interdependent: losing a plot of land may reduce the value of a farmer’s other land or buildings. This further heightens the incentive to resist the loss and increases the value of the property to the owner (but not the taker).¹²

Asset specificity gives rise to conflicting incentives for policymakers. On the one hand, policy can be tailored to please constituents by providing (or protecting) rents accruing to such assets. Precisely because the policy decision can be extremely favorable to the private owner, politicians can realize substantial political benefits from such decisions. Policymakers routinely act directly to favor industrial sectors, thus providing rents to the owners, managers, and workers whose physical and human capital are specific to the industry. For example, politicians may be happy to give protection or subsidies to those whose assets are specific to the steel industry, and eager to claim direct credit for the resulting rents.

On the other hand, there are reasons why policymakers might want to avoid making individual decisions about the provision or protection of rents to private owners. Politicians may face a myriad of complex and potentially cross-cutting claims, the processing of which would be prohibitive and the satisfaction of which may, in turn, inflame other constituents. To return to the steel sector, if each individual owner, manager, and worker in the steel industry were to request such benefits independently, policymakers would be overwhelmed and would face serious problems of determining the appropriate benefits to assign each individual.

It is easy to imagine circumstances in which the political costs of processing and responding to such demands would outweigh their political benefits. Where the transaction costs of dealing with the claims of owners of specific assets are greater than the net benefits policymakers may expect from satisfying some of the claimants, we would expect that politicians would want to avoid making these

12. In some sense these are simply two sides of the same coin—it is the interdependence of assets that increases the quasi-rents—but they are worth separating for purposes of expositional clarity.

decisions. This is analogous to the difficulties of using private bills for specific benefits to constituents, as has been the case in many parliamentary democracies, but which has been abandoned almost everywhere because of excessive cost to politicians in time, energy, and political capital.

Modern political analysis asserts that the institutions of policymaking adapt to the needs of the social actors that use them. A critical example of this is *delegation*, which is motivated by the idea that politicians may have reasons to remove themselves from the direct formulation and implementation of policy. There are many possible reasons for delegation. These reasons include improving information gathering, reducing transaction costs, insulating oneself from political pressure, or avoiding blame. All involve facilitating politicians' actions in issue areas that are complex, controversial, or socially costly.¹³ And most of them are related to the specificity of the assets about which policy is being made to their current uses.

In this context, prevailing policies toward the taking of land represent an extreme form of delegation. In virtually every society, compensation for taken property is guaranteed and determined by an agency that is formally independent of the normal political-electoral process. The logic presented above implies that the very high transaction costs of processing and responding to these claims outweigh the political benefits of satisfying claimants of physical injury to landed property.

The hypothesis presented here, then, is that the universal and extreme form of delegation used in compensation for takings is a political-economy response to the great specificity of landed assets. This specificity makes compensation decisions informationally complicated, subject to strenuous political lobbying, and potentially socially very costly. Policymakers have powerful incentives to delegate these decisions to an independent agency.

13. For a general statement, see Matthew D. McCubbins et al., *Administrative Procedures as Instruments of Political Control*, 3 J. LAW ECON. ORG. 242 (1987). For an empirical application to British parliamentary politics that focuses on some of these issues, see GARY W. COX, *THE EFFICIENT SECRET: THE CABINET AND THE DEVELOPMENT OF POLITICAL PARTIES IN VICTORIAN ENGLAND* (1987).

Neither asset specificity nor political delegation is unique to land. Nor is asset specificity the *only* reason for delegation. However, to the extent that the argument presented here is correct, there should be a positive relationship between the specificity of an asset class, or of the effects of a type of policy on an asset class, and the degree to which policy is delegated (holding other things constant, of course). Broad redistributive policies will not be delegated, because their effects are not specific. But, narrower regulatory, industrial, and trade policies tend to be delegated more often and delegated more fully. This in fact seems to accord with casual observation.¹⁴ Again, the countervailing impact of political credit given to the provider of benefits must be taken into account: a politician who can provide important targeted benefits to a very small group of asset-holders may have little reason to delegate the decision. The difficulties arise where there is so large a population of interested parties that satisfying their owner-specific demands expeditiously would be extremely difficult.

I admit that this conjecture is only that—an idea that seems (at least to me) to be plausible. In its favor is that it is (I think) logically consistent, in line with current thinking in the political economy of policymaking, and amenable to being subjected to rigorous empirical evaluation.

The conjecture could be evaluated by looking at the treatment of different kinds of assets. It would be interesting to see whether, in fact, the purported relationship between asset specificity and delegation holds (*ceteris paribus*) in other policy realms. It also would be interesting to see whether the manners in which political systems handle the valuation of taken property for compensation are sensitive to the specificity of the property. For example, in the case of compensation for expropriated foreign investments, we might investigate whether governments have treated different kinds of investments differently. Superficially, this seems to be the case as consideration of what should be done about the expropriation of creditors is normally handled directly by national governments, while

14. For example, general trade policy is typically made by the legislature and executive, while such firm-specific complaints, such as “dumping,” are typically delegated to independent agencies.

compensation for corporate property is often decided by a (variably) independent commission. Bonds are, of course, less specific than foreign corporate property.¹⁵ But this is anecdotal; more serious consideration of the hypothesis seems both feasible and potentially valuable.

This argument can be used to help us embark on comparative investigations across political systems. If the political implications of the treatment of takings are important to their institutional status, there should be variation in the ways in which the taking of property is handled that bears a relationship to the features of the political system – whether parties are disciplined and policies centralized, how strong the scope is for local special interests.

III. CONCLUSION

The physical taking or impairment of land is treated very differently from policies that affect the value of other assets. I have suggested that we search for the reasons for this difference in characteristics of the assets themselves and how these characteristics affect the incentives to private actors and policymakers. I have argued that the great specificity of land to its current use leads to the great difficulties of arriving at a commonly accepted valuation and provides powerful incentives for owners to exert political pressure for favorable treatment. In this context, I propose that politicians have reasons to remove compensation for land from the political process to a great extent (full removal is, of course, impossible). Otherwise, they risk confronting a continuing series of time-consuming and politically costly, owner-specific political pressures.

Although this is little more than an educated guess, most alternate explanations are untenable. The efficiency effects of compensation for land are no different than for many other assets, nor can tradition simply be invoked to explain away startling national similarities. To be sure, this hypothesis is little more than a basis for discussion and analysis. At the very least, I hope to have shown that the issue of

15. I have looked at this from the standpoint of the investing country. See Jeffrey Frieden, *International Investment and Colonial Control: A New Interpretation*, 48 INT'L ORG. 559 (1994).

takings should be considered one of *political economy*, and that the tools of the political economy trade might be profitably applied to it.