Land Grab:
Takings, the Market Process, and Regime Uncertainty

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Abstract
Property rights are a key aspect of the rules governing economic interactions, providing individuals with dependable information and incentives. Well-defined and stable property rights encourage the effective use of existing scarce resources and also provide the incentive to innovate. In this context, we explore the impact of government takings on entrepreneurship and the market process. By changing the rules of the game, takings distorts the market process by shifting the opportunities and incentives facing entrepreneurs. The use of takings also introduces “regime uncertainty” whereby the predictability of the rules of the game is weakened. These costs of takings are typically overlooked because they involve unrealized entrepreneurial opportunities that cannot be captured in standard cost-benefit calculations.
1 Introduction

Eminent domain is the power of the state to confiscate private property for its own use without the owner’s consent. The takings clause of the Fifth Amendment grants the US federal government the authority to use eminent domain provided the taking is for “public use” and the property’s owner is “justly compensated.” The Fourteenth Amendment extends right to state and local governments.

The logic behind granting government the power of eminent domain is that it will occasionally need large tracts of land for public projects such as highways, schools, parks, hospitals, etc. The main problem is that acquiring adjacent pieces of property may result in a holdout problem whereby a project is delayed by a small number of owners who refuse to sell their property to the government. Granting government the right to confiscate the property of holdouts is meant to overcome this problem.\(^1\)

The associated conditions of “public use” and “just compensation” aim to prevent political abuse by placing constraints on the government’s power of eminent domain. For instance, the condition that the confiscated property must be for public use is meant to limit government’s ability to interfere with the private market and the valuations of private individuals. Stated differently, the public use requirement is intended to prevent the state from using its coercive power to bypass the market and transfer property from one private owner to another. Likewise, the condition of just compensation, which requires government to pay the market rate for confiscated property, aims to prevent government from arbitrarily taking private property to finance state operations. The logic here is that if the government is required to pay the market price for the confiscated property, there can be no profit from takings.

\(^1\) For a critique of the “holdout problem,” see Benson (2005).
Of course the conditions of public use and just compensation are broad in nature and often pose significant difficulties in practice. For instance, what projects fall under the category of public use? Similarly, how is just compensation to be determined given that compensation from government will, almost inevitably, be different from how the owner values the property? Given the vagueness of these conditions, there is much room for interpretation by both governments and courts. Although the recent case of *Kelo v. City of New London*\(^2\) has made the government’s power of eminent domain front-page news, the interpretation of the conditions associated with government takings has a long and controversial history (see Paul 1985).

For example, in the case of *Berman v. Parker*\(^3\) the United States Supreme Court upheld the rights of the District of Columbia to seize and demolish properties that were partially blighted in order to replace them with a privately-owned department store. In doing so, the Court broadened the interpretation of public use to include redevelopment. In *Poletown Neighborhood Council v. City of Detroit*,\(^4\) the Michigan Supreme Court upheld the right of the City of Detroit to use eminent domain to displace several thousand private residents for the construction of a General Motors factory. The justification was that the expected creation of jobs and associated economic benefit were for the public use. For decades, state Supreme Courts have referenced the *Poletown* decision (including the Connecticut Supreme Court in *Kelo*) in deciding similar cases.

The issues associated with government takings become even murkier when one includes cases of regulatory takings. Regulatory takings refer to situations where government regulations severely reduce the value of a property such that it effectively involves government takings. Examples of these types of indirect takings include zoning laws and land-use regulations. In a

\(^2\) 125 S. Ct. 2655 (2005).
\(^3\) 348 U.S. 26 (1954).
1987 decision, the US Supreme Court held that regulation is the equivalent of a government taking when regulation deprives the property owner of economically viable use of the property.\textsuperscript{5} Given this, the central issue is determining when a regulation has sufficiently infringed upon property rights such that it amounts to takings by the government. Typically, in order to receive compensation, the owner must demonstrate he has been deprived all value of the property or that he was required to dedicate part of his property to government use without a justifiable reason. In reality, most government regulations may reduce the value the property to its owners while not fully reducing the value to zero. In these cases, the owner bears the cost of the regulations.

In this paper, we examine a subsidiary cost of government takings. Specifically, we focus on the impact of government takings on entrepreneurship and the market process. Takings redirect the market process along a new path, generating costs that are often overlooked. These costs manifest themselves in forgone entrepreneurial opportunities as well as the emergence of undesirable consequences.\textsuperscript{6} We use the term government takings in the broadest sense to include both direct (i.e., eminent domain) and indirect (i.e., regulatory takings) takings.

The starting point of our analysis is the basic premise that institutional context and the resulting “rules of the game” matter for economic, political, and social outcomes. All interactions presuppose some rules of the game and players must know what the rules are and agree to them for the game to function properly. When rules become unclear, unstable, or are altogether absent, the game tends to break down resulting in dysfunction or chaos. To provide an example of this latter point consider that a central issue facing countries transitioning from centrally planned economies to market-based systems was the absence of clear and accepted

\textsuperscript{5} First Lutheran Church v. Los Angeles County, 482 U.S. 304 (1987). The courts recognition that a statue or ordinance may impose restrictions on the use of property that are so burdensome that they amount to takings by the government can be traced back to Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922) (see Fischel 1998).

\textsuperscript{6} Benson (2004) considers the costs of forgone opportunities associated with government regulation in general.
rules for the new game that was being adopted (see Boettke 1993). The absence of clear rules not only slowed the transition, but in many cases also led to corruption, inflation, and black market activity.

Property rights are a critical aspect of the broader rules of the game. By deciding what belongs to whom under which circumstance, property rights provide individuals with dependable information and incentives. Well-defined and stable property rights encourage the effective use of existing scarce resources and also provide an incentive to innovate by discovering new resources, introducing new cost-cutting technologies and developing human capital. It is in this context that we analyze the impact of government takings.

We focus on the role of property rights as a central part of the market process. Government takings change the rules of the game and hence the opportunities and incentives that entrepreneurs face. Moreover, the use of government takings introduces regime uncertainty whereby the predictability of the rules of the game is weakened. In many cases the unintended subsidiary costs of takings cannot be captured in standard cost-benefit analysis because they consist of entrepreneurial opportunities and activities that are never realized due to changes in the rules of the game.

In order to pursue this analysis we proceed as follows. In the next section we discuss the market process and the adverse impact that intervention and regulation in general has on this process. We pay particular attention to the institutional context within which entrepreneurs act and discuss how changes in the rules of the game change the relative payoff to certain types of

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7 We fully recognize that rules facilitating social and economic interactions are beneficial only up to a point. Too few rules will lead to chaos and dysfunction, but too many rules can be stifling. For instance, Michael Heller (1998) has identified the “tragedy of the anticommons,” whereby individuals collectively waste a resource by underutilizing it because too many individuals have the right of exclusion. Heller and Eisenberg (1998) apply this logic to biomedical research and conclude that competition over patent rights may prevent beneficial products from reaching market. While fully recognizing that rules have diminishing returns, it is not our purpose here to determine the “optimal” level of rules and property rights. Instead, our focus is on exploring the costs of eminent domain on the entrepreneurial process.
behaviors. We then extend this logic and focus specifically on the impact of takings on the rules of the game and the market process. We conclude by considering the implications of the analysis.

2 The Market Process and the Perils of Intervention

2.1 The Market Process

The market is best viewed as a dynamic process driven by entrepreneurs seeking pure profit (see Kirzner 1973, 1979a). Given that interventions, such as takings, distort the nature of the market process, it makes sense to briefly review the key aspects of the process view of the market. This will provide a context to better understand some of the significant, but often unrealized, subsidiary costs of government takings.

The existence of competition, defined as the freedom of entry and exit, is the essence of the dynamic market process. This freedom serves to continually pressure market participants to reallocate resources in pursuit of perceived profit opportunities. Those that perceive potential profit opportunities must be free to enter the market to pursue them and those that do enter the market but fail to successfully exploit perceived opportunities must be free to exit.

The central participant in the market process is the entrepreneur (Kirzner 1973). Acting on perceived profit opportunities, entrepreneurs serve the dual role of pushing the economy toward the production possibility frontier and shifting the frontier outward (an increase in real output due to an increase in real productivity). For the entrepreneur, yesterday’s inefficiencies are today’s profit opportunities and, in exploiting those opportunities, entrepreneurs serve as the catalyst of economic change. In an institutional context characterized by well-defined property rights and minimal to no government regulation, entrepreneurship will be productive in
continually reallocating resources to their most highly-valued use known to the entrepreneur at the moment of action. Moreover, productive entrepreneurial actions create new opportunities to produce more goods and services by introducing new or cost-cutting production techniques and technologies.

Every economic action has an element of entrepreneurship to it. Economic decision-makers do not simply react to given data and allocate their scarce means to realize given ends. The entrepreneurial element in human action entails the discovery of new data and information, discovering anew not only the appropriate means, but also the ends that are to be pursued. As such, entrepreneurs are the central mechanism through which market inefficiencies are corrected. Of course, market inefficiencies are never completely eradicated; but entrepreneurs are the most effective means for correcting existing errors (see Leeson, Coyne, and Boettke 2006).

Entrepreneurs lack perfect information and face constant uncertainty. As such, the market process view emphasizes “competition as a discovery procedure.” As F.A. Hayek notes, competition is a “procedure for discovering facts which, if the procedure did not exist, would remain unknown or at least would not be used” (2002, 9). The competitive market process described above affords market participants the opportunity to act on existing knowledge and information and also the ability to generate previously unknown knowledge and information. Much of this knowledge is context specific or knowledge of time and place that cannot possibly be known by those other than the actor (Hayek 1945). In other words, the market process allows participants the opportunity to utilize existing knowledge and information while engaging in the ongoing process of discovering new knowledge and information and opportunities for profit.

Yet another critical realization is that the market process takes place within an institutional context. Institutions can be understood as the formal and informal rules governing

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8 On the important distinction between knowledge and information, see Boettke (2002).
human behavior and their enforcement. This enforcement can occur through the internalization of certain norms of behavior, the social pressure exerted on the individual by the group, or the power of third party enforcers who can utilize force on violators of the rules. Institutions can be traditional values or codified laws. However, as binding constraints on human action, they govern human affairs for good or bad, and as they change, so will the course of economic and social development.

Both formal and informal institutional regimes provide the rules of the game that create incentives for market participants. A regime of stable and predictable property rights is critical for creating an environment where market participants can continually reallocate resources to pursue new profit opportunities. For instance, it is the lure of profit which provides an incentive for entrepreneurs to enter the market to pursue a perceived opportunity. In order for this incentive to persist, entrepreneurs must be confident that their property and any profits generated from their actions will be secure.

In addition to providing incentives, a stable and predictable regime of property rights also serves the central role in communicating information to all market participants. Ludwig von Mises (1920) emphasized that private property in the means of production were necessary for the emergence of prices. These prices reflect relative scarcities, which are the very result of entrepreneurial activity. As such, the existing prices at any point in time reflect the entrepreneurial discoveries that have been made until that point. At the same time, existing prices reflect entrepreneurial errors and the potential for profit opportunities. It is the existence of the opportunity for profit that drives entrepreneurial activity and hence the market process. As

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9 For an overview of the socialist calculation debate and the parallels with the issue of government intervention, see Kirzner (1979b, 121-129).
the market process unfolds and entrepreneurs make adjustments to the allocation of resources, prices will adjust accordingly to reflect those changes.

2.2 The Perils of Government Intervention

Government interventions are implemented to influence the outcome of the market process. For instance, price controls seek to influence the nature of the prices that the market process would generate absent that intervention. Similarly, zoning laws, which are regulations that restrict the uses of land and buildings, are meant to constrain the outcomes generated in real estate markets. The key point for our purposes is that interventions change the institutional context and hence the rules of the game. These interventions distort the market process relative to what would have unfolded if those regulations had not been implemented. As Israel Kirzner indicates, “government controls constrain and constrict; they rearrange and repattern the structure of incentives; they redistribute incomes and wealth and sharply modify both the process of production and composition of consumption” (1979b, 134-5).

Although interventions change the nature of the market process, they do not eradicate that process or associated profit opportunities. Instead, in altering the rules of the game, interventions and regulations alter the opportunities and incentives that entrepreneurs face. Entrepreneurs responding to the new incentives created by intervention shift their activities to take advantage of the new profit opportunities. While the exact nature and magnitude of the distortions caused by interventions will vary from case to case, there are some general insights that we can postulate regarding government intervention in the market process. Kirzner (1979b, 136-145) considers four distinct ways in which government intervention and regulation adversely impacts the market process. We consider each category in turn.
First, the use of government interventions to correct market outcomes assumes that the manipulated process will be superior to the unregulated future outcome of the market process. This, however, neglects the fact that market process is just that, a process. Future states of the world (i.e., market outcomes) are unknown, which is why the market process is inherently one of continuous discovery, as discussed earlier. Government interventions assume that a desired or perhaps even a superior, yet unknown, outcome cannot be expected to emerge as the market process continually unfolds.

In discussing this category of government intervention, Kirzner (1979b, 137-8) highlights two central misunderstandings. First, the call for government intervention overlooks the fact that it may very well be the case that that entrepreneurs have discovered everything that is currently efficient to discover at a specific point in time. In this case, what appear to be inefficiencies to those outside the market process are really not inefficiencies given the context-specific knowledge possessed by market participants. The second key misunderstanding is that without government interventions the market process will fail to correct existing inefficiencies in the future. This misunderstanding fundamentally fails to appreciate the nature of the market process. As we discussed above, the very existence of inefficiencies is what provides the incentive for future entrepreneurial action.

Kirzner’s second category of government intervention in the market process deals with the fundamental knowledge problem faced by regulators. Specifically, any government intervention intended to generate a desired outcome assumes a level of knowledge on the part of government officials that they cannot possibly possess. Even if regulators have the best of intentions, how will they know the specifics of how to bring about the desired outcome? Whether it is price controls, mandated standards, redistribution, or urban development and
planning, regulators cannot possibly know the “right” or “correct” levels of intervention required to generate the desired allocation of resources. Further, outside the feedback loop of profit and loss, regulators will be unable to judge if earlier decisions were correct or not. In the absence of profit and loss, there is no way for regulators to discover inefficiencies and determine if their actions generated corrections or subsequent errors in the market process. As such, one should expect inefficiencies to emerge and persist when government intervenes in the market because “nothing within the regulatory process seems able to simulate even remotely well the discovery process that is so integral to the unregulated market” (Kirzner 1979b, 141).

The third impact of government regulation is that it stifles the process of discovery. As Kirzner notes, “the most serious effect of government regulation on the market discovery process well might be the likelihood that regulation, in a variety of ways, may discourage, hamper, and even completely stifle the discovery process of the unregulated market” (Kirzner 1979b, 141). The exact nature and magnitude of the stifling of the market process will depend on the specific type of intervention. For instance, some regulations may raise the cost of engaging in certain activities while others may actually restrict competition and freedom of entry and exit.

It is important to note the impact of interventions and regulations on yet undiscovered opportunities. Government regulation not only hampers the market for existing goods and services; it also hampers the very process by which previously nonexistent goods and services are discovered. Regulations tend to distort or constrain profit opportunities for productive activities that provide the incentive for the discovery of entirely new opportunities for profit from such activities. This negative consequence of government regulation is often neglected because

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10 This is a fundamentally different point then the “dynamics of intervention” criticism of government intervention which holds that one intervention will lead to a series of subsequent interventions (see Mises 1929 and Ikeda 1997). While this criticism is relevant, our point here is one regarding fundamental discovery. Regulators have no means of discovering the means of correcting inefficiencies in the market process.
it is unobservable by its very nature. For instance, one can observe the shortages or surpluses associated with price controls, but one cannot similarly observe an opportunity for discovery that would have taken place absent government intervention but which goes unrealized because of intervention. Precisely because they cannot be observed or quantified, the subsidiary costs of intervention in terms of foregone entrepreneurial opportunities that are never realized due to the intervention are rarely considered or even recognized.

Yet another way that intervention may stifle the entrepreneurial discovery process is by introducing uncertainty into the rules of the game. For example, government interventions in the present period may create uncertainty regarding the likelihood and magnitude of future government interventions. In his analysis of why the Great Depression lasted as long as it did, Robert Higgs (1997) introduced the notion of “regime uncertainty.” Higgs argues that the length of the Great Depression was due to a slow recovery in private investment which “…reflected a pervasive uncertainty among investors about the security of their property rights in their capital and its prospective returns” (1997, 563).

Similar reasoning can be extended to government interventions in general, including takings. Interventions create uncertainty in the institutional regime in which entrepreneurs must act. As a result, the incentives for entrepreneurs to pursue perceived profit opportunities are weakened. The full effects of this regime uncertainty cannot be known since opportunities that would have existed absent that uncertainty will no longer be exploited. In the case of takings, the perceived uncertainty by the American public is evident from their response to the Kelo decision. In many states this backlash has produced laws placing restrictions on government takings (see Lopez and Totah 2007 and the chapter in this volume by Ilya Somin).\textsuperscript{11}

\textsuperscript{11} For a similar response from the American public regarding the uncertainty created by regulatory takings in the 1990s, see Boudreaux, Lipford and Yandle (1995).
The fourth and final impact of government intervention in the market process is that “whether intended by regulatory authorities or not and whether suspected by them or not, the imposition of regulatory restraints and requirements tends to create entirely new, and not necessarily desirable opportunities for entrepreneurial discovery” (Kirzner 1979b, 144). Government interventions alter the pattern of profit opportunities and the full effects of this alteration cannot possibly be known in advance by those designing and implementing the intervention. Productive entrepreneurial activities either push the economy toward the production possibility frontier or shift the frontier outward. As discussed, one adverse effect of intervention is that it stifles some of these productive activities. However, another unintended consequence of intervention is that it may create undesirable profit opportunities. Interventions, in altering the pattern of profit opportunities, tend not just to stifle productive activities but also create opportunities for unproductive activities.

In contrast to productive activities, unproductive activities include crime, rent-seeking and the destruction of existing resources among other socially destructive activities (Baumol 1990, Boettke and Coyne 2003, Coyne and Leeson 2004). In the case of unproductive entrepreneurship it is possible that profits are being earned, but by activities that do not shift the production possibility frontier outward. As an example, consider resources dedicated to rent-seeking. Rent-seeking occurs when actors seek to extract uncompensated value from others by manipulating the economic and political environment. While rent-seeking activities often lead to increased profit for the entrepreneur undertaking the activity, they result in inefficiencies for society as a whole.

Given this understanding of the perils of government intervention, we next turn to a consideration of takings. We argue that government intervention through the use of takings
suffers from the problems discussed by Kirzner and is therefore more costly than most people think. Some specific examples will illuminate these claims.

3 The Perils of Government Takings

William Minnich and his nephew, Bill Minnich, are the owners of Minic Custom Woodwork, a small family business over 75 years old. In 1981 they bought a run-down building in East Harlem to relocate their business. In addition to buying the building, the Minnich’s also invested more than $250,000 in renovating and updating the building. All was going well with the business until William Minnich read in the *New York Times* that the Empire State Development Corporation (ESDC) – a public authority of the State of New York that finances and operates state projects – planned to redevelop the East Harlem area. Upon closer inspection of the map associated with this project, Minnich realized that the area for redevelopment included his building. The government planned to use eminent domain to seize the property and sell it to the Blumenfeld Development Corporation to build a Home Depot, Costco, and other retail stores. The justification was that the transfer of property would be a net benefit to the community in terms of jobs and tax revenue (Berliner 2003, 145-146; Carney 2006, 91-96).

Much of the maneuvering between the ESDC and the Blumenfeld Development Corporation was done behind closed doors, leavening the Minnich’s in a position where they could not defend their property until it was too late. This lack of transparency became clear when the New York Supreme Court dismissed the Minnich’s lawsuit to prevent the project because they had missed the 30-day period to appeal based on a previous notice of “determination and findings,” which authorized the confiscation of their property at some future time. The problem, William Minnich claimed, was that he never knew the project had been
officially approved and therefore was unaware that the 30-day period had actually begun. A federal court confirmed this decision and after exhausting all efforts at appeals, the Minnich’s were forced to sell their building (Berliner 2003, 145-146; Carney 2006, 91-96).

The Minnich’s story illuminates the perils of intervention discussed earlier and can be generalized to understand the adverse impacts of government takings. Takings are fundamentally an exercise in central planning in which government officials intervene to change the outcome of the natural market process. As the Minnich case indicates, the condition of “public use” has been broadly interpreted to include economic benefits (i.e., job creation, tax revenue, etc.) to the community. As discussed in the Introduction, this interpretation has historical precedent in *Berman v. Parker* (1954), *Poletown Neighborhood Council v. City of Detroit* (1981), and more recently in *Kelo v. City of New London* (2005). These economic benefits are typically calculated by carrying out an “impact analysis” that considers the associated costs and benefits of an intervention. Such an analysis attempts to place a monetary value on all of the costs of confiscating property and compares it to the expected benefits of redevelopment. However, this approach poses several key problems.

In assigning monetary values to expected costs and benefits, those carrying out the study must consider situations that have not even occurred yet. In producing these calculations, assumptions about the future must be made regarding profitability, associated tax revenue, and job creation. Typically, assumptions are also made about the “multiplier effect” of each dollar spent on the redeveloped property. Recall that Israel Kirzner noted that interventions of all types assume that government planners have superior information as compared to market participants and that interventions will produce superior outcomes compared to the unregulated market process. It is far from clear that either of these assumptions is accurate in the case of takings.
Further, because the use of takings does not entail a penalty on private developers for failing to deliver on the estimated benefits, there is an incentive to overstate the estimates to support the case for takings.

As an example to illustrate some of these points, consider a study published by the Cato Institute regarding the economic benefits of bringing a Major League Baseball team to Washington, D.C. (Coates and Humphreys 2004). A key aspect of the negotiations between the city and baseball team was the promise of a new stadium using direct takings to acquire the land if necessary.\(^\text{12}\) Regarding the impact studies conducted in these types of situations, the authors of the Cato report note that “The results of those studies invariably reflect the desires of the people who commission them, and advocates of stadiums and franchises typically produce impact studies that find large economic benefits from building a stadium or enticing a team to relocate to the city” (2004, 3). In an analysis of 37 cities with sports teams over a 35-year period, the authors of the report found no positive effect on overall growth rates of real per capita income and a statistically significant, negative impact on the level of real per capita income (2004, 5). The authors attribute these findings to the tax breaks that these sports teams often receive to entice them to locate to a certain city in the first place. Also, influencing this outcome is the presence of a substitution effect whereby spending on the sports team increases but spending in other areas in the community simultaneously declines.

For our purposes the important point of this study is that it is a mistake to assume that government officials, and developers attempting to convince government to utilize takings, have information superior to market participants. Similarly, it is a mistake to assume that the outcome from intervention will be superior to the outcome produced absent that intervention. As the

\(^{12}\) In fact it was ultimately necessary for the city of Washington, D.C. to employ eminent domain to secure the property for the new stadium (see Lemke 2005).
aforementioned report indicates, there is some evidence to suggest that many cities have taken land to give to sports franchises expecting economic growth only to have a negative or no effect. Moreover, since governments act outside the market context of profit and loss, there is no means of correcting these errors where they do occur.

In general, the use of takings distorts the structure of production that arises naturally from the market process. As Murray Rothbard notes, when government uses eminent domain “the result is an overextension of resources (a malinvestment) in the privileged firm or industry and an underinvestment in other firms and industries” (1977, 77). Rothbard’s point is that government takings shifts the relative payoffs associated with various entrepreneurial opportunities. The taking of property by government raises the cost of investing in certain types of business ventures and lowers the cost of investing in others. The structure of production that arises on the unhampered market is a function of consumer preferences and prices. Government intervention distorts this process by creating incentives to divert resources into other firms and industries that may not represent consumer preferences. Further, because the structure of production is an emergent process, these distortions to the structure of production, or the associated costs, are not readily evident to the outside observer because they represent forgone opportunities that never actually took place.

In changing the rules of the game, government intervention through takings also generates an unintended consequence in the form of uncertainty in formal and informal institutional regimes. This has adverse effects the magnitude of which, similar to the impact on the structure of production, cannot be measured or even realized by government bureaucrats. For instance, in those areas where it is relatively easy for government to use takings, it provides a disincentive to purchase land or make improvements to existing land. Sandy Ikeda (2004) has
analyzed how government interventions not only distort the price system itself but also erode the norms and trust levels that facilitate interpersonal interaction through the price system. Focusing his analysis on interventions in the form of “urban renewal,” Ikeda emphasizes that such interventions “can threaten the stability of local communities because of the drastic changes it brings to an area in a time period too short for the informal networks to form that are needed for healthy economic development” (2004, 258). Similar logic can be extended to intervention in the form of takings, which can destroy existing social networks and norms and introduce uncertainty into informal institutional regimes. As Jane Jacobs notes, takings for economic development destroy “thousands upon thousands of small businesses….whole communities are torn apart and sown to the winds, with a reaping of cynicism, resentment and despair that must be seen to be believed” (1961, 5).

To the extent that regime uncertainty exists, it lowers the payoff to productive entrepreneurial activities (Benson 2004). As such, productive activities that would have existed and been exploited absent the possibility of intervention no longer take place. For example, in the case of environmental regulations, uncompensated regulatory takings tend to increase uncertainty while discouraging private, voluntary conservation, and encourage the destruction of certain environmental resources. Further, the absence of compensation lowers the cost associated with government use of environmental regulations (see the chapter in this volume by Jonathan Adler).

It is well known that secure property rights are a critical ingredient for economic development. This is evident when from the evidence presented by both empirical studies (Acemoglu and Johnson 2005; Acemoglu, Johnson. and Robinson 2001, 2002; Hoskins and Eiras 2002; Rodrik, Subramanian, and Trebbi 2004) and fieldwork in underdeveloped countries.
For instance, in his study of Peru, Hernando de Soto (1989) noted how the regime uncertainty created in the form of poorly defined and enforced property rights, corruption and burdensome regulations, drove a majority of productive activities underground. The fundamental problem for poor countries, de Soto concludes, is transforming “dead capital” into “live capital” (2000). This process can only take place through the recognition and enforcement of stable and predictable property rights.

Of course, the US does not suffer from the extent of regime uncertainty present in Peru and other underdeveloped countries. Nonetheless, the existence of takings in the US is a less extreme variant of the more extreme land-use policies that exist in many third world countries where governments expropriate property as they see fit. One can see the connection between the instability created by the land and property rights policies in these third world countries and confiscatory policies, such as government takings in the U.S. While the uncertainty created by takings in the US is not as great as the uncertainty in those countries where property rights are almost nonexistent, it still exists and any movement in the direction of weakening the strength and predictability of property rights serves to increase regime uncertainty on the margin.

Between 1998 and 2002, The Institute for Justice documented over 10,000 cases nationwide of the threatened or actual use of eminent domain for private development (Berliner 2003). Perhaps a bigger issue than the large number of cases identified is that each of these cases is different in its specific characteristics. This makes it for difficult for entrepreneurs to determine any kind of general and predictable characteristics of when property will be taken for public use. There are cases of larger development corporations and “big box” retailers using eminent domain to seize land; but there are also many cases of smaller businesses using political means to avoid private markets and secure property through eminent domain (see, for instance,
Staley 2003; Staley and Blair 2005). The general vagueness of when and how takings laws are applied contributes further to the distortion of the market process as well as regime uncertainty at all levels.

In his analysis of land use regulation, Bruce Benson suggests that “land use regulations are the result of public sector responses to demands of politically powerful special interest groups, rather than attempts to correct for market failures (1981, 435). Benson’s main point is that government interventions regarding land use regulations should not be assumed to be benevolent in nature but rather must be viewed as the outcome of the political decision-making process. This process is largely influenced by special interest groups, which attempt to manipulate political outcomes in their favor. Similarly, Jane Jacobs (1961, 270-290, 311-314) argues that the use of eminent domain for the economic development and urban renewal often serves private interests at the expense of the communities it is intended to help. Donald Kochan contends that the “public use doctrine is no longer an impediment to interest-group capture of the condemnation power in order to acquire private land by employing the power of the state to that end…” (1998, 51). The result, according to Kochan, is that legislatures can sell their power of takings to special interest groups because of the low probability that the judiciary will overturn it on the grounds that it violates public use.

In general, when the rules of the game allow for the use of the political decision-making process to secure transfers of private property, the payoff associated with unproductive activities such as rent-seeking increases. Recall that in his analysis of government intervention in the market process, Kirzner noted that government intervention not only stifles existing entrepreneurial opportunities but also creates new and often undesirable opportunities as well. This is indeed the case with government takings.
In order to provide a concrete example of the dynamics of the political decision-making process as they relate to government takings, return to the example of New York, where the Minnich case took place. Recall that the Empire State Development Corporation (ESDC) used the state’s power of eminent domain to take the Minnich’s property to transfer it to the Blumenfeld Development Corporation under the guise of “economic redevelopment.” However, a closer look at the ESDC and Blumenfeld indicates that there were close political connections that most likely played some role in the takings.

A 1996 report issued by the office of Democratic State Senator Franz Leichter indicated that “Since Pataki took office, more than 25 firms that made campaign contributions to Pataki, U.S. senator Al D’Amato and other State Republican political committee members have received grants and loans from the Empire State Development Corporation” (quoted in Carney 2006, 97). Indeed, since 1989, Blumenfeld had made political contributions to New York Mayor Ed Koch, Charles Schumer, Rudy Giuliani, and Al D’Amato, among many others (Carney 2006, 98). The resources that Blumenfeld invested in developing relationships with the political leaders of New York seem to have paid off. In addition to obtaining the land in East Harlem via direct takings, he also received subsidies for the redevelopment project itself in the form of tax-breaks and low-interest loans from the state.

The fact that the use of takings is heavily influenced by the political decision-making process further contributes to the perils of government interventions of this form. Decisions in the public realm are not guided by market prices and profit and loss but by political pressures. Further, when takings become a tool of first resort for private parties to acquire private property, they create new opportunities for profit through political means. As such, resources are reallocated to influencing the outcome of political decisions.
4 Conclusion

F. A. Hayek emphasized that the main issue facing social scientists was “how the spontaneous interaction of a number of people, each possessing only bits of knowledge, brings about a state of affairs in which prices correspond to costs, etc. and which could be brought about by deliberate direction only by somebody who possessed the combined knowledge of all those individuals” (1937, 50-51). Precisely because individuals face incomplete and dispersed knowledge, Hayek argued for general rules that would create an environment where individuals could discover and act on new experiences. Hayek went on to argue that in order for this learning process to take place, institutions and rules must be predictable so that people can foresee the consequences of their actions and engage in interactions and transactions with confidence (1960, 148-161). Unpredictable and unstable rules create regime uncertainty, preventing this learning process from taking place. Takings are an example of a government power that has such an effect.

We have explored the dynamics of the market process and how the use of government takings can distort that process and generate unintended subsidiary costs. The use of takings to correct market outcomes assumes that the outcome generated by the intervention will be superior to the market outcome. However, because government actors suffer from a fundamental knowledge problem regarding future entrepreneurial opportunities and the true costs and benefits of the redistribution, there is no reason to assume this will be the case. When one also considers that the use of takings is heavily influenced by the political-decision making process, we have good reason to assume that the outcome may very well be worse than that which would be generated absent the intervention. The costs of government takings identified in our analysis are excluded from standard cost-benefit impact analysis because they represent forgone
opportunities that were never actually realized. Further, the unintended consequences of regime uncertainty will be neglected in these studies because such costs cannot be captured using conventional means.

Whether the debate is focused on if the government should have the power of takings, or on the scope of the state’s existing power, the issues addressed in our analysis must be realized and taken into consideration. To date, these issues have received little to no attention. It is our hope that this paper is a first step in correcting this state of affairs.
References


