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Paul Burrows

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Paul Burrows *

A Deferential Role for Efficiency Analysis in Unravelling the Takings Tangle

There has been an extensive and interesting debate in the United States, involving academic lawyers and economists, which has been concerned with the conditions under which a government should be allowed to take assets away from private owners. Such "takings" by the state from the private sector generally fall into one of two categories. The first category, usually referred to as "physical takings", is the kind of case in which the government takes over ownership of an asset (for example, a plot of land) in order to utilise it for a public project (such as the building of a new road). The second category, often called "regulatory takings", concerns the situation in which a private asset-owner experiences a reduction in the value of his asset as a result of a government regulation. An example here is a case in which an owner of property on the seafront experiences a loss in the value of his asset when he is prevented from building on the land because the regulatory authority wishes to retain the coastal barrier of sand dunes to reduce the risk of storm damage to the local environment.

The takings issue has focused upon the question of the rights of the state and of the private asset owner when an asset has competing public and private sector uses. For example, does the state have the right to take an asset it needs, and if so is this right conditional upon the payment of compensation?

In the last decade or so a number of economists have argued that a resolution of this "takings problem" should centre upon the efficiency consequences of takings by the state. Unfortunately, however, a review of two decades of the literature on the takings issue does not convince one that the arrival of efficiency analysis on the scene has succeeded in increasing either the clarity of the reasoning on takings decisions or the coherence of the judgements made by the U.S. Supreme Court. Many observers still say that the U.S. takings law lacks coherence and remains a puzzle, (for example, Rose-Ackerman, 1988, Kmiec, 1988 and Farber, 1992) and the literature displays a considerable variety of prescriptions for the

* University of York.

development of a consistent legal approach to takings.[1] Nevertheless from a European perspective it is instructive to examine the American approach to the problem because, in a sense, the literature fills a gap in the European attempts to analyse the limits of the powers of the state.

However, if we are to learn from the American debate, it is necessary to recognise the shortcomings of some of the research which it has generated. In this paper it will be suggested that a modified approach to the incorporation of efficiency arguments into legal reasoning is needed in the takings law context. My basic proposition is that efficiency analysts have tended to further muddy the waters because of the *ways* in which they have employed efficiency analysis, but that a more deferential approach would be fruitful as we attempt to identify the *logical sequence of judgements* that would yield a clearer and more consistent and just takings law.

The presentation of the argument will be as follows. In order to establish the need for a reorientation of efficiency reasoning in the takings context it is necessary to begin negatively, in the next section, by criticising the two kinds of efficiency approach that have previously been employed. Firstly, it will be suggested that using efficiency theory to try to *rationalise* the existing takings law is unproductive both because the analysis is inherently tautological, and because it is unhelpful when most observers are seeking a well directed and consistent alternative to the existing law. Secondly, it will be argued that a strong efficiency orientation of an analysis of takings, with efficiency incentives treated as the *primary objective* of the law, runs the risk of arriving at recommendations that are at variance with widely held notions of justice. The result is likely to be that the recommendations will cut little ice with many legal thinkers, let alone convince legal practitioners of the need for a new orientation of the judgements given in cases that come before the U.S. Supreme Court.

The more positive analysis which follows begins with four good reasons why efficiency arguments should be integrated in a deferential manner into a justice-dominated analysis of takings law. It then proceeds to make a start on developing such an analytical structure; this is intended to generate a checklist of the points at which explicit and clear judgements by the Supreme Court are essential. The analysis will be founded on the proposition that the central objective of takings law is to ensure the *just protection* of the potential losers from government takings, but that attempts should be made to minimise any inefficiencies that providing just protection may give rise to.

The checklist of essential judgements is finally presented in skeletal form in the concluding section.

Why efficiency theory has not (so far) helped to clarify the takings issues.

Takings law is concerned with establishing the conditions under which the state can take private assets. Those who have analysed takings law using efficiency theory have tended to adopt one of two approaches. Either they have sought to "explain", or rationalise, the existing U.S. takings law on efficiency grounds, or they have attempted to base a case for particular legal remedies, such as the payment or non-payment of com-

1. Fischel's (1988) Introduction to the Dartmouth College conference papers is revealing in this respect.

pensation for government-imposed losses, upon their predicted efficiency consequences. Unfortunately both of these approaches have their problematic aspects, which have led me to the conclusion that a less salient employment of efficiency arguments is required. We will consider the two approaches in turn, using a typical study to illustrate the argument in each case.

Efficiency rationalisation. The efficiency rationalisation approach consists of selecting some characteristic of the law, such as the practice of paying compensation to the asset losers in the event of the state physically invading private property, and searching for conditions under which this characteristic would be efficient. If such conditions are discovered (and they are inclined to be) it is concluded that the law is efficient in this respect, and that efficiency theory has "explained" the legal practice. As earlier criticisms of the application of this approach, as applied to the common law, made clear, such efficiency rationalisation suffers from two seriously damaging deficiencies. First, the proposition that the law is efficient has no meaning unless it is qualified by a clear identification of the context within which the efficiency proposition can be shown to hold *and* evidence is produced to establish that this context is the one within which the law actually operates. If it is simply *assumed* that this context is the empirically relevant one, then the analysis is inherently tautological.[2] The inherent ambiguity of the efficiency theory can easily be seen if we consider whether an owner of a plot of land should be compensated when the government compulsorily acquires it for a new road. Imagine that the *only* efficiency effect of the acquisition is the plot owner's incentive to invest in a restaurant on his land before the occurrence of compulsory acquisition is known with certainty. Efficiency requires that the decision whether to build the restaurant be based on its potential returns *discounted* for the risk that the government will later acquire the plot. The efficient incentive to the private landowner will be maintained if *no* compensation is forthcoming in the event of government acquisition. So a no- compensation takings law would be "efficient" in this case. Now, instead, imagine that the *only* efficiency effect of the acquisition is the *government's* own incentive to limit the number of its projects to those in which the land would be more valuable in public use than it would be in the private owner's hands. To provide the government with the correct incentive (assuming the government maximises projects subject to a budget constraint) it is necessary for takings law to incorporate a compensation *requirement.* So in this context compensation would be "efficient". Thus, efficiency theory can usually be used to dredge up "explanation" for an existing, or an alternative to the existing, takings law. But unless we *know* which of the two imagined contexts is the one within which the law operates the efficiency arguments cannot tell us which of the legal structures is "efficient".

Second, the search for an efficiency rationalisation of the existing law may tempt the analyst to over-reach by selecting efficiency arguments that fit the rationalisation, while rejecting on thinly reasoned theoretical grounds, or by using impressionistic evidence, efficiency arguments that are inconsistent with the rationalisation. The temptation, in other

2. See Burrows and Veljanovski (1982) for further details on the 'tautology' criticism.

words, is to overcome the *ambiguity* of efficiency theory as an explanatory device by cutting out those arguments that suggest the existing law may have adverse efficiency effects.[3]

An example of the efficiency rationalisation approach to takings law is Professor Farber's analysis of just compensation in takings cases. What is so striking about his analysis overall is that even though he refers to takings law as a "puzzle" and notes that, in the case of regulatory takings, "most writers consider the Court's opinion analytically incoherent", nevertheless he does not concede that *any* characteristic of the existing takings law (which pays compensation) has any adverse efficiency consequences.[4] There seems always to be *some* efficiency "explanation" of the existing law, but *no recognition* of the possibility that some aspects of the legal design may be inefficient either unintentionally, because the Court did not anticipate its efficiency consequences, or intentionally because the law deliberately was not directed at achieving the most efficient outcome possible. The particular efficiency "explanation" for the compensation requirement which Farber relies on is that it galvanises taxpayers into resisting inefficient government projects (those for which the acquired assets would be better left in private hands). Of course such a possibility cannot be ruled out, but then neither can it be ruled in without evidence to suggest that this incentive effect (and no others) results from the compensation requirement.

Farber's conclusion from his selection of efficiency arguments is, in the absence of the necessary empirical support, inevitably vulnerable to the suggestion that there are other efficiency effects that are more important. The efficiency rationalisation approach cannot "explain" the existing state of takings law, and it is extremely doubtful that it is useful to try to do so. Some features of the existing U.S. law, such as the Supreme Court's attachment to the physical invasion test (see pages 117–118 below), certainly defy logic, and analysts would, perhaps, be better employed working out what the consequences would be, for both justice and efficiency, if the Court were to extend its protection further into takings which involve no physical invasion of an asset, that is into the category of regulatory takings.

Using efficiency theory to prescribe changes in takings law. There is no shortage of articles on takings law that recommend changes in legal practice largely, and in some cases entirely, on the grounds that efficiency would be enhanced, (see Blume, Rubinfeld and Shapiro, 1984, Blume and Rubinfeld, 1984, Rose-Ackerman, 1988). Some of these pay lip service to the question of the *just protection* of private asset owners, but they do not allow such considerations to have a dominant effect on their recommendations. For reasons to be explored in the second main section, I believe that justice requirements and efficiency arguments need to be interrelated in an analysis of the takings problem; at this point the aim is to show that a heavy reliance on efficiency arguments can generate policy prescriptions that look distinctly odd when viewed from a wider perspective. To illustrate the point let us consider the strongly expressed recommendations offered, mainly on efficiency grounds, by Professor Rose-Ackerman.

3. See, for example, Burrows (1984) on Shavell's (1980) rationalisation of legal restrictions on the scope of tort lability.
4. Quotations from Farber (1992), ps. 125 and 136 respectively.

Rose-Ackerman, responding to Professor Michelman's claim that the Supreme Court is reformulating regulatory-takings doctrine, denies that the Court is "articulating consistent formal principles in the takings area", and argues that the law needs "a good dose of formalisation".[5] She is concerned that the Court should come up with clear and predictable standards to determine when compensation will be paid and she appears to believe that eschewing case-by-case analysis in favour of *efficiency-orientated rules* will help to achieve this clarity. The desire for clear statement in the law leads Rose-Ackerman to the remarkable conclusion that "this is one legal area in which almost any consistent publicly articulated approach is better than none" (p.1711).

While a reading of the four 1987 Supreme Court cases reviewed by Michelman, together with the more recent case of *Lucas*, certainly makes it easy to agree with Rose-Ackerman's opinion that consistent formal principles do not appear to be emerging, there are, I think, some convincing reasons for questioning the recommendations that she makes for determining who is eligible for compensation.[6] Let us consider her main recommendations, and the route by which she arrives at them. They consist of a "rough guide to deciding cases" justified by efficiency arguments (p.1707), and a curiously separate set of recommended exclusions from compensation. And they are applied equally to both physical and regulatory takings: Rose-Ackerman asserts, but does not attempt to establish, that a distinction between the two types of taking is not meaningful in efficiency terms and cannot be justified under most ethical theories (p.1702).

The "rough guide" is as follows:

(i) Compensate for any property taken that the government will use in the same form and therefore will not destroy.

(ii) Compensate for any property taken and not used by the government *only if* the owner is an individual (as distinct from a corporation) *and* if the individual loses a major proportion of his wealth. Therefore, do not compensate individuals for less than "major proportion" losses, and do not compensate firms for any property taken from them and not used by the government.

(iii) Mitigate compensation, in order to control moral hazard, by limiting it to exclude any new investments that will be destroyed by the government or would be irrational in the absence of compensation.

In addition the following exclusions from compensation should apply:

(a) Losses that are imposed as a result of the government's control of nuisances.
(b) Losses of monopoly profits resulting from government actions.
(c) Losses that result from government market competition (pecuniary externalities).

It would not be reasonable to criticise these recommendations for their lack of procedural detail because the author does not claim them to be a fully worked out set of proposals for change. On the other hand, the recommendations do display some problematic

5. Quotations from Rose-Ackerman (1988), ps. 1697 and 1700 respectively. The article is a comment on Michelman (1988a).
6. The four 1987 cases are *Keystone Bituminous Coal Association v. De Benedictus*, 107 S.Ct.1232, 1250-51 (1987), *Nollan v. California Coastal Commission*, 107 S.Ct.2076 (1987), *First English Evangelical Lutheran Church v. County of Los Angeles*, 107 S.Ct.2378, 2387-88 (1987), and *Hodel v. Irving*, 107, S.Ct.2076 (1987). The Lucas case is *Lucas v. South Carolina Coastal Council*, 112, S.Ct.2886 (1992).

characteristics which are germane to my main theme – which is that an analysis with a justice-orientation integrated with deferential efficiency elements would produce proposals that are both clearer and more persuasive to the lay person and the legal practitioner.

Consider two aspects of Rose-Ackerman's recommendations for the reform of takings law. The first problem lies in the use made of efficiency analysis to support the rough guide. It was apparent from the previous discussion of the efficiency rationalisation approach that a particular legal design can usually be justified by efficiency *theory* arguments only by selecting some of the efficiency arguments and rejecting others, because efficiency considerations rarely all point to the same design. We should not be surprised to discover, therefore, that Rose-Ackerman's rough guide is founded upon a concentration on improving the efficiency incentives of property owners, while ignoring the effects that a *patchy* compensation scheme would have on the efficiency incentives for the government in its takings decisions.

The three elements in the rough guide ((i)-(iii) on page 109) are derived from two arguments concerning the investment incentives of property owners who face the risk of taking. First, adopting the assumption that the taking risk is set at its optimal level, it is suggested correctly that compensation is *required* to induce efficient private investment, on the land which is at risk, only in those cases where the government will *use* the capital previously installed (pp.1702-4). However, it does *not* follow that paying compensation in the cases where the capital will be destroyed will necessarily lead to inefficiency. This will be so only where the compensation is not limited to the loss which would result from the efficient level of private investment based on a correct appreciation of the risk of a taking by the state. A correctly set level of compensation is compatible with efficient private investment incentives, and the mitigation of damages in element (iii) aims in this direction.[7] In any case the moral hazard argument (in this context relating to investors ignoring the taking risk) which so many efficiency analysts lean heavily upon is of uncertain importance, because there is no empirical evidence to support it, and its magnitude is not expected to be great in the many cases where the taking risk is small.

The consequence of this analysis is that Rose-Ackerman must rely, for her exclusions from compensation under element (ii), upon the insurance argument that risk averse individuals will be the only ones to under invest in the absence of compensation (p.1705). But this, too, is a problematic compensation criterion because it would require the courts to *know* the degree of risk aversion of any claimant. It is too easy an escape from such information demands to propose that risk aversion should be *assumed* when (and only when) the individual stands to lose a major proportion of his total wealth (p.1705). The reason is that people may well differ considerably in their degrees of risk aversion even for losses of a given percentage of their wealth, so that limiting compensation to "major proportion" losses would have highly uncertain efficiency consequences even on the limited view offered by the insurance argument..

The private incentive arguments are not very convincing as a foundation for the rough guide, and Rose-Ackerman's judgement (p.1707) that they should take priority over the argument that a compensation require-

7. For a fuller discussion of the consequences of paying compensation see Burrows (1991), pp.56-62.

ment improves the incentives to public officials in making their takings decisions seems rather thinly justified. In principle a compensation requirement may discourage over-investment in the public sector, and there does not seem to be any reason for expecting that it will lead to adverse consequences in the public sector.[8] The exclusions from eligibility that are mandated under element (ii) of the rough guide would weaken any potential efficiency gain from this source.

Finally, an important consequence of efficiency-orientated rules is that they can lead to the highly discriminatory treatment of individuals and firms who suffer the same level of government-imposed loss. This appears not be compatible with the requirements of just protection. Rose-Ackerman alludes to fairness arguments, but makes no attempt to face the question of the injustice that her recommended rules might create. Michelman mildly suggests, referring to her analysis, that "Its instrumental concerns drive it to incorporate some standards and distinctions that it seems would be controversial within common morality or counter-intuitive to it." (see Michelman, 1988b, p.1712). He somehow leaves one with the impression that instrumental concerns *inevitably* have this consequence. But I do not think that a concern with efficiency inevitably leads to the advocacy of such counter-intuitive rules; the consequence of recognising the possibility that a law may alter efficiency incentives depends on the degree of *priority* that is attached to such effects. It surely is not correct to suggest that *any* consistent, articulated approach is better than none, if it would lead to serious injustice. On the other hand, Rose-Ackerman's scepticism towards the case-by-case formulation of takings doctrine, and her preference for the articulation of formal principles, *is justified* by the present state of obscurity of the takings law. All this suggests that the search for a consistent set of explicit judgements more in accord with our perception of the principles of justice should continue.

The conclusion of this section is that neither using the efficiency-rationalisation approach nor giving efficiency objectives priority in analysing the takings problem, has done much to unravel the takings tangle.[9] When some scholars claim that the *existing* takings law is efficient, while others claim that, on the contrary, a variety of radical *changes* to the law would enhance efficiency, it is hard to see how non-economists can be expected to gain enlightenment from the previous efficiency analyses of the takings problem. But the question remains: can *any* analysis of takings law which does utilise efficiency arguments do any better?

A deferential role for efficiency analysis

Arguably there are four good reasons for making efficiency arguments subservient in takings law judgements. First, many legal analysts, and judges, appear instinctively to see the fundamental purpose of the law as justice: recognising the constitutional imperative of a *just* compensation, rather than an efficient compensation, requirement. Second, efficiency theory alone cannot offer

8. See Burrows (1991), pp.55-8, on the efficiency implications of a compensation requirement when government project decisions are subject to a budget constraint.
9. Small wonder, then, that Michelman (1988a), reviewing the 1987 takings cases, falls back on legal reasoning and rarely mentions any efficiency aspects of the decisions.

an unambiguous basis for prescribing legal rules. Third, there exists no empirical evidence to justify giving priority to the risk of moral hazard in determining the eligibility for compensation. Fourth, the information demands of making truly efficiency-orientated judgements on takings probably exceed the expertise and resources of the courts.

Consider, therefore, how an analysis of takings could proceed when efficiency arguments are recognised, but when justice is centre stage. The unravelling of the takings tangle must involve the Supreme Court in making and justifying *a logical series of explicit judgements* which will identify the substance and limitations of the legal obligations of the state when its activities impose losses on individuals and organisations. I will identify four 'steps' in this series:[10]

(1) A statement of legal purpose.
(2) A demarcation of takings law, separating the compensation issue from questions of correct procedure.
(3) An identification of 'takings' in principle.
(4) An enumeration of exclusions from compensation.

The discussion of these steps can be viewed on two levels. First, I hope the reader will be persuaded that an explicit and consistent set of judgements in these four categories would help to clarify takings law. Second, the reader can consider which set of judgements s/he finds most persuasive: although I will illustrate the argument by taking a particular view on each step, another set of judgements can be substituted without invalidating the claim that the four categories are all in need of a clear resolution.

(1) *A statement of legal purposes.* It is hard to imagine that a coherent takings law can ever emerge unless there is some agreement on the primary *purpose* of the law. Some analysts of takings law have proved adept at producing different prescriptions for legal rules by making different assumptions about *objectives*. Others have eschewed consideration of legal purpose: thus Michelman aims to provide a "cogent account" of the 1987 takings decisions without attempting to establish the legal purpose as a criterion by which to judge the success of the Supreme Court's decisions.[11] To his suggestion that the Court has been moving away from a "non-formal, open-ended, multi-factor balancing method" towards "a resolution into a series of categorical 'either-ors'" (ps. 1621, 1622) the question should be: is such a change of direction likely to enhance the achievement of the *purpose* of the law? Perhaps it is time the Supreme Court made a pronouncement on general purpose in the takings context.

Some judges and some writers have attempted to elucidate the primary purpose of takings law in terms of just protection (and by implication *not* in terms of maintaining efficient incentives!). It is their interpretation that I shall follow. Thus Justice Brennan sees the "fundamental purpose" of

10. Readers familiar with Epstein's 1985 book will note overlaps between these steps and his agenda (p.31). Epstein's analysis has the great merit of elucidating central issues, but the overall controversial conservatism of his analysis, in particular the insistence on such a broad reading of the eminent domain clause, leads him to some very different interpretations to those that will be suggested here.

11. Michelman (1988a), p.1601. Note Kmiec's telling comment that despite Michelman's claim merely to be narrating the 1987 takings decisions "his interpretations often lean against compensation", Kmiec (1988), p.1630.

the Just Compensation Clause as being to protect individuals from bearing public burdens.[12] Similarly, Justice Stevens states that the Clause was designed to prevent the government from forcing individuals to bear public burdens which "in all fairness and justice, should be borne by the public as a whole".[13] In line with these opinions Kmiec's interpretation of the original meaning of the takings clause is that it poses the "true question": has this landowner been singled out to bear a disproportionate burden not justified by his own harmful activities?"[14] Providing such just protection is intended to serve the instrumental purpose of blocking *arbitrary* redistributions of wealth by the government.

It is compatible with articulated, systematic redistribution policies, so that logic does not compel us to extend such protection to those whom the legislature requires to bear the burden of those policies which seek distributive justice.[15] It is *consistent*, therefore, to argue that people (or institutions) should be protected from those losses which are not the explicit objective of the government activity, but not be protected from losses which it is the stated *purpose* of legislation to impose so that others may benefit.

An important (but often hidden) element in this 'first step' judgement on legal purpose is the decision as to what constitutes just protection. In linking their opinions to the Just Compensation Clause Justices Brennan and Stevens are implicitly accepting the judgement that *monetary compensation* can satisfy the requirements of justice; in other words that a liability rule is sufficiently just for a property rule not to be required. It would be better for the Supreme Court to make this element in legal purpose explicit. Is it the Court's opinion that monetary compensation is sufficient for *all* of those state-imposed losses from which people are to be protected? In articulating its opinion the Court would need to address Radin's argument that, in the case of personal property, *compelling* the asset-loser to accept money may be damaging, and by implication unjust.[16] If the Court confirms the desirability of the current emphasis on com-

12. Brennan, J. dissenting in *San Diego Gas and Electric v. City of San Diego*, 450 U.S., 621 (1981) at 655-56, quoted by Kmiec (1988), p.1662.
13. Stevens, J. dissenting in *Lucas v. South Carolina Coastal Council*, 112, U.S., 2886 (1981) at 2923, quoting *Armstrong*.
14. Kmiec (1988), p.1663. See also Radin (1988), p.1687. Fischel and Shapiro (1989) have shown that constitution framers who anticipate majoritarian government will choose to restrain the government by writing in a compensation requirement. This is compatible with the assumption made here that the fundamental purpose of takings law is to justly protect those upon whom the state imposes disproportionate burdens.
15. See Burrows (1989) for a denial of the logical coherence of Epstein's (1985) attempt to use the eminent domain clause to obstruct all government redistribution policies.
16. Radin (1988), P.1691. Radin's analysis seems to be ambiguous on an important point. It *appears* that she is referring to the injustice arising from the fact of compulsion per se, in which case presumably she would argue this whatever the level of compensation provided. In practice the injustice is compounded by limiting compensation to the market value of the asset taken, which will undercompensate those who gain consumer surplus from their assets. Attempts to overcome such undercompensation through extra payments (on which see Burrows (1991), footnote 22) do not address the more fundamental question of the injustice from compulsion per se.

    I do not pursue Radin's proposal to exclude from compensation all fungible assets taken by the state, since it is clearly contrary to the requirements of just protection as they are being interpreted here. There is considerable doubt as to the justification for a system which would compensate those who work hard to improve their homes but exclude those who do the same to improve their business.

pensation as a means of affording just protection then its judgement can probably be viewed as simply reaffirming the concession to efficiency that underlies the constitutional power of the state to compulsorily acquire assets for public purposes. Without this state power private asset-holders would retain the option to hold out against publicly beneficial (efficient) uses of their assets. But it is important for efficiency theorists to recognise, before they press for exclusions from just compensation on efficiency grounds, that restricting the rights of asset-holders to compensation means that only a *weak* justice constraint is being imposed. To this extent the objective of facilitating the efficient public use of resources is *already* built into the compensation requirement of the constitution.

The particular judgement of the legal purpose of takings law that I shall use to develop the argument is the presumption that, subject to any limitation or exclusions that follow in the succeeding 'steps', those who suffer from *any* losses imposed by the state which are not a consequence of a deliberate, explicit, systematic policy of redistribution should (at least) be compensated.

(2) *A demarcation of takings law.* The second 'step' concerns which issues do, and which do not, come within the ambit of takings law. There are three issues in the takings context which in principle are distinct, but which in Supreme Court decisions, as well as in the writings of legal analysts, have not always been kept separate, to the detriment of legal clarity. The issues are:

(a) Whether the government action (either the compulsory acquisition of private assets or the regulatory control of the use of private assets), is an *effective* means of furthering the intended and legislated public purpose.
(b) Whether the government regulation, or the government project requiring the input of assets from the private sector, is *efficient* in its impact.
(c) Whether those who lose as a result of the government action should be compensated.

A reading of the takings literature does not reveal a clear statement as to which of these issues it is constitutionally legitimate for the Supreme Court to encompass in its takings decisions. Consequently the references in the literature to the "heightened judicial scrutiny" and "balancing" activities of the Court are quite perplexing, because it is not evident which of the three issues these activities are intended to resolve (terms used by Michelman, 1988a, for example).

I will tentatively employ one interpretation of the limits of takings law in order to suggest that the analytical complexity of takings cases could be much reduced by a narrow focus and an explicit concentration on one issue at a time. I will assume that issues (a) and (c), but not (b), are the concern of the Supreme Court in takings decisions. Excluding issue (b) assumes a relatively deferential posture for the Court, leaving the statement of policy objectives, *and* the ex post evaluation of the success of policy instruments, to the legislature in conjunction with the executive.[17]

17. Kmiec's objection to the Court's "unwitting revival of substantive due process" in *Keystone,* (1988), p.1632, seems to imply the stronger exclusion of both issues (b) *and* issue (a) from the Court's consideration.

That the issues (a), (b) and (c) *are* distinct in principle can be shown by considering a stylised case. Imagine that a state legislature introduces a statute preventing beachfront land owners from building houses on their land, with the stated intention of preventing an increase in storm damage through the weakening of the sand dune storm barriers. One of the landowners so restricted claims a taking. Are *all three* of the issues involved here? I do not think that a resolution of the plaintiff's claim does need *the Court* to resolve *all* of them. Issue (a), in a regulatory case like this, takes the form: given that the objective of the regulation is to reduce storm damage, is the restriction on the plaintiff's building an effective means of helping to achieve the objective? To resolve issue (a) the Court needs information *only* on the expected effect of the plaintiff's building on the dune barrier and the consequential benefit of the restriction to those whom the barrier protects from storm damage. If the building would not affect the barrier then the restriction would not serve the intended public purpose. Note that there is no "balancing" of interests involved in resolving issue (a). Similarly, in the cases where the government compulsorily acquires assets the crux of issue (a) is *not* the efficiency question of whether the public use has a greater value than the private use; it is whether the asset taken is *required* for the proposed public use and actually has been used for that purpose.

Issue (b) is broader than (a). It would require the Court to calculate, in each case, the value of the asset taken *in its public use*, which is the benefit of the taking, and compare it with its value to the owner, the cost of the taking. This is the efficiency balancing test at the individual case level. In the beachfront case the benefit is the value of the storm damage that is prevented by the building restriction; the cost is the consequence for the plaintiff of abiding by the building restriction, basically the value of his foregone opportunity. But why should the Court get involved in this difficult comparison? Having satisfied itself on issue (a), that a public use is being served, the Court can turn to its fundamental purpose, to judge whether compensation should be paid, issue (c). This requires the Court to decide whether the restriction on building has or has not imposed a loss on the plaintiff (step 3 below) and, if it has, whether imposing this loss is justified, for example because the plaintiff's activity falls under the nuisance exclusion (step 4 below), in which case compensation need not be paid. There is *no need* for these questions to involve the efficiency balancing that would be required in dealing with issue (b). The Court could follow the lines of strict liability in common law cases: in contrast to following a negligence rule, determining liability would not then involve an efficiency balancing of the interests of the plaintiff (asset loser) and defendant (asset taker). Rather it would centre on the causal question 'did the defendant's act cause the plaintiff's loss?'; in other words did the restriction imposed by the statute cause the plaintiff to incur a loss? As under strict liability in tort the plaintiff's eligibility for compensation would *not* then depend upon the efficiency of the taking: he would be justly compensated for efficient and inefficient takings alike, *as long as* they caused his loss.[18] Once the Court has determined the compensation requirement the balancing involved in designing *efficient* takings policy can be left to the

18. For an analogous argument in relation to tort law see Burrows (1986), p.203.

government. That is, (b) is left for the legislature/executive to resolve.

A clear thread of legal resolution could be achieved if the Court were to keep a narrow focus and to explicitly classify its statements in takings cases into two parts which answer the two questions: Is the government's action effective in terms of its stated public purpose? Is there a loss that should be compensated? This procedure involves a limited judicial scrutiny, in answering the first question, and it requires no *efficiency balancing* of the kind that issue (b) would have given rise to.[19] If the answer to the first question is no, then the Court would invalidate the statute in its application to the plaintiff's case, lifting the building restriction. If the answer to the second question is yes then compensation would be required for the period (which would be indefinite if the restriction is not lifted) for which the plaintiff has been constrained by the application of the statute.

The Supreme Court has not always simplified takings decisions by following such a clear thread; consider a classic case, *Miller v Schoene*, and a recent decision, *Lucas v South Carolina Coastal Council*.[20] In *Miller* the Supreme Court allowed its argument on issues (a) and (c) to be contaminated with an efficiency balancing argument on issue (b) upon which it based its refusal of compensation.[21] There may be an element of doubt as to whether a causal enquiry could have established that the defendant, in growing cedar trees, caused a nuisance which damaged the plaintiff's apple trees (by fostering a fungus harmful to the apple trees). But what is significant here is that the Court overrode such a causal enquiry with the efficiency argument that the cedars should be cut down, without compensation, to protect the *more valuable* apple trees. The efficiency judgement (issue (b)) may have been correct, but it is not germane to the issue, (c), as to whether the plaintiff should be entitled to compensation.

Sixty four years later the Supreme Court again confused the causal issue with the efficiency issue in *Lucas*. Facing the question of whether the plaintiff's planned beachfront building would have caused local ecological damage the Court (at 2898), in its confusing and probably inconsistent review of the distinction between causing a harm and conferring a benefit, argued that the answer will depend on which of the two competing uses *is the more valuable*.[22] Was the Court saying that if the plaintiff's building is the more highly valuable then it would be harmed by the local ecology? Clearly, if it can be established that constructing the building would adversely affect the risk of storm damage then the plaintiff's activity and the activities of those at risk are in *asymmetrical* causal positions, because there is no suggestion that the plaintiff's activity was at

19. Michelman's opinion, (1988a), p.1629, that "balancing .... is not law's antithesis but a part of law's essence" is too vague either to confirm or to refute. We need to know which particular issue within the takings context the balancing of interests is alleged to resolve, and exactly what *form* the balancing is supposed to take. For example it would do much to clarify the lawyers' notion of a "balancing test" if we were given a sufficiently precise definition to enable us to see to what extent it corresponds to the economists' notion of *efficiency* balancing. Similarly Fischel's interpretation of Michelman's opinion is hard to relate to the particular issues that takings law must resolve (see Fischel (1988), p.1590).

20. *Miller v. Schoene*, 276 U.S. 272 (1928) and *Lucas v. South Carolina Coastal Council*, 112 S.Ct.2886 (1996).

21. For compelling argument that "questions of value" (which an economist would interpret as questions of efficiency) wrongly prevented the award of compensation, see Epstein (1985), pp.113-115.

22. Judge Blackmun, dissenting in *Lucas* at 2910, repeated the confusion.

risk from the nearby activities.[23] Henceforth, as we proceed with the subsequent 'steps', it will be assumed that the Court should *eschew efficiency balancing* and concentrate on issues (a) and (c). Therefore the Court must first determine whether the government's action is furthering a public purpose. In the physical invasion cases this merely requires the government to establish that the asset is required for a specific public project. In the regulation cases the Court must analyse the plaintiff's activity and the government's intervention to check the validity of the government's claim that the regulation of the plaintiff's activity does further the stated public purpose. Having completed the public use test the Court can then turn to the compensation question, which involves 'steps' 3 and 4.

(3) *An identification of 'takings' in principle.* The third 'step' aims to establish whether a government action has imposed a loss upon a plaintiff which is not the outcome of an articulated, systematic redistribution policy (see page 51 above). If it has then this will be referred to as a 'taking in principle'.[24] The finding of a taking-in-principle will lead to a requirement that the government compensates the plaintiff *unless* some justification is uncovered in 'step' 4.

Let us be precise about the just protection purpose outlined in 'step' 1. I will interpret it as meaning that those who suffer from an *unjustified* taking-in-principle should receive compensation payments

(a) which do not depend upon the nature of the government activities that cause the losses,

and

(b) which are of equal size for losses that are equal in *absolute* magnitude.

The nature of these two characteristics of the compensation payments will emerge as we consider what is meant by 'a loss' and how it should be measured. One of the main points I will make is that the Supreme Court has adopted a method of identifying losses which has added a quite unnecessary degree of uncertainty and confusion to takings law, a method in which legal commentators appear to have acquiesced.

A plaintiff will be said to have incurred 'a loss' caused by a government action (a taking-in-principle) when the action can be shown to have reduced the absolute value of the plaintiff's assets. In compulsory acquisition cases the loss is the value of the assets transferred from the plaintiff to the government. In regulation cases the loss is the reduction in the absolute value of the plaintiff's assets as the result of the reduction in some valuable attribute of those assets caused by the regulation. In the case of a restriction on beachfront building, for example, the loss is the reduction in the absolute value of the land which results from the loss of its use for building purposes.

Defining 'a loss' in this way seems natural for an economist, yet it is at variance with Supreme Court practice in two respects, which appear to make the previous paragraph controversial. In the first place the Supreme Court has never accepted the fact that those losses that result from *regulations* are just as much 'losses' as those, of equal magnitude, caused by *physical invasions.* Numerous writers have criticised this imbalance in the treatment of similar losses from different

23. The ghost of Coase's misrepresentation of conflicting use as *causal* symmetry lives on in the Supreme Court. See Coase (1960). A good analysis of causation in tort cases can be found in Wright (1985).
24. Epstein (1985), Part II, refers to .takings prima facie..

causes, and the Court's recent extension of its definition of a taking, beyond physical occupation, only to those instances in which regulation is such as to *totally* deny an owner "economically viable use of his land", does little to weaken the substance of these criticisms.[25] As a result *trivial* losses from physical invasions can be compensated while *serious* losses from regulation are not. The imbalance clearly leads to inequality in the treatment of similarly harmed plaintiffs, and the Court needs either to articulate its justification for discriminating against plaintiffs who fall into the regulatory takings category, or to abandon the practice. In the second place, I have emphasised the definition of losses in terms of the diminution of the *absolute* value of the plaintiff's assets, the measurement of which involves only a comparison of the values of the affected assets before and after the government action. If the Court wishes to offer equal protection for losses of equal absolute size this seems to be the appropriate measure of loss. Yet the Court habitually defines losses in *percentage* instead of absolute terms. The reason offered in *Keystone* is that its test for a regulatory taking, which is whether the regulation denies the owner economically viable use, *requires* the loss of value of the property to be compared with the value of the remaining property, if any.[26] Thus, the Court's practice of limiting compensation to cases of 100% loss from regulation by the government, which itself is highly arbitrary in the protection it offers to plaintiffs in regulation cases, is used as a reason for defining losses in percentage terms.[27] But defining losses in this way introduces an unnecessary uncertainty concerning the denominator to be used in the calculation of the percentage; this uncertainty has led to wrangles over the definition of the "unit" of property whose percentage of loss of value is to be calculated. Obviously the government would like to maximise the denominator, the plaintiff to minimise it. The strategies this brings about have produced the notion of *conceptual severance:* the definition of the unit of property in such a way as to find (or not to find, whichever is the objective) that a 100% loss has occurred.[28] The uncertainty concerning the Court's choice of denominator makes it even harder for the potential litigants to guess the likely implications of the Court's compensation rule.

Defining losses in absolute terms avoids all of this, and it saves the Court the trouble of having to measure the "total" property to be used in the denominator. Of course it would mean the Court would lose a degree of discretion in identifying a taking-in-principle . But the strongest argument in favour of using the absolute loss measure is that in a system which attempted to protect people

25. The quotation is from *Lucas*, 112 S.Ct.2886 (1992) at 2894 and 2895. For criticism of the imbalance see, for example, Blume and Rubinfeld (1984), pp.623-24, Rose-Ackerman (1988), p.1702, Kmiec (1988), section IIIB. In this context Michelman's adherence to *physical* occupation and *total* denial of economic viability as "formulas having both the feel of legality and the feel of resonance" is puzzling, even though he says in the next breath that he is not defending these doctrines! (1988), ps.1628-1629.

26. *Keystone* 107 S.Ct.1232 (1987) at 1248. Other cases in which this test is used are *Agins* 447 U.S. 255 (1980) and *Lucas* 112 S.Ct.2886 (1992).

27. Justice Stevens, dissenting in *Lucas* id. at 2919, comments on the "arbitrariness" of a compensation rule by which an owner whose property is diminished in value by 100% is fully compensated, while another owner whose property is diminished in value by 95% recovers nothing.

28. On conceptual severance see Radman (1988), p.1676, and Michelman (1988a), section IV.

from regulatory losses generally, the equal treatment of equal losers would require absolute losses to be measured by the Court.

Defining losses in absolute rather than percentage terms would simplify step 3, but it would not address the problem which has preoccupied economists writing on takings law, namely the risk of moral hazard in the payment of compensation. The moral hazard risk only arises if compensation is provided in a form that indemnifies potential plaintiffs against all government imposed losses *regardless* of whether the plaintiff has made any effort to mitigate the losses. It was suggested in Section 2 that this risk is often overstated. Nevertheless the Court may wish to control the moral hazard risk by choosing a *form* of compensation which protects the incentive of asset owners to take the taking risk into account in their decisions on how to use their assets. There is not space to discuss alternative forms of compensation here.[29] But in principle it should be possible to limit compensation approximately to the levels of loss that public use acquisitions and regulations would impose if the owners were to make efficient investment decisions. For example, mitigating compensation to the loss that would have been created given the condition of the asset prior to the acquisition or regulation planning period would weaken the incentive of owners to ignore the taking risk. (see Rose-Ackerman,1988, p.1704 and Burrows, 1991, p.62). In an analysis of takings in which efficiency plays a deferential role this mitigation concession to the requirements of efficiency would be acceptable only if the failure to compensate for the "excessive" losses incurred by asset owners were not judged to be seriously unjust. At the very least, the injustice would be moderate compared with that which would be created by the compensation exclusions which economists have tried to justify on grounds of the adverse efficiency consequences of moral hazard by relying on the assumption that compensation is "full" in the sense of unmitigated.[30]

(4) *An enumeration of exclusions from compensation.* Once the Court has found a taking-in-principle from the plaintiff the requirements of just protection compel compensation unless there is a *justification* for leaving the taking uncompensated. There are two grounds for excluding a taking-in-principle from compensation that are compatible with the pursuit of just protection and with a deferential role for efficiency. One of the exclusions concerns the nature of the plaintiff's activity, the second relates to the resource limitations faced by the justice system as a whole:

(a) the nuisance exception
(b) the small takings exception

(a) *the nuisance exception.* The Supreme Court and the legal commentators seem to be agreed that certain kinds of behaviour by the plaintiff, in particular his participation in an activity that harms others, can justly be used as a reason for refusing compensation when his activity is regulated. However, this agreement on the matter of principle does not extend to the question of how this justification of uncompensated takings should be implemented. On this question the writings of some legal analysts are

29. On the expected impact of compensation based on the value of assets (especially land) in comparable sales, currently the most widely used method of calculating compensation, see Burrows (1991), P.56 et seq.
30. For analyses whose recommendations rely on this assumption see Blume, Rubinfeld and Shapiro (1984), p.79 et seq., Blume and Rubinfeld (1984), section V, and Kaplow (1986), p.541.

strikingly more lucid and logically consistent than the opinions offered in various cases by the Supreme Court. Let us consider two aspects of this first exception to the compensation-requirement rule: the logical basis of the exception and the breadth of the exception.

The logical basis of the nuisance exception is that the state must have the (police) power to control "the full catalogue of common law wrongs involving force and misrepresentation, deliberate or accidental, against other persons, including private nuisances," and that those who undertake such harmful acts forfeit a right to protection from the consequences of the government actions designed to prevent the harms.[31] This is the "nuisance" or "noxious use" exception, upon which doctrine the Court in *Keystone* was unanimous, and which has been stated in many other cases, for example in the recent *Lucas* case.[32]

There is one worrying aspect of the nuisance exception from the point of view of the just protection of those upon whom the government imposes takings-in-principle: if the exception is *broadly construed* it can wash out the presumption that such takings require compensation (see Epstein,1985, ch.9 and Kmiec,1988, section 1, B and C). A tendency towards a broad interpretation permeates modern decisions, as the Court readily admitted in *Lucas* (quoting its decisions in *Nollan, Penn Central* and *Euclid*): "'Harmful or noxious use' analysis was, in other words, simply the progenitor of our more contemporary statements that 'land-use regulation does not effect a taking if it substantially advances legitimate state interests'."[33] The reason given for this broadening is the claim that a narrower focus is made impossible by the fact a clear distinction cannot be made between preventing a harm and conferring a benefit; so that the drawing of a line between those takings-in-principle which result from controlling nuisances and those which result from other public uses is not operational. The implication of this argument would be that the Court would exclude from compensation not only those who lose out from controls on their harmful activities, but also those whose *benign* activities are controlled in the public interest.

I fear that this opinion derives originally from the misinterpretation of an efficiency argument which originated in Coase's famous paper (see Coase,1960, section 2 and Rose-Ackerman,1988, p.1709). In a situation in which two activities conflict, for example where one landowner's factory interferes with another landowner's crop production, it can be said both that the factory owner imposes a cost on the farmer *and* that preventing this would impose a cost on the factory owner. Efficiency requires the lower of these two costs to be chosen. And clearly, preventing the harm confers a benefit on the farmer. But the fact that both parties are (in some degree) in symmetrical positions *as regards costs* does not mean that the two activities are in symmetrical *causal* positions (see Epstein, 1985, pp.115-121). It is true that the factory causes harm to the farm; it is not true that the farm, a benign activity in this case, causes harm to the factory. It is surprising that the Supreme Court has not recognised the distinction between cost symmetry and

31. Quotation from Epstein (1985), p.111.
32. *Keystone* 107 S.Ct. (1988) at 1256, *Lucas* 112 S.Ct. (1992) at 2897. An early statement of the property owners' obligation to avoid imposing harms is in *Mugler* 123 U.S. 623, (1987).
33. *Lucas* 112 S.Ct. (1992) at 2897.

causal symmetry. The fallacy of using cost symmetry as an indicator of causal symmetry is obvious in other contexts. The psychopath enjoys killing and it would impose a 'cost' on him to prevent him doing so. But nobody would argue that this implies causal symmetry. There is no reason to draw such an implication in the takings context either.

A careful causal analysis would be able, in most cases, to distinguish between takings which prevent a harm and those which confer a benefit on the public, and thereby allow the limitation of the nuisance exception to those, harm prevention, cases in which just protection does not compel the payment of compensation. (see Epstein, 1985 and Kmiec, 1988). The Supreme Court needs to provide a more persuasive reason for its view that logic forces it to expand the nuisance exception to provide a justification for uncompensated takings in a broader class of public use cases. Its argument in *Lucas* scarcely does this, because it follows the assertion that preventing harms and conferring benefits are indistinguishable activities with the statement that in order to win its case against Lucas the South Carolina Coastal Council must "identify background principles of nuisance and property law that prohibit the uses he now intends (building a seafront house) ... Only on this showing can the State fairly claim that, in proscribing all such beneficial uses, the Beachfront Management Act is taking nothing".[34] As Justice Blackmun (dissenting) remarked, the Court did not explain why this proposal to rely on common law principles is not subject to the same objection, that the lower courts also cannot distinguish between harm caused and benefit conferred.[35] In fact the lower counts *are* able to do so using causal analysis (see Wright, 1985, for case examples), and the Supreme Court needs to review the stance by which it has tried to justify what may prove to be an unjustly wide use of the nuisance exception. It is not the case, of course, that a narrow, causation-based interpretation of the nuisance exception will prove to be straightforward in all cases, because in borderline cases there is always the risk of disagreements about causation. For example, in *Lucas* there was disagreement between the judges as to whether Lucas' activity constituted an infringement of nuisance regulation. Nevertheless, when implementing a narrow interpretation of the nuisance exception at least the *objective* would be clear, namely to deny the government the right to avoid compensation for significant takings unless the plaintiff is culpable and beyond the purpose of just protection.

(b) *the small takings exception.* In one respect the ability of takings law to protect people from takings-in-principle is inevitably constrained by economic conditions. In all areas of the law we accept that there are some intrusions which are beyond legal remedy simply because it would not be worthwhile to devote scarce resources to remedying minor infringements to our right to freedom from interference. Takings law is no exception and there will inevitably be a lower-end cut-off point below which the taking-in-principle is so small that the Court would not be prepared to devote resources to evaluating the case and arranging compensation. However, the repetition of even trivial takings could raise the total losses to a level above the lower

34. *Lucas* 112 S.Ct. (1992) at
35. Blackmun, J. dissenting in *Lucas* id., at 2912-14.

limit of the small-takings exception. There is much to be said for the Supreme Court stating clearly the level of absolute loss below which the exception would apply. Given that the fundamental aim of takings law is to prevent the imposition of *disproportionate* burdens on individuals by the state, the exclusion of small takings from everyone's protection is far less damaging to just protection than would be the exclusion of the takings which are suffered by some people, *regardless of the size* of those takings, just because such an exclusion is said to have some efficiency merit.

Conclusion

It is a curious fact that while there are numerous instances of takings law in European countries, there is, as yet, no integrated literature on the "takings problem". While there are, as we have seen, questionable aspects of the American literature on takings, nevertheless there is much for European lawyers to learn from the attempt to make this aspect of the power of the state explicit and coherent.

The analysis in this paper has been in two parts, one negative and one positive. The main point of the negative section on efficiency theory was to suggest that the two forms of efficiency analysis that previously have been applied to the takings problem have failed to help to unravel the tangle. The efficiency rationalisation approach is inherently unhelpful, and the strongly efficiency-orientated analyses have produced recommendations for changing takings law that are at variance with widely held notions of justice.

Having cleared the decks, so to speak, the more positive section which followed proceeded to develop an analytical structure which treats just protection as the *central* objective, but which recognises a subservient role for efficiency arguments. A fundamental premise of this analysis is the belief that there is a case for strong anti-takings law even in a society which accepts a systematic-redistribution role for the state. It emerged in the development of the analysis that U.S. takings law would be substantially clarified if the Supreme Court were to offer an explicit and structured series of judgements on the following issues:

Category (1): Statement of legal purpose

- (a) Pronouncement on fundamental purpose.
- (b) Indication of situations in which monetary compensation would offer insufficient protection.
- (c) Judgement on the relationship in principle between the just protection for takings and government policies intended to achieve systematic redistributions.

Category (2): Demarcation of takings law

- (a) Recognition that there are three separable issues here, and requiring judgements on the relevance, if any, of each of them to the Court's takings decisions.
- (b) Issue 1: Is the government action an effective means of furthering the public purpose?
- (c) *Issue 2*: Is the government action efficient in its impact?
- (d) *Issue 3*: Should those who lose be compensated?

Category (3): Identification of takings-in-principle

- (a) A statement of the meaning of a 'taking-in-principle', including the choice between definitions in terms of absolute losses and percentage losses.

(b) Judgement on the equivalence of physical takings and regulatory takings.
(c) Judgement on the argument for a comprehensive inclusion of government-imposed losses in 'takings-in-principle'.
(d) Decision on the appropriate method of measuring losses for compensation, taking account of the effect of alternative methods on the risk of moral hazard.

Category (4): Exclusions from compensation
(a) Judgement on the acceptable justifications for excluding a taking-in-principle from the just protection requirement.
(b) Reconsideration of the role of causation analysis as a means of distinguishing between 'preventing a harm' and 'conferring a benefit'.
(c) Judgement on the appropriate breadth of the nuisance exception in the light of the objective stated under category (1).
(d) Drawing the line on the small takings exception.

How many European countries could claim to have developed laws to control takings by the state that are based on clear judgements along these lines?

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