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BIG DIFFERENCES FOR SMALL GOVERNMENTS: LOCAL GOVERNMENTS AND THE TAKINGS CLAUSE

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This Article argues that the Fifth Amendment's Takings Clause should apply differently to local governments than to higher levels of government. The Takings Clause is at the heart of an increasingly contentious debate between property rights advocates and proponents of deference to government regulation. More often than not, the terms of the debate have focused on a traditional economic account of the Takings Clause. Property rights advocates argue that expanding the compensation requirement is necessary to force the government to internalize the costs of its actions, ensuring that regulations will occur only where benefits exceed costs. Others, however, argue that governments respond to political and not monetary costs, so that a compensation requirement will not influence government decision-making in any predictable way. Public choice theorists, in particular, argue that regulations are more likely to result from special interest group rent-seeking, while costs are passed on to taxpayers generally. Where the public choice theory critique applies, compensation will not serve as a meaningful check on regulatory incentives.

This Article argues that the strength of the public choice critique rises and falls with the level of government. Local governments are largely majoritarian and specifically responsive to local homeowners. Because local governments also receive most of their revenue from local property taxes, forcing local governments to compensate under the Takings Clause will, in fact, force them to internalize the costs of their actions. However, local governments' regulatory incentives are subject to their own specific distortions. Local governments are risk averse, so the prospect of a large takings judgment may over-deter them from acting. Local government regulations also tend to impose significant positive and negative externalities on neighboring communities. This Article therefore proposes (1) ratcheting down compensation for takings by local governments to account for their risk aversion, and (2) creating a form of intergovernmental liability to allow local governments to capture the positive externalities of their actions and to force them to pay for the negative externalities.

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INTRODUCTION

As even the casual student of property law knows, the content of the Fifth Amendment's Takings Clause¹ remains up for grabs.² In fact, few areas of the law are home to as many different explanatory theories.³ The lack of coherence does not necessarily reflect a problem with the theories themselves, however, but is instead rooted in the unrealistic expectation that they each apply with equal descriptive and prescriptive force in all situations. The persistence of the takings problem is the result, at least in part, of a failure to recognize how diverse the category "takings" has become. This Article seeks to take apart the Takings Clause along one of its dimensions, arguing that takings by different levels of government implicate different theoretical and doctrinal concerns.⁴ The animating intuition is that a different answer to the takings puzzle might apply to federal actions—like wetlands regulation—than to local actions—like a town's denial of a building permit—even if the effect on a particular property owner is substantially the same.

The battle over the Takings Clause has grown increasingly contentious in recent years. Proponents of strong private property rights believe the government should have to pay whenever its actions infringe on private property and should compensate for all the costs it imposes on property owners.⁵ They argue that allowing the govern-

¹ U.S. CONST. amend. V.

² In its most recent term, the Supreme Court revisited a fundamental question of takings law and clarified for the lower courts that a regulation's ineffectiveness in advancing a legitimate state interest is not the basis for a takings claim. *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 543 (2005).

³ Leading theories include Frank Michelman's utilitarian formula, see Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1216 (1967), Margaret Jane Radin's personality theory of takings, see Margaret Jane Radin, *Property and Personhood*, 34 STAN. L. REV. 957, 965 (1982), Richard Epstein's Aristotelian theory, see generally RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985), Hanoch Dagan's distributive justice theory, see Hanoch Dagan, *Takings and Distributive Justice*, 85 VA. L. REV. 741, 755 (1999), economic theories, see *infra* text accompanying notes 35–45, public choice theories, see *infra* text accompanying notes 46–74, and many others.

⁴ This Article is part of a broader effort to provide more nuance to takings law across a number of different dimensions. For the first piece of this project, see Christopher Serkin, *The Meaning of Value: Assessing Just Compensation for Regulatory Takings*, 99 NW. U. L. REV. 677 (2005), which identifies different approaches to compensation under the fair market value standard.

⁵ See, e.g., Richard A. Epstein, *Whose Democratic Vision of the Takings Clause? A Comment on Frank Michelman's Testimony on Senate Bill 605*, 49 WASH. U. J. URB. & CONTEMP. L. 17, 23 (1996) ("The sole judicial constraint, one that says 'take and pay,' beats a world of just plain 'take.'"); Glynn S. Lunney, Jr., *Compensation for Takings: How Much Is Just?*, 42 CATH. U. L. REV. 721, 770 (1993) (proposing that courts "award a measure of

ment to escape paying for these costs will lead consistently to overregulation.⁶ Compensation, in what turns out to be a relatively traditional economic account of the Takings Clause, is necessary to force the government to internalize the costs of its actions.⁷

This traditional economic justification for the Fifth Amendment's compensation requirement has been assailed recently by critics who contend that governments do not internalize costs the way private firms do.⁸ They argue that paying compensation will not necessarily force the government to internalize the *political* costs of its actions, and it is political—not monetary—costs that matter for creating efficient regulatory incentives.⁹ Hand-in-hand with this claim is the insight from public choice theory that well-organized special interest groups can generate more political power than a diffuse and disinterested majority.¹⁰ Since the ultimate costs of compensation are born by taxpayers generally, compensation may have much less of an impact on regulatory incentives than does special interest group rent-seeking. If the traditional economic account of the Takings Clause cannot explain how governments internalize costs, then it fails as a justification for expanding the compensation requirement.

This dispute has so far overlooked the fact that not all governments are alike. Unlike larger governments, local governments are relatively majoritarian and rely on property taxes to fund compensation. The traditional economic account of the Takings Clause is therefore much more compelling at the local level. This Article explores the specific mechanisms by which local governments do, in fact, inter-

compensation that realistically ensures that the former owner receives a 'full and exact equivalent' for the taken property").

⁶ E.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 64 (5th ed. 1998); see also Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345, 348–50 (2000) (describing traditional economic account of Takings Clause).

⁷ See Abraham Bell & Gideon Parchomovsky, *Givings*, 111 YALE L.J. 547, 580 (2001) ("Under traditional takings analysis, the just compensation requirement effectively forces the government to internalize the cost of its decisions and impose burdens only when the net gain of so doing exceeds the cost."); Hanoeh Dagan, *Just Compensation, Incentives, and Social Meanings*, 99 MICH. L. REV. 134, 138 (2000) ("Assuming that democratic mechanisms make public officials accountable for budget management, compensation is important to create a budgetary effect that forces governments to internalize the costs that their decisions impose on private resource holders.").

⁸ E.g., Levinson, *supra* note 6, at 348–51.

⁹ See Daniel A. Farber & Philip P. Frickey, *Public Choice Revisited*, 96 MICH. L. REV. 1715, 1717 (1998) (reviewing MAXWELL L. STEARNS, *PUBLIC CHOICE AND PUBLIC LAW: READINGS AND COMMENTARY* (1997)) ("What holds this diverse [public choice] movement together is a common methodology based on the concept of rational decisionmaking: simply put, political actors, like economic ones, make rational decisions designed to maximize the achievement of their preferences.").

¹⁰ This claim is treated in note 50 *infra*.

nalize both the costs and benefits of their actions: homeowners' desire to maximize property values while minimizing property taxes.¹¹ Fiscal and political costs are surprisingly well aligned at the local level, where forcing the government to compensate will tend to create more efficient regulatory incentives. The strength of the critique of the economic account of the Takings Clause therefore rises and falls in tandem with the level and size of the government responsible for the challenged action or regulation.

There are, however, two important and uniquely local constraints on efficient regulatory incentives that pose new and distinct challenges to compensation as a mechanism for creating efficient government incentives. First, risk aversion increases as the size of government decreases. The prospect of a \$500,000 takings judgment can paralyze a local government and deter it from enacting a regulation that would, in fact, create more gain than harm. Second, local-government regulations come with significant externalities, both positive and negative. Costs that are not translated into local property taxes will lead to inefficient overregulation, but benefits that fall outside a local government's jurisdictional limits will have the opposite effect. This Article therefore argues that takings law should be responsive to the level of government doing the taking and offers three specific proposals: (1) ratcheting down compensation to account for risk aversion; (2) relying on intergovernmental grants to pay compensation for local takings that create positive externalities; and (3) creating interlocal balance sheets reflecting the costs and benefits that local governments impose on each other and that need to be settled up periodically.¹²

¹¹ William Fischel has explored this claim in considerable detail in his book, WILLIAM A. FISCHEL, *THE HOMEVOTER HYPOTHESIS* (2001). Although his hypothesis requires some modification—undertaken in Part II—this Article accepts his foundational insight that local governments are primarily controlled by homeowners who vote. For an excellent review of Fischel's book, examining the distributional consequences of some of Fischel's assumptions and prescriptions, see Lee Anne Fennell, *Homes Rule*, 112 *YALE L.J.* 617 (2002). See also Richard Schragger, *Consuming Government*, 101 *MICH. L. REV.* 1824 (2003) (reviewing *THE HOMEVOTER HYPOTHESIS*); Henry A. Span, *Public Choice Theory and the Political Utility of the Takings Clause*, 40 *IDAHO L. REV.* 11, 40–50 (2003) (discussing *THE HOMEVOTER HYPOTHESIS*).

¹² While other scholarship—most notably that of William Fischel—has explored what the characteristics of local governments might mean for the Takings Clause, its prescriptions have focused on changing the kind of scrutiny that courts should apply to local regulations. See WILLIAM A. FISCHEL, *REGULATORY TAKINGS: LAW, ECONOMICS, AND POLITICS* 139 (1995) (“[R]egulation of immobile property by independent local governments and state agencies . . . requires most of the attention of judges in regulatory takings cases.”); Mark Cordes, *Policing Bias and Conflicts of Interest in Zoning Decisionmaking*, 65 *N.D. L. REV.* 161, 195 (1989) (arguing that judicial intervention in local zoning decisions is justified); Henry A. Span, *How the Courts Should Fight Exclusionary Zoning*, 32 *SETON*

This Article's approach to takings by local government joins a field admittedly crowded by competing approaches to the Takings Clause. A significant body of takings literature examines government liability through an economic lens with an eye to creating efficient regulatory incentives.¹³ Separately, political scientists, tracing their roots directly to James Madison,¹⁴ have examined the unique character of local governments.¹⁵ This Article bridges these two scholarly areas, identifying those characteristics of local governments that make them particularly sensitive—perhaps even too sensitive—to the fiscal discipline of takings liability.

Modifying takings law so that it applies differently at the local level might seem constitutionally unorthodox. Following the long-settled incorporation debates, most people have at least implicitly assumed that constitutional protections must apply in the same way as against federal, state, and local governments.¹⁶ But this does not necessarily have to be the case, as some scholars in the last few years have begun to recognize.¹⁷ Courts, too, have occasionally acknowledged

HALL L. REV. 1, 25–26 (2001) (“[If] a legally cognizable issue is involved, the courts should try to do something to fashion a remedy despite the difficulties involved.”).

This Article responds to a very different set of arguments and concerns, using insights about local political processes to examine the limits of takings law's incentives for creating efficient local decisionmaking.

¹³ See generally Bell & Parchomovsky, *supra* note 7; Dagan, *supra* note 7; Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385 (1977) (developing takings approach designed to generate efficient levels of housing consumption); Michael H. Schill, *Intergovernmental Takings and Just Compensation: A Question of Federalism*, 137 U. PA. L. REV. 829, 852 (1989) (stating that compensation may be justified on ground that it reduces individual risk, presumably promoting efficiency).

¹⁴ THE FEDERALIST NO. 10 (James Madison). For a more complete quotation from Federalist 10, see note 84 *infra*.

¹⁵ See, e.g., Carol M. Rose, *Planning and Dealing: Piecemeal Land Controls as a Problem of Local Legitimacy*, 71 CAL. L. REV. 837, 854 (1983) (“Federalist No. 10 . . . suggests why a local elected government should not always be seen as a legislature.”). This Article relies most heavily on the account of local governments offered by FISCHEL, *supra* note 11.

¹⁶ E.g., BRUCE ACKERMAN, WE THE PEOPLE: FOUNDATIONS 94–96 (1991); DANIEL A. FARBER ET AL., CASES AND MATERIALS ON CONSTITUTIONAL LAW: THEMES FOR THE CONSTITUTION'S THIRD CENTURY 408–10, 577–78 (2d ed. 1998). The Takings Clause was incorporated against the states through the Fourteenth Amendment in *Chicago, B. & Q. Railroad v. Chicago*, 166 U.S. 226 (1897), which the Supreme Court cited in *Lingle v. Chevron*, 544 U.S. 528, 536 (2005). The incorporation of the Takings Clause against the states is subject to some scholarly dispute. William Michael Treanor, *The Original Understanding of the Takings Clause and the Political Process*, 95 COLUM. L. REV. 782, 860 n.369 (1995) (noting numerous alternate theories regarding which case incorporated the Takings Clause).

¹⁷ See generally Mark D. Rosen, *The Surprisingly Strong Case for Tailoring Constitutional Principles*, 153 U. PA. L. REV. 1513, 1516 (2005) (noting that “a given constitutional principle may apply differently” to “different levels of government”); Richard C. Schragger, *The Role of the Local in the Doctrine and Discourse of Religious Liberty*, 117

that state and federal actions might trigger different concerns.¹⁸ Nevertheless, adopting a new, nonuniform takings rule is not to be undertaken lightly. It threatens to create a patchwork of overlapping rights—a quilt whose patterns could become as complex as the imagination of enterprising jurists and academics. Why stop at the distinction between local governments and state and federal governments? Why not add different takings rules for towns of different sizes?¹⁹

The answer, as this Article shows, is that differences between local and higher levels of government are qualitative and not just quantitative. The same is not true of more fine-grained distinctions within levels of government, subject to the following important caveat. For the most part, this Article examines two opposite extremes: (1) small, local governments like towns and outer-ring suburbs; and (2) state or federal governments.²⁰ Cities and other large municipalities present difficult line-drawing problems that this Article largely elides. Although they share the formal characteristics of local governments, they receive less of their funding through property taxation, are subject to more special interest group pressure, and are fundamentally less majoritarian.²¹ Some political science literature has proposed ten-

HARV. L. REV. 1810, 1813 (2004) (“[T]he predominantly local character of Religious Clause disputes should have theoretical and doctrinal significance.”). In a footnote, Robert Ellickson limited his observations about compensation for excessive exactions to suburbs, noting that other kinds of governments might implicate different political dynamics. Ellickson, *supra* note 13, at 420 n.91. Similarly, Carol Rose suggested that local governments’ land use controls implicate different concerns than state and federal regulations. Rose, *supra* note 15, at 855–57 (arguing generally that local land use decisions should be viewed neither as legislative nor adjudicative but instead through mediation model). Daryl Levinson, too, appears to have anticipated that a different political story might be told at the local level than at the state or federal level. Levinson, *supra* note 6, at 374 n.85 (noting, but not examining, hypothesis that compensation may play different roles at local, state, and federal levels).

¹⁸ See *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 44 (1973) (education); *Johnson v. Louisiana*, 406 U.S. 356, 375 (1972) (Powell, J., concurring) (due process); *Williams v. Florida*, 399 U.S. 78, 136–38 (1970) (Harlan, J., dissenting and concurring) (criminal law).

¹⁹ Henry Span has criticized Fischel’s analysis on these grounds, arguing against the arbitrariness of a constitutional doctrine that applies differently to municipalities with a population of 199,999 versus 200,000. Span, *supra* note 11, at 44.

²⁰ Distinctions of this type are common in the political science literature. See David J. Barron & Gerald E. Frug, *Defensive Localism: A View of the Field from the Field*, 21 J.L. & POL. 261, 267–69 (2005) (reviewing literature drawing distinction between central city and suburban governments).

²¹ See *infra* Part II.A (describing local governments). Others agree that cities act differently from other local governments. See, e.g., Melvyn R. Durchslag, *Village of Euclid v. Ambler Realty Co., Seventy-Five Years Later: This Is Not Your Father’s Zoning Ordinance*, 51 CASE W. RES. L. REV. 645, 658 (2001) (“It is also difficult to deny the public choice assertion that the size of the governing unit has something to do with the degree to which constituent desires are reflected in local land use decisions.”).

tative size cutoffs that are relevant to the analysis that follows. For example, according to William Fischel, communities of less than 100,000 people tend to be more majoritarian than those with more than 100,000 people.²² Another size cutoff comes from Robert Inman and Daniel Rubinfeld. According to their empirical work, communities with 5000 to 10,000 residents are the most efficient providers of public services.²³ Wherever the line should be drawn, this Article's use of the term "local governments" envisions suburbs and towns and not their larger cousins, although this definition still includes the vast majority of local governments in the United States.²⁴ Admittedly, this is a specific definition of "local governments."

Ultimately, understanding when and how the traditional economic account of the Takings Clause does apply is necessary for understanding its limitations. This project takes on even greater significance as the debate over property rights continues to heat up. According to recent articles in the mainstream press, there may be no political fight more important to conservatives and liberals alike than that over the government's power to regulate private property.²⁵ The Supreme Court's recent decision in *Kelo v. City of New London*²⁶ offered a stark demonstration of how raw emotions in this area are.²⁷ *Kelo* generated a host of state legislative responses restricting the

²² FISCHEL, *supra* note 11, at 92.

²³ Robert P. Inman & Daniel L. Rubinfeld, *The Political Economy of Federalism*, in *PERSPECTIVES ON PUBLIC CHOICE* 73, 81 (Dennis C. Mueller ed., 1997).

²⁴ *Private Property Rights Implementation Act of 1999: Hearing on H.R. 2372 Before the Subcomm. on the Constitution of the H. Comm. on the Judiciary*, 106th Cong. 24 (1999) (statement of Diane Shea, Associate Legislative Director, National Association of Counties and National League of Cities) ("Ninety-seven percent of the cities and towns in America have populations of under 10,000, and 52 percent have populations of under 1,000."). In any given situation, some fact-finding might be necessary to determine whether a city shares the relevant characteristics of a local government, including: (1) a high percentage of households in owner-occupied units; (2) high median dwelling-unit value and median family income; (3) relatively small population; (4) relatively small land area; and (5) relatively small variance in the value of owner-occupied units. *Cf.* Ellickson, *supra* note 13, at 407 n.57 (listing similar variables).

²⁵ *See* Benjamin Wittes, *The Hapless Toad*, *ATLANTIC MONTHLY*, May 2005, at 48, 49–50 (describing threat conservative judges pose to environmental regulation impacting on private property rights); *see generally* Jeffrey Rosen, *The Unregulated Offensive*, *N.Y. TIMES MAG.*, Apr. 17, 2005, at 42 (describing libertarian, anti-New Deal "Constitution in Exile" movement).

²⁶ 125 S. Ct. 2655 (2005).

²⁷ *Kelo* immediately spawned a raft of criticism from mainstream and academic commentators. *See, e.g.*, Gideon Kanner, *The Public Use Clause: Constitutional Mandate or "Hortatory Fluff"?*, 33 *PEPP. L. REV.* 335, 336–38 (2006) (arguing that *Kelo* Court misread precedents and established approach contrary to traditional constitutional analysis); *see also* Donald E. Sander & Patricia Pattison, *The Aftermath of Kelo*, 34 *REAL EST. L.J.* 157, 164–70 (2005) (describing backlash in response to *Kelo*); John M. Broder, *States Curbing Right to Seize Private Homes*, *N.Y. TIMES*, Feb. 21, 2006, at A1 (same).

states' and local governments' authority to take private property for a nontraditional "public use."²⁸ In addition, conservative property rights advocates recently managed to convince voters in Oregon—usually a bastion of progressive land use planning—to pass a ballot initiative requiring compensation whenever a government action decreases property values.²⁹ But if, as this Article argues, not all government regulations implicate the same set of concerns, then categorical approaches to protecting property rights will often miss the mark by glossing over important differences.

Part I of this Article describes the traditional economic account of the Takings Clause and the more recent public choice theory critique leveled against it. Part II identifies the mechanisms that force local governments to internalize both the economic costs and benefits of their actions, and examines why the same mechanisms are not present in larger governments. Most importantly for this Article's normative claim, Part II argues that local governments are dominated by homeowner interests, at least when it comes to land use decisions, and that compensation for regulatory takings comes principally from property tax revenue or local bond issues that are paid for by homeowners. Having identified the mechanisms by which local governments internalize costs, in Part III the Article examines how risk aversion and interjurisdictional externalities can interfere with local governments' efficient decisionmaking. Takings doctrine blind to these differences is as likely to over-deter local governments as it is to under-deter them. Part IV therefore proposes altering compensation rules, as well

²⁸ Joyce Howard Price, *Drawing the Line on Eminent Domain; States Rush to Counter Court Ruling*, WASH. TIMES, Oct. 9, 2005, at A1 (listing states that have proposed legislation); T.R. Reid, *Missouri Condemnation No Longer So Imminent; Supreme Court Ruling Ignites Political Backlash*, WASH. POST, Sept. 6, 2005, at A2 ("Hundreds of local governments around the country are also debating new ordinances to restrict the use of eminent domain. Many have passed laws this summer barring any seizure of private property for commercial development. Other cities are tightening the conditions that could authorize such seizure."). For an updated collection of federal, state, and local legislative proposals, see Castle Coalition, Legislative Center, <http://www.castlecoalition.org/legislation> (last visited Aug. 15, 2006). State supreme courts have also begun narrowing the definition of "public use" as a matter of state constitutional law. See, e.g., *City of Norwood v. Horney*, No. 2005-0227, 2006 Ohio LEXIS 2170, at *134 (July 26, 2006) (holding that economic benefits, standing alone, do not satisfy Ohio Constitution's public use requirement).

²⁹ See Edward Walsh, *Activists Propose Altering State*, OREGONIAN, Jan. 9, 2006, at B1 (describing conservative property rights group's advocacy for new Oregon law). For a description of the effect that the change in the law has had, see Felicity Barringer, *Property Rights Law May Alter Oregon Landscape*, N.Y. TIMES, Nov. 26, 2004, at A1; Blaine Harden, *Anti-Sprawl Laws, Property Rights Collide in Oregon*, WASH. POST, Feb. 28, 2005, at A1 (noting that passage of Measure 37 has begun "to unravel smart-growth laws that defined living patterns, set land prices and protected open space" for more than thirty years as government can no longer afford to restrict private land use).

as other nonjudicial responses, to recalibrate compensation's effect on local governments' regulatory incentives.

I

AN ECONOMIC ACCOUNT OF THE TAKINGS CLAUSE

The active struggle to provide content to the Takings Clause has spanned the better part of a century and has taken many forms.³⁰ The concerns underlying these various approaches generally fall into one of two broad categories: efficiency and fairness.³¹ While fairness considerations have been the hallmark of Supreme Court opinions,³² efficiency has dominated much of the takings scholarship.³³

Compensation's deterrent effect on the government's regulatory appetite has become increasingly important in recent years, with the property rights movement pitted against environmental and progressive land use interests. Underlying this dispute is an assumption that the more the government has to pay for its actions, the less willing it will be to act.³⁴ Recent scholarship, however, has problematized this

³⁰ Some of the leading theories are catalogued in note 3 *supra*.

³¹ Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 HARV. L. REV. 997, 998 (1999) (describing "virtual consensus" among scholarly works and judicial opinions that two central aims of Takings Clause are "utility" and "fairness," and arguing that traditional approaches to Takings Clause are inadequate when these aims conflict); *see also* James E. Krier, *Takings from Freund to Fischel*, 84 GEO. L.J. 1895, 1898 (1996) (reviewing FISCHEL, *supra* note 12) ("Anyone passingly familiar with the takings problem knows that it entails two concerns, one being fairness and the other being efficiency."). According to Ellickson, "the legal doctrines developed to resolve growth control issues [should] be designed to promote three principal goals: efficiency, horizontal equity, and vertical equity." Ellickson, *supra* note 13, at 414. The latter two goals Ellickson identifies can be considered together under the more general term "fairness."

³² According to the Supreme Court, the Takings Clause is "designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). This formulation is a straightforward articulation of the fairness rationale, and has been repeated often by the Court. *E.g.*, *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 320 (2002); *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 123–24 (1978). The language from *Armstrong* was most recently quoted in *Lingle v. Chevron*, 544 U.S. 528, 537 (2005).

³³ *See* Laura H. Burney, *Just Compensation and the Condemnation of Future Interests: Empirical Evidence of the Failure of Fair Market Value*, 1989 BYU L. REV. 789, 796–97 (describing economic account and citing sources); Eric D. Albert, Student Article, *If the Shoe Fits, [Don't] Wear It: Preacquisition Notice and Stepping into the Shoes of Prior Owners in Takings Cases After Palazzolo*, 11 N.Y.U. ENVTL. L.J. 758, 765–66 (2003) (same).

³⁴ At least some judges also share this view. In *Florida Rock Industry, Inc. v. United States*, 18 F.3d 1560 (Fed. Cir. 1994), the Federal Circuit wrote:

No legal subject has received the attention of scholars more than "takings" jurisprudence in recent years. A flood of literature has been produced advocating various theories of property and social responsibilities. Some espouse the view that property is held subject to complete control as to its use by the

assumption, pointing out that under more sophisticated accounts of government decisionmaking, making the government pay may have little to do with government incentives. What follows here, then, is an overview of the traditional economic account of the Takings Clause and an introduction to recent criticisms that have been leveled against it. Following the long tradition of scholarship in the area, this Article will put to one side other justifications for the Takings Clause, including fairness considerations and property owners' investment incentives, focusing instead on the traditional and still dominant economic account of takings law's effect on government incentives to regulate property.

A. *An Economic Account of the Takings Clause
and Majoritarianism*

Under the traditional efficiency-based account of the Takings Clause, the Fifth Amendment compensation requirement forces the government to internalize the costs of its actions, preventing fiscal illusion and helping to ensure that the government will undertake only projects that generate more gain than harm.³⁵ The idea is straightforward. In the absence of a compensation requirement, the government could ignore the costs its actions impose on property owners.³⁶ And, if allowed to avoid these costs, the government is more likely to enact regulations that harm property owners more than they benefit the government. On this view, then, compensation serves the laudatory purpose of helping to create efficient regulatory incentives by forcing the government to internalize the costs it imposes.

For property rights advocates, examples of inefficient overregulation are easy to find, from preventing timber harvesting in order to save the spotted owl to disallowing new development in order to preserve a historic district.³⁷ There is an assumption—shared, it must be

state and federal governments. Others, at the opposite extreme, start from a premise that owners have a right to use their property in any manner, virtually without restriction, and, damages must be paid for any governmental interference with their use. The more often the government must pay for exercising control over private property, the less control there will be. That is the reality.

Id. at 1574–75 (Nies, C.J., dissenting).

³⁵ As Ellickson has described the efficiency goal: “[A] rule requiring compensation, by shifting the costs back to the electoral majority, may help induce these officials to weigh more accurately the costs and benefits of alternative measures.” Ellickson, *supra* note 13, at 420.

³⁶ This phenomenon is often referred to as “fiscal illusion.” See Abraham Bell & Gideon Parchomovsky, *A Theory of Property*, 90 CORNELL L. REV. 531, 605 n.386 (2005).

³⁷ See, e.g., William A. Niskanen, *Environmental Policy: A Time for Reflection*, REGULATION: CATO REV. BUS. & GOV'T, Winter 1994, at 9, 9–10, available at <http://www.cato.org/pubs/regulation/reg17n1-niskanen.html> (describing inefficiency of Endangered Species

admitted, by property rights groups and their critics alike—that if the government had to pay for these regulations, it would be much less willing to act.³⁸ Since judgments about the benefits of any government action are extremely value-laden—How important is the spotted owl? Biodiversity? Historic preservation?—the compensation requirement also puts to the test the government’s judgment that a given regulation is worthwhile. If the spotted owl is really worth the millions of dollars in lost timber revenue that logging could generate, then the government should be willing to pay. Compensation serves as a form of pricing mechanism.³⁹ If taxpayers are willing to shoulder the additional expense of paying current timberland owners for their property, then protecting the spotted owl necessarily creates more gain than harm. So long as the government is forced to pay just compensation, taxpayers in effect get to choose whether a government program is worth more to them than the cost in increased taxes.

Compensation is most obviously a pricing mechanism whenever government financing for a project appears as its own item on a ballot. A bond issue, for example, may ask voters to approve incurring a specific amount of debt—at a specific cost—in order to finance some new

Act, Superfund, Corps of Engineers’ interpretation of Clean Water Act, and Clean Air Act); Robert J. Smith, *The Endangered Species Act: Saving Species or Stopping Growth?*, REGULATION: CATO REV. BUS. & GOV’T, Winter 1992, available at <http://www.cato.org/pubs/regulation/reg15n1-smith.html> (arguing for more efficient incentives in Endangered Species Act); Editorial, *When Does a Landmark Become a Roadblock?*, SEATTLE TIMES, Sept. 25, 1995, at B4 (“When the landmarks process is used as a tool to obstruct legitimate projects, it frustrates property owners, fuels the property-rights movement and cheapens the original concept.”).

³⁸ E.g., CHARLES FRIED, ORDER AND LAW: ARGUING THE REAGAN REVOLUTION—A FIRSTHAND ACCOUNT 183 (1991). As Fried describes the conservative-led “Takings Project”:

The grand plan was to make government pay compensation as for a taking of property every time its regulations impinged too severely on a property right—limiting the possible uses for a parcel of land or restricting or tying up a business in regulatory red tape. If the government labored under so severe an obligation, there would be, to say the least, much less regulation.

Id. Environmentalists have termed the Takings Project “indefensible” for numerous reasons, but not because they disagree with this assumption. E.g., Douglas T. Kendall & Charles P. Lord, *The Takings Project: A Critical Analysis and Assessment of the Progress So Far*, 25 B.C. ENVTL. AFF. L. REV. 509, 512–13 (1998).

³⁹ See Ellickson, *supra* note 13, at 458 (“When municipal officials do not charge for services, they have no clear evidence of how their constituents value public programs.”); see also David A. Dana, *Land Use Regulation in an Age of Heightened Scrutiny*, 75 N.C. L. REV. 1243, 1248 (1997) (“Under conditions of incomplete information, regulators must rely on development conditions to ensure that developers do not proceed with development that will decrease current residents’ welfare by more than it will increase the developer’s (and by extension, future residents’) welfare.”).

public project.⁴⁰ A vote approving the bond issue is a direct expression that the project is worth more to a majority of voters than it will cost.⁴¹ But this idea does not apply only to up-or-down votes on specific projects. Compensation is no less of a pricing mechanism in representative governments where politicians must constantly mediate between voters' preferences and government expenditures. The length of a politician's career is directly related to her ability to calculate costs and benefits on her constituents' behalf.⁴²

Allowing the government to act for free is particularly likely to lead to wasteful regulations where the government is benefiting a majority of constituents at the expense of individual property owners. Requiring compensation in this scenario seems to make good sense. Operating without any constitutional or other legal constraints, a community wanting a new park, dump, or recreational area, or wanting simply to preserve open space, could create the use it wants by legislative fiat.⁴³ If the government does not have to pay for the costs it imposes, the majority might vote to impose more restrictive regulations than it would choose if it had to pay for their costs. Why not protect the Delhi Sands Flower-Loving fly, whatever the expense, if saving the fly is free to everyone except the one burdened property owner?⁴⁴ Concern about this kind of abuse is consistent with the Framers' understanding of the Fifth Amendment,⁴⁵ and requiring

⁴⁰ For example, open-space initiatives to combat urban sprawl often require public financing through ballot initiatives. These initiatives often succeed if the average voter feels the impact of sprawl in her own life. See Jennifer Preston, *Suburban Sprawl Becomes a 'Mom's Issue,' Altering Township Politics*, N.Y. TIMES, Dec. 27, 1998, § 1, at 29 ("Planning board hearings that were poorly attended are now often packed with residents complaining about the building boom threatening their way of life."); Todd S. Purdum, *Suburban 'Sprawl' Takes Its Place on the Political Landscape*, N.Y. TIMES, Feb. 6, 1999, at A1 (noting "some 200 measures worth \$7 billion" passed nationwide that "will force every proposed development that requires a zoning change to be approved by a public referendum"). For an excellent introduction to the politics of local bond issues, see Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEGAL ISSUES 365, 367 (2004).

⁴¹ Compensation's effectiveness as a pricing mechanism is also obvious in direct democracies, like New England town meetings or specific ballot initiatives or referendums. For a discussion of these political processes, see generally FRANK M. BRYAN, *REAL DEMOCRACY: THE NEW ENGLAND TOWN MEETING AND HOW IT WORKS* (2004).

⁴² In fact, studies confirm that local governments make decisions as if they had been voted on by popular referendums. FISCHER, *supra* note 11, at 87-88 (citing studies).

⁴³ See Ellickson, *supra* note 13, at 421 ("[A] policy of complete judicial deference to antinuisance measures . . . would ignore the awesome allocational mischief that a suburb dominated by a homeowner majority can work").

⁴⁴ See generally John Copeland Nagle, *The Commerce Clause Meets the Delhi Sands Flower-Loving Fly*, 97 MICH. L. REV. 174 (1998) (discussing efforts to protect fly against erection of new hospital).

⁴⁵ See AKHIL REED AMAR, *THE BILL OF RIGHTS: CREATION AND RECONSTRUCTION* 77 (1998) ("This prohibition [in the Takings Clause] seems primarily designed to protect individuals and minority groups."); Treanor, *supra* note 16, at 851 (explaining Madison's

compensation appears to be a satisfactory response.

Often hidden from view, however, is that the political system implicit in this economic account is one in which the government is politically responsive to the same group that provides its funding. A stylized paradigm here is a constituency of 100 taxpaying voters, 99 of whom gang up to impose disproportionate burdens on one individual. Requiring the government to compensate the burdened property owner forces the 99-person majority to internalize the costs of the government action. The government, in essence, is a relatively transparent conduit for the majority's preferences. This is only one vision of political decisionmaking, however, and the traditional economic model does not fare as well once some of its assumptions are relaxed.

B. The Public Choice Theory Critique and Minoritarianism

The compensation requirement in the traditional takings story forces the government to internalize the costs of its actions only when the government is responsive to the same people who fund those actions. This is not always—and perhaps not even usually—the case. According to public choice theory, a mobilized, well-connected minority can exert more political influence than a numerically superior but unorganized or apathetic majority, and compensation for government actions resulting from special interest group pressure has a very different effect on regulatory incentives.⁴⁶ Public choice theory's ascendancy in the legal literature is marked by a number of important contributions from fields as diverse as voting theory and property rights.⁴⁷ It is a varied and contested terrain, but even its most basic observations have implications for the economic account of the Takings Clause.⁴⁸

belief that property owners could not depend solely on political process for their protection).

⁴⁶ As Neil Komesar writes:

Interest groups with small numbers but high per capita stakes have sizeable advantages in political action over interest groups with larger numbers and smaller per capita stakes, because higher per capita stakes mean that the members of the interest group will have greater incentive to expend the effort necessary to recognize and understand the issues. In the extreme but not uncommon case, the members of the low per capita stakes losing majority (often consumers or taxpayers) do not even have the incentive to recognize that they are being harmed.

NEIL K. KOMESAR, *LAW'S LIMITS: THE RULE OF LAW AND THE SUPPLY AND DEMANDS OF RIGHTS* 61 (2001).

⁴⁷ For a survey of the different manifestations of public choice theory in the legal literature, see generally Farber & Frickey, *supra* note 9.

⁴⁸ I have previously described, in general terms, the public choice literature relating to the Takings Clause. Serkin, *supra* note 4, at 726–28.

The origins of public choice theory can be traced directly to Mancur Olson's seminal work on collective action.⁴⁹ He observed that it is more difficult for large groups than for small groups to organize effectively because of free-rider problems, transaction costs, information costs, and organizational hurdles.⁵⁰ Small groups therefore enjoy an advantage in the political process.⁵¹ In contemporary politics, their relative advantage can explain special interest groups' frequent ability to capture legislatures, regardless of the preferences of the majority of voters.⁵² Examples of this political dynamic—sometimes dubbed minoritarianism⁵³—are legion, and include farm subsidies and gun laws, among many others.⁵⁴ At its most fundamental level, public choice theory recognizes that government actors have their own self-interest at stake, in addition to the interests of their constituents.⁵⁵ Forcing the government to internalize the monetary costs of its actions is not necessarily the same as forcing government actors to bear the political costs of their actions.

In the absence of a compensation requirement, minoritarianism would appear to be an unlikely political failure in the takings context. If a special interest group wants to use the government to take

⁴⁹ MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 53–57 (1965).

⁵⁰ *Id.* at 53 (explaining “greater effectiveness of relatively small groups”); see also Farber & Frickey, *supra* note 9, at 1718 (“Group size is crucial for two reasons: (1) given the same total benefit to the group, size is inversely related to the magnitude of any individual's stake; and (2) size increases transaction costs.”). For the various views on public choice theory, compare Abner J. Mikva, *Foreword*, 74 VA. L. REV. 167, 167 (1988) (rejecting idea of self-interested economic actors in political process), with Michael E. DeBow & Dwight R. Lee, *Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey*, 66 TEX. L. REV. 993, 996–97 (1988) (arguing for strong view of politicians as rational economic actors). Farber and Frickey are themselves somewhere in the middle, suggesting that politicians express both their own interests as well as the public-minded interests of their constituents. Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873, 883 (1987). All of these sources are summarized briefly in Farber & Frickey, *supra* note 9, at 1718–19.

⁵¹ Farber & Frickey, *The Jurisprudence of Public Choice*, *supra* note 50, at 892 (summarizing Mancur Olson's work).

⁵² As one economist has written: “There are economies of scale in politics because it is more effective to pursue groups than individual voters. Politicians are brokers between groups and individual voters. The policies that result, such as protection, represent the price that particularized (lobby) groups can exact from generalized (voters) groups.” Stephen P. Magee, *Endogenous Protection: The Empirical Evidence*, in *PERSPECTIVES ON PUBLIC CHOICE*, *supra* note 23, at 528–29.

⁵³ See KOMESAR, *supra* note 46, at 7 (discussing minoritarian bias). Ellickson describes this concept as an “influence model” of local politics. Ellickson, *supra* note 13, at 407.

⁵⁴ Farber & Frickey, *The Jurisprudence of Public Choice*, *supra* note 50, at 910; Carol M. Rose, *Takings, Federalism, Norms*, 105 YALE L.J. 1121, 1136–37 (1996) (reviewing FISCHER, *supra* note 12).

⁵⁵ Farber & Frickey, *supra* note 9, at 1718.

someone else's property, the property's current owners will create their own offsetting political pressure resisting the government action. Instead of a mobilized minority burdening a diffuse majority, the inevitable political duel would seem to pit a special interest group against an equally mobilized minority consisting of the burdened property owners themselves, as well as any other property owners with enough foresight to realize they might be next in the government's crosshairs. While there is no guaranteeing which interest group would win—nor, in the abstract, should there be—the political interests are properly aligned with two groups vying competitively for the government's attention. This is not the stuff of public choice theorists' concerns.

The compensation requirement, however, threatens to change this political calculus. As Daniel Farber has observed, compensation may serve to “buy off” the burdened property owners, the one group sufficiently motivated to resist the governmental action.⁵⁶ In addition, money for compensation will be raised from the taxpayers generally, and they constitute precisely the kind of diffuse and unorganized majority that a mobilized special interest group's political pressure is likely to overwhelm. To the extent compensation makes burdened property owners more-or-less indifferent as to the government's action, they will be removed from the political equation, pitting the special interest group supporting the action against the diffuse taxpayers who must ultimately shoulder the resulting financial burden.⁵⁷ As long as the marginal increase in people's taxes is sufficiently small, individual taxpayers will have little motivation to object. Perversely, then, in the world of minoritarian politics, compensation not only will fail to prevent inefficient government actions but actually will serve to insulate the government from the political costs that otherwise would have been at stake.⁵⁸ With the burdened property owners out of the equation, no one else is well situated to generate significant political opposition to an inefficient government action.

⁵⁶ Daniel A. Farber, *Public Choice and Just Compensation*, 9 CONST. COMMENT. 279, 282 (1992).

⁵⁷ It is simply not true, as an empirical matter, that current compensation practices leave property owners genuinely indifferent to takings of their property. See *infra* note 59. Compensation, then, may not fully blunt burdened property owners' political opposition. If the relationship between compensation and political opposition is not linear, it might take significantly more compensation than current practices provide before the public choice criticism has its full bite. See Serkin, *supra* note 4, at 719–20 (suggesting that compensation and political opposition are not necessarily linearly related). Nevertheless, it seems plausible enough that compensation will at least lower the stakes for burdened property owners and reduce their political opposition.

⁵⁸ It is for this reason that Daniel Farber has proposed making compensation discretionary instead of mandatory. Farber, *supra* note 56, at 294–95.

There are some compelling reasons to be skeptical of the strong version of this claim about compensation's effect. If the political interests align the way public choice theorists suggest, the government would minimize political costs by maximizing compensation. However, even in condemnations, when the compensation requirement squarely applies, the government usually seeks to pay as little as it can. Property owners routinely anticipate receiving far less than the real harms they suffer.⁵⁹ While academic critiques can—at their best—point out the unintended and unforeseen consequences of political positions, politicians are generally adept at navigating political pressures. If political capital is maximized by paying *more*, then we would expect to see higher compensation than the minimum required by the Constitution. We do not. Indeed, political scientists are largely skeptical about the purer forms of public choice theory that often appear in the legal literature.⁶⁰

There is a rebuttal to at least some of this skepticism, however. When government actions impose costs on more expensive property, governments frequently do pay more than the property's fair market value.⁶¹ This is entirely consistent with the political dynamic anticipated by public choice theorists. Governments' first choice may be to place burdens on property owners who are unable to generate substantial political opposition.⁶² But when the government must burden

⁵⁹ Lee Anne Fennell has recently identified what she calls the "uncompensated increment" in takings: the aspects of ownership for which a property owner receives no compensation. Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 MICH. ST. L. REV. 957, 962–67; see also James E. Krier & Christopher Serkin, *Public Ruses*, 2004 MICH. ST. L. REV. 859, 865–66 (noting frequent objection that compensation for takings is inadequate). But see Serkin, *supra* note 4, at 679 ("Criticisms about the adequacy of compensation have too often elided the difficult prior question, 'adequate for what?'). Nicole Garnett has attacked conventional assumptions about compensation for takings, arguing that statutorily required relocation assistance can amount to a substantial windfall for burdened property owners. Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. (forthcoming Nov. 2006) (manuscript at 25, on file with the *New York University Law Review*), available at <http://ssrn.com/abstract=875412>.

⁶⁰ See Farber & Frickey, *supra* note 9, at 1716 & n.4 (citing sources); see also Durchslag, *supra* note 21, at 657–60 (reviewing studies of local government decisionmaking).

⁶¹ Patricia Munch, *An Economic Analysis of Eminent Domain*, 84 J. POL. ECON. 473, 495 (1976); cf. George Washington Plunkitt, *Honest Graft and Dishonest Graft*, in *PLUNKITT OF TAMMANY HALL* 3–4 (William L. Riordon ed., 1963) (1905) (describing buying land in order to have it condemned for profit); LEONARD M. WALLSTEIN, *REPORT ON LAW AND PROCEDURE IN CONDEMNATION APPLICABLE TO PROCEEDINGS BROUGHT BY THE CITY OF NEW YORK* 11–42 (1932) (describing cases of profiteering by speculating in land slated for condemnation). Thanks to William Nelson at NYU for drawing my attention to this interesting condemnation story.

⁶² This is at the heart of the environmental justice critique which posits that environmental harms are generally imposed on the poor or politically powerless. See generally

property owned by wealthier constituents able to generate greater political opposition, it will indeed seek to buy off this opposition by offering higher than market value compensation.

Ultimately, even a weaker version of public choice theory raises a serious challenge to the traditional economic account of the Takings Clause. Disproportionate special interest group pressure changes the traditional cost-internalization calculus. By putting pressure on either the cost or benefit side of the scale, special interest groups can prevent compensation from promoting—let alone ensuring—efficient regulatory incentives. A special interest group favoring a proposed regulation will make it appear more valuable to the government than it actually is to the taxpayers footing the bill. Likewise, special interest group opposition to an action may increase the apparent costs of a proposed action and cause the government to underregulate.⁶³ Where the special interest group pressure is strong enough, and the political costs of compensation small enough, it is not at all clear that compensation will function as any kind of meaningful check on the government's regulatory incentives.

To see why this is true, imagine a stylized version of *Kelo*⁶⁴ in which a local government is considering a plan to condemn property for retransfer to a developer. Imagine, further, that the costs of condemnation will be \$100, and that the new development is expected to generate \$50 worth of gain.⁶⁵ But now add some stylized numbers representing political pressures to the equation. Imagine that every \$5 of financial gain or loss translates into only 1 unit of political cost—call it a “pol” for short—reflecting the relative inattention that most taxpayers pay to government expenditures. The \$50 loss on the project translates into only 10 pols. But there are other sources of political pressure that will bear on the government's decision. The first comes from the burdened property owners. In the absence of com-

Vicki Been, *What's Fairness Got to Do with It? Environmental Justice and the Siting of Locally Undesirable Land Uses*, 78 CORNELL L. REV. 1001 (1993).

⁶³ In fact, there is an even greater possibility of distortion in this direction; empirical evidence suggests that special interest group pressure is more effective at blocking than encouraging government action. KAY LEHMAN SCHLOZMAN & JOHN T. TIERNEY, *ORGANIZED INTERESTS AND AMERICAN DEMOCRACY* 314–15, 395–96, 398 (1986), discussed in Farber & Frickey, *The Jurisprudence of Public Choice*, *supra* note 50, at 887, 906; see also JESSE H. CHOPER, *JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS: A FUNCTIONAL RECONSIDERATION OF THE ROLE OF THE SUPREME COURT* 26 (1980) (suggesting antimajoritarian problems result in too little legislation).

⁶⁴ 125 S. Ct. 2655 (2005).

⁶⁵ The form that such gain might take is considered in detail in the text accompanying notes 118–59 *infra*.

pensation, they might generate 100 pols in political costs.⁶⁶ With compensation, however, according to Farber's insight, this might be reduced to 25 pols—their opposition is not eliminated but is significantly blunted. But the developer, too, can generate political pressure; let's say 100 pols of political support for the project, because the developer enjoys the familiar political advantages of a special interest group. What looked like a \$50 financial loss now looks like a 65 pol gain for the government.⁶⁷ Or, to compare a compensation rule with a no-compensation rule, what would have been a net loss of 10 pols without compensation becomes a net gain of 65 pols with compensation.

Notice, too, that this effect does not rely on any particular relationship between budgetary expenditures and political costs. It would be equally possible to construct a model where expenditures are exponentially related to political costs, where a certain level of expenditures is a threshold for the imposition of political costs, or some other idiosyncratic relationship. These possibilities do not undermine the central purpose of the example: to demonstrate the effect of slippage between fiscal and political costs, as well as the potential impact of special interest group pressure.

This problem of political pressure applies to both the costs and the benefits of government actions. Recently, Daryl Levinson pointed out that arguments about the Takings Clause—in addition to other government compensation requirements like constitutional torts—contain a hidden and unjustified assumption that governments internalize costs and benefits differently.⁶⁸ Under the traditional economic account of compensation, governments only internalize those costs that are monetized by a compensation requirement. In contrast, the mechanism for internalizing gains is mysteriously undefined. There is no Givings Clause in the Constitution requiring property owners to pay compensation to the government when they benefit from a regulation, yet the government is somehow supposed to internalize gains spontaneously.⁶⁹ There is no reason to think that costs and benefits

⁶⁶ Political opposition, of course, cannot be measured so easily. This example is intended only to concretize the intuition that special interest groups can wield disproportionate pressure in the political process.

⁶⁷ On the cost side are 20 pols for \$100 of compensation and 25 pols of opposition from the property owners. On the gain side are 10 pols for the gains of the development and 100 pols from the developer. This amounts to: (110 pols support) – (45 pols opposition) = 65 pols.

⁶⁸ Levinson, *supra* note 6, at 349–50 (noting takings literature's failure to explain this “puzzling asymmetry”).

⁶⁹ It should be noted that at least some scholarship has proposed introducing a “Givings Clause.” See generally Bell & Parchomovsky, *supra* note 7.

should be internalized asymmetrically.⁷⁰ Hence, the effect of compensation is in even greater doubt.

Where does this leave us? Under the strongest version of public choice theory, government actions are purely the result of special interest rent-seeking. But even where a more modest version of public choice theory applies, so that any given regulation or government action is the result of a combination of economic and political pressures, compensation will not necessarily force the government to internalize the costs of its actions and may even have the opposite effect.⁷¹ There is no real doubt that some government decisions are primarily the result of well-organized special interest groups exercising their influence on political decisionmakers.⁷²

In the takings literature, these concerns have spawned a number of creative and quite radical proposals, from making compensation optional to replacing compensation with property rule protection and enjoining government actions.⁷³ Before throwing out the baby with the bathwater—no matter how dirty takings' bathwater has become—it is important to step back and ask how broadly the public choice theory critique applies. Unfortunately, takings challenges do not usually come with a neatly packaged political backstory for courts to adopt.⁷⁴ When is a tyranny of the minority more likely than majoritarian excess? When will compensation serve to create efficient

⁷⁰ Levinson, *supra* note 6, at 350–54.

⁷¹ See generally Farber & Frickey, *The Jurisprudence of Public Choice*, *supra* note 50 (arguing that legal scholars are too quick to adopt strongest versions of public choice theory, despite deep skepticism in political science literature).

⁷² Cheryl M. Holey & Thomas E. Borcherding, *Why Does Government's Share of National Income Grow?*, in PERSPECTIVES ON PUBLIC CHOICE, *supra* note 23, at 578 (“[A]s communities expand and become more heterogeneous and markets become more impersonal, the general interest is less easily articulated and hence, its representation is less vigorously pursued.”); Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. CHI. L. REV. 63, 86 (1990) (“Interest groups that are small, single-minded, and well-organized tend to convey their messages more clearly than large interest groups with diverse agendas. This produces a significant bias in the legislative process in favor of smaller, more efficient special interest groups.”). On the other hand, Hovenkamp ultimately contends that special interest groups have less power than is wielded by a majority of voters. *Id.* at 89.

⁷³ *E.g.*, Farber, *supra* note 56, at 295 (arguing that rule MAKING COMPENSATION OPTIONAL for legislature would produce COMPENSATION in most cases); Margaret Jane Radin, *The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings*, 88 COLUM. L. REV. 1667, 1690–91 (1988) (“[C]ourts should not always allow governments to condemn property and then transfer it to a user adjudged to benefit the community. . . . In essence, we should recognize a substantive due process limitation on the eminent domain power.”).

⁷⁴ As Farber and Frickey write: “[I]nvestigating the influences behind a specific statute offers little prospect for isolating a distinct class of nonpublic interest legislation.” Farber & Frickey, *The Jurisprudence of Public Choice*, *supra* note 50, at 909.

regulatory incentives, or at least function in the right direction? The answer can be found by focusing on the level of government.

II

LOCAL GOVERNMENT POLITICS: PROPERTY VALUES AND PROPERTY TAXES

The public choice critique sketched above applies whenever the government is responsive to a special interest group that will not bear the (full) costs of compensating burdened property owners. Conversely, if the government is controlled by the same people who foot the bill, then compensation will, in fact, force the relevant decisionmakers to internalize the costs of their actions. The litmus test is whether the people who have to pay for the compensation are the same people who both control the government and stand to benefit from the challenged action.⁷⁵

As it turns out, this is more likely to be true at the local level, especially with regard to the kinds of land use regulations that give rise to takings claims.⁷⁶ According to public finance literature, the fact that local governments are funded primarily by property taxes means that costs are passed on directly to local property owners.⁷⁷ Under a leading view, the property tax is a pure benefit tax, “a pay-

⁷⁵ Cf. Todd J. Zywicki, *A Unanimity-Reinforcing Model of Efficiency in the Common Law: An Institutional Comparison of Common Law and Legislative Solutions to Large-Number Externality Problems*, 46 CASE W. RES. L. REV. 961, 988 (1996) (“As long as there remains a disparity between political and externality boundaries, there is the possibility that outsiders (those not directly affected by the pollution source) will pass inefficient regulations.”).

⁷⁶ See FISCHER, *supra* note 11, at 19 (arguing that immobility of real estate makes homeowners particularly attentive to local government decisions); KOMESAR, *supra* note 46, at 73 (“The case for majoritarian bias in local zoning—at least in smaller and less developed locales—is strong.”); Ellickson, *supra* note 13, at 405–06 (discussing majoritarian nature of small municipalities). The political dynamic is different in other governments. For example, smaller, democratic polities are sometimes seen as better at preventing a tyranny of the majority because they are more fluid politically, creating a significant risk for any group of being tyrannized itself in the future, and because exit is an easier option. Inman & Rubinfeld, *supra* note 23, at 74–75; see also Akhil Reed Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425, 1428 (1987) (arguing that competition among limited governments can protect popular sovereignty); Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1057, 1061 (1980) (explaining and arguing against contemporary city powerlessness); Andrzej Rapaczynski, *From Sovereignty to Process: The Jurisprudence of Federalism after Garcia*, 1985 SUP. CT. REV. 341, 380–91 (discussing states’ role in federal structure in protecting against tyranny of majority).

⁷⁷ E.g., John Joseph Wallis, *A History of the Property Tax in America*, in PROPERTY TAXATION AND LOCAL GOVERNMENT FINANCE 123, 145 (Wallace E. Oates ed., 2001) [hereinafter PROPERTY TAXATION].

ment for local public services received.”⁷⁸ It therefore amounts to a user charge that property owners can decide whether or not to pay by moving between communities that provide different mixes of government services and property taxes. This account of property taxation relies on the interrelationship of the Tiebout Hypothesis, property taxes, and, fundamentally, homeowner control over local government decisionmaking around land use planning, all of which are the subject of Part A. Part B makes explicit how much local governments differ from state and federal governments. The implication for the Takings Clause is that forcing local governments to pay compensation will, in fact, increase incentives towards regulatory efficiency because the costs and benefits of local government actions are born by the same people who control the political process. This claim requires some important modifications, discussed in Part III, but it nevertheless provides the missing mechanisms that translate a monetary compensation requirement for local governments into political costs and benefits for their land use decisions.

A. *Local Governments’ Majoritarianism*

The traditional economic account of the Takings Clause implicitly assumes a majoritarian political system, while public choice theory posits that governments are more often subject to minoritarian pressures.⁷⁹ Received wisdom suggests that, unlike the state and federal governments, local governments are majoritarian. According to William Fischel, local governments’ majoritarianism is actually a responsiveness to one particular majority: homeowners.⁸⁰ Moreover,

⁷⁸ Roy Bahl, *Local Government Expenditures and Revenues*, in *MANAGEMENT POLICIES IN LOCAL GOVERNMENT FINANCE* 77, 77–78 (J. Richard Aronson & Eli Schwartz eds., 4th ed. 1996) [hereinafter *MANAGEMENT POLICIES*] (“Economic efficiency requires that government fiscal decisions match local preferences for public services. In other words, the government should try to deliver the package of government services and taxes that the population wants Syracuse requires more snow removal than does St. Petersburg, which requires more services for elderly residents.”); George R. Zodrow, *Reflections on the New View and the Benefit View of the Property Tax*, in *PROPERTY TAXATION*, *supra* note 77, at 79.

⁷⁹ Ellickson defines a majoritarian model of politics as one in which “an individual’s influence over governmental decisions is proportionate to his voting strength at general elections.” Ellickson, *supra* note 13, at 405. This contrasts with a minoritarian model in which “the strength of an interest group is purely a function of its ability to contribute money, manpower, or other political assets to election campaigns.” *Id.* at 407.

⁸⁰ Fischel’s most comprehensive treatment of the subject can be found in FISCHEL, *supra* note 11. His prior book on takings introduced the central importance of homeowners in motivating local government land use controls. FISCHEL, *supra* note 12, at 258–59. Carol Rose offers a trenchant discussion of Fischel’s takings theory, accusing him of engaging simply in “localism bashing.” Rose, *supra* note 54, at 1131. Fischel’s other, shorter treatments of the subject can be found in William A. Fischel, *Municipal Corpora-*

homeowners pay for local government services through property taxes and receive the benefit of those services in increased property values. Local governments therefore internalize costs and benefits through property values and property taxes. Each piece of this story requires serious consideration before turning to important limitations.

First, however, it is important to acknowledge that claims about local government majoritarianism in this Article are limited to those areas that generate takings claims. At the local level, this means land use regulations.⁸¹ These are among the most visible actions that local governments undertake and, along with decisions about education, tend to be the most important exercises of local regulatory power.⁸² Instead of advancing a theory of local decisionmaking that applies to all aspects of local control, the discussion that follows is limited to land use decisions. If local government decisions are likely to be majoritarian anywhere, it is here, with highly visible government actions affecting people's land.⁸³

1. Homeowners Dominate Local Politics

The broad claim that local governments are fundamentally majoritarian has a distinguished pedigree. In this country, it traces

tions, Homeowners and the Benefit View of the Property Tax, in PROPERTY TAXATION, *supra* note 77, at 33, and William A. Fischel, *The Political Economy of Public Use in Poletown: How Federal Grants Encourage Excessive Use of Eminent Domain*, 2004 MICH. ST. L. REV. 929 [hereinafter Fischel, *Political Economy*]. Wallace Oates succinctly articulates Fischel's argument:

[T]he benefits from local public programs and their costs in terms of property tax liabilities tend to be "capitalized" into local property values. That is to say, the benefits from such things as superior local schools and low crime rates, on the one hand, and low tax rates, on the other, tend to manifest themselves in the price of local dwellings. . . . [T]his gives local residents a powerful incentive to undertake only those local measures for which benefits exceed costs in order to promote the value of their property.

Wallace E. Oates, *Property Taxation and Local Government Finance*, in PROPERTY TAXATION, *supra* note 77, at 21, 22; *see also* Ellickson, *supra* note 13, at 404 (identifying homeowners as source of majoritarianism in local politics).

⁸¹ This is a relatively broad category of local regulations, including everything from zoning ordinances, *see* *City of Coeur D'Alene v. Simpson*, 136 P.3d 310, 313 (Idaho 2006) (challenging shoreline regulations as taking), to permit denials, *see* *Jaikins v. Rose Twp.*, No. 264695, 2006 WL 1185464, at *1 (Mich. Ct. App. May 4, 2006) (challenging conditions imposed on land division application).

⁸² *See* Richard Briffault, *The Role of Local Control in School Finance Reform*, 24 CONN. L. REV. 773, 784 n.48 (1992) (describing land use as "the most important local regulatory power").

⁸³ *Cf.* Clayton P. Gillette, *The Exercise of Trumps by Decentralized Governments*, 83 VA. L. REV. 1347, 1404 (1997) (discussing when different interest groups are likely to control different areas of government decisionmaking).

directly back to James Madison and the Federalist Papers.⁸⁴ The theory goes that in a small enough polity, logrolling by competing constituencies is less likely to ensure that every group will get its say. Instead, a dominant majority can effectively shut out competing voices and systemically have its way.⁸⁵

Some might resist this characterization of local politics,⁸⁶ even though it is a staple of basic civics classes. Voter turnout in local elections is notoriously low, and community participation by all groups has declined in recent years.⁸⁷ The mechanisms for homeowner control over local governments are therefore not readily apparent. Moreover, on one opposing view, local governments are particularly ill-equipped to resist the pressures of sophisticated special interest groups. Indeed, groups of developers, or special commercial interests, are sometimes perceived as wielding disproportionate power at the local level.⁸⁸ Despite this competing intuition, homeowners provide the key to local government majoritarianism, because they have both the incentive and the means to dominate local politics, at least when it comes to local land use regulations.⁸⁹

⁸⁴ THE FEDERALIST No. 10, at 49 (James Madison) (Clinton Rossiter ed., 1961). As Madison famously wrote:

[A] pure democracy . . . a society consisting of a small number of citizens, who assemble and administer the government in person, can admit of no cure for the mischiefs of faction. A common passion or interest will, in almost every case, be felt by a majority of the whole; a communication and concert results from the form of government itself; and there is nothing to check the inducements to sacrifice the weaker party or an obnoxious individual.

Id.

⁸⁵ See Rose, *supra* note 15, at 853–57 (examining theoretical justifications behind Federalist No. 10).

⁸⁶ E.g., Vicki Been, *The Perils of Paradoxes—Comment on William A. Fischel, “Exploring the Kozinski Paradox: Why Is More Efficient Regulation a Taking of Property?”*, 67 CHI-KENT L. REV. 913, 920 (1991) (questioning whether all or even most local governments fit majoritarian model); Dana, *supra* note 39, at 1273 (“[T]here seems to be a slim empirical basis for concluding that small locality politics are generally rife with majoritarian abuse of power.”); see also Rose, *supra* note 15, at 863 (identifying perception in 1970s that local governments were too responsive to developers).

⁸⁷ FISCHEL, *supra* note 11, at 89–90 (describing voter turnout in local elections); ROBERT D. PUTNAM, *BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY* 31–47 (2000) (same).

⁸⁸ See CLINT BOLICK, *LEVIATHAN: THE GROWTH OF LOCAL GOVERNMENT AND THE EROSION OF LIBERTY* xiii–xiv (2004) (“[T]oo often the rules are rigged in favor of government—and particularly local government. Ordinary Americans are usually no match for special-interest groups whose sole purpose is to manipulate the power of government for their own benefit.”).

⁸⁹ To put the scale of homeowners’ influence on local politics into perspective, two-thirds of all homes are owner-occupied. FISCHEL, *supra* note 11, at 4.

The source of homeowners' incentive to control local politics is their common goal of preserving the value of their property.⁹⁰ The financial stakes alone are enormous. A person's home usually represents her most significant asset. Recent economic figures suggest 42% of homeowners' wealth, on average, is invested in their homes.⁹¹ This, combined with an owner's strong personal attachment to her property, creates a powerful incentive for homeowners to protect local property values.⁹² As a practical matter, this means carefully policing local government land use decisions.

This is not intended to suggest some far-fetched vision of homeowners attending every meeting of the local zoning board or planning commission. Homeowners' diligent monitoring of local governments is not always formal, nor is it limited to posted meetings. Instead, the claim here is only that homeowners are aware of changes in their communities. If land is being cleared for a parking lot or new development, homeowners notice and find out what is being built. If an area is going to be rezoned, homeowners are interested, and news about the proposal will travel quickly through the community. This informal but close attention to issues around town amounts to a comprehensive information-gathering network familiar to homeowners in communities nationwide.

Not only do homeowners have an incentive to monitor local government decisionmaking, they are also uniquely situated to exert political influence locally. They are the largest constituency in most small local governments, giving them formal political power.⁹³ But

⁹⁰ According to Fischel:

The homevoter hypothesis holds that homeowners, who are the most numerous and politically influential group within most localities, are guided by their concern for the value of their homes to make political decisions that are more efficient than those that would be made at a higher level of government. . . . They balance the benefits of local policies against the costs when the policies affect the value of their home, and they will tend to choose those policies that preserve or increase the value of their homes.

FISCHEL, *supra* note 11, at 4. This point is discussed in greater depth in the text accompanying notes 118–41 *infra*.

⁹¹ Broderick Perkins, *Home Prime Source of Wealth for Some Groups*, REALTY TIMES, Dec. 19, 2003, http://realtytimes.com/rtcpages/20031219_wealth.htm.

⁹² See Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CAL. L. REV. 569, 591–92 (1984) (arguing that homeowners are likely to be risk averse because their houses represent substantial portion of their wealth). This includes the subjective use value of property, and not just market value. See *infra* text accompanying notes 123–26.

⁹³ Ellickson, *supra* note 13, at 406 (noting that “70% of suburban households live in owner-occupied housing units,” so “homeowners are frequently able to dominate municipal politics”); Span, *supra* note 12, at 23–24 (“[I]t is residential homeowners who are the dominant force in local suburban politics . . . usually constituting a substantial majority of voters in such jurisdictions . . .”).

their power extends far beyond voting.⁹⁴ Homeowner influence on local politics often occurs informally—and, perhaps, more effectively—through conversations with neighbors, participation in meetings, and letters to the local newspaper, for example.⁹⁵ In fact, the relatively low voter turnout in local elections may be more of a testament to the effectiveness of local governments to discern and respond to the will of the majority than it is to voter apathy. There is little need for the majority of homeowners to vote if all of the available choices in a local election are likely to serve their fundamental interests.⁹⁶

There are additional systemic forces contributing to homeowners' dominant political influence on local decisionmaking. First, almost all local politicians are themselves property owners in the towns they serve. They therefore have their own self-interested reasons to pursue goals common to homeowners—not least of which is facing their neighbors. Second, actual participation in local decisionmaking is relatively easy.⁹⁷ Individuals can attend and participate in most local meetings, which are physically easier to reach than those in the state capital or Washington, D.C. and are more accessible in important,

⁹⁴ See, e.g., Carol M. Rose, *The Ancient Constitution vs. the Federalist Empire: Anti-Federalism from the Attack on "Monarchism" to Modern Localism*, 84 Nw. U. L. REV. 74, 97 (1989) (identifying other forms of local civic participation that may be more important than voting, including informal constituent contacts, PTA meetings, and civic groups "banging on the door at city hall").

⁹⁵ Fischel identifies the following mechanisms for exerting political pressure on local governments: "[l]etter writing, buttonholing, attending meetings and hearings, and organizing neighborhood groups." Fischel, *supra* note 11, at 90. Other empirical research along these lines is quite strong. According to Inman and Rubinfeld: "Surveys do show that citizens are more likely to seek to influence their local governments than national governments through nonelectoral channels Further, these local efforts are likely to have a greater effect of [sic] policy." Inman & Rubinfeld, *supra* note 23, at 77 (citations omitted); cf. Komesar, *supra* note 46, at 56 ("Communities can operate through informal sanctions, such as shunning and gossip, to enforce norms about land use."). Carol Rose has similarly argued that actual voting may be less important for control over local governments than exit and voice. Rose, *supra* note 15, at 882–87. In his book, Robert Putnam presents empirical evidence detailing the decline in these forms of informal political participation as part of what he calls a general decline in community participation. Putnam, *supra* note 87, at 25–26. It is possible that the homeowner-dominated account of local government is changing, in which case this Article's central claims will need to be revisited in the years to come. This is, however, hard to predict with much certainty, as most of Putnam's claims do not distinguish between political activities at the local, state, and federal levels. He also provides evidence that the size of the government still matters very much for political participation. *Id.* at 281–82.

⁹⁶ FISCHEL, *supra* note 11, at 89–90.

⁹⁷ Cf. KOMESAR, *supra* note 46, at 63 ("Smaller legislatures with fewer legislators make it easier to understand the position of any legislator and, therefore, it is easier to discipline unwanted action at the ballot box and to make the threat of such voting known and credible.").

intangible ways.⁹⁸ Participation does not require any particular level of expertise, and lawyers or professional advocates are the exception rather than the norm. Finally, political influence in small, local governments is much more likely to track personal connections than money, and these connections develop over time, primarily by living in the community.⁹⁹ While other constituencies have an incentive to participate in local government, it is either lower than the incentive for homeowners or the mechanisms of participation are less available. As Fischel identifies other groups' interests, renters tend to be less invested in the communities in which they live,¹⁰⁰ and businesses tend to have more opportunities to spread risk, reducing their incentive to participate in local government.¹⁰¹

Neil Komesar's work on the relative institutional competence of courts and legislatures provides additional support for the majoritarianism of small local governments. He has argued that low organization costs, combined with large per capita stakes, are the necessary preconditions for a majority to control the political process.¹⁰² According to Komesar, the biggest impediments to political participation are information and organization costs. He has examined these issues in detail and argues that the costs of participating in the political process "depend largely on the cost of information, which in turn depends on the complexity of the substantive issues and the com-

⁹⁸ Krier, *supra* note 31, at 1910 (noting geographical hurdles often facing people wanting to participate in state or federal decisionmaking).

⁹⁹ Cf. SIDNEY VERBA & NORMAN H. NIE, *PARTICIPATION IN AMERICA: POLITICAL DEMOCRACY AND SOCIAL EQUALITY* 231 (1972) ("In the small town . . . [c]itizens can know the ropes of politics, know whom to contact, know each other so that they can form political groups."); Inman & Rubinfeld, *supra* note 23, at 77 ("[C]itizens are more likely to seek to influence their local governments than national governments through nonelectoral channels and . . . these informal activities are more likely in stable rural communities than in large, urban centers.").

¹⁰⁰ FISCHEL, *supra* note 11, at 80 ("Nearly every study has shown that renters participate in local affairs in disproportionately low numbers compared to homeowners."). Rent stabilization can change this equation somewhat, but it tends to be the exclusive domain of a few large municipalities and so is outside the scope of this Article. See *id.* at 81-82 (discussing rent control's general scarcity).

¹⁰¹ *Id.* at 34. This last point, however, may be slightly too facile, because many small business owners do not have any greater ability to spread risk than homeowners. Nevertheless, there is something important in Fischel's insight. Almost every local government action affects either or both the subjective and market value of people's homes. See, e.g., FISCHEL, *supra* note 11, at 47-51. The same is not true of businesses, which may be largely unaffected by the bulk of local decisionmaking. This means that business interests may not participate at all in many local government decisions, and when they do participate, they will not have the same well-developed mechanisms for exerting political influence as homeowners with their near-constant monitoring and (informal) participation. And, more basically, homeowners usually outnumber other local constituencies and therefore represent a greater political force.

¹⁰² See KOMESAR, *supra* note 46, at 61.

plexity of the political process involved.”¹⁰³ The latter is a function of the complexity of the agency or legislative agenda. It will be far less costly, for example, to participate in a decision by a local planning commission than by the Environmental Protection Agency. Organization costs depend on the size and heterogeneity of the group involved, so local governments with smaller, homogenous groups of voters face lower costs.¹⁰⁴

On the other side of Komesar’s equation are the per capita stakes. Even where the absolute value of the government action is high, it may still be difficult to mobilize a majority of voters or taxpayers unless their per capita stakes are also high. So, for example, if the government condemns property requiring compensation of \$100,000 but that money is spread over a mid-size community of 50,000 people, the average cost of \$2 may be insufficient for voters to care very much or bother to examine whether the \$100,000 expenditure actually creates \$100,000 worth of gain or if it is instead a giveaway to a special interest. The same cost imposed on a smaller constituency, however, will create substantially higher per capita costs, and the incentive to participate and monitor such costs increases accordingly.

There is empirical support, too, for the claim that local governments are primarily responsive to homeowner majorities. A number of studies have demonstrated that local governments tend to provide the mix of services and property taxes favored by the median homeowner in the town.¹⁰⁵ Although the studies focus generally on second-order observations about the levels of public services offered by local governments, Fischel comfortably concludes from these studies that local governments are concerned with satisfying the interests of the median homeowner.¹⁰⁶ He is not alone in his conclusion about the character of local government decisionmaking.¹⁰⁷

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ FISCHEL, *supra* note 11, at 87–88; *see also* Bahl, *supra* note 78, at 77 (“The most important fiscal role in local government is to decide on the level and mix of taxes and expenditures that best match the needs and preferences of the local population. That local governments take this allocation function seriously is evidenced by the wide variety of choices they actually make.”).

¹⁰⁶ FISCHEL, *supra* note 11, at 87–89. The studies he cites largely measured the extent to which local governments provided specific levels of different public goods, hypothesizing that a local government responsive to median voters will provide the level of services that the median voter demands.

¹⁰⁷ *E.g.*, CHARLES M. HAAR, *SUBURBS UNDER SIEGE: RACE, SPACE, AND AUDACIOUS JUDGES* 179 (1996); Ellickson, *supra* note 13, at 405; *see also* Stephen David Galowitz, *Interstate Metro-Regional Responses to Exclusionary Zoning*, 27 *REAL PROP. PROB. & TR. J.* 49, 71 (1992) (“In decisions affecting land use, landlords and homeowners naturally unite

What about developers and special interest groups? They often seem successful at the local level. But the question is not whether special interest groups ever get their way. They do. The question instead is whether they are able to have their plans approved despite homeowner opposition, or whether they have to secure homeowner support. Although the political story is often complex, special interest groups are better viewed as petitioners for homeowner approval.¹⁰⁸ Through exactions and other compromises, developers and special interest groups must essentially negotiate for homeowner approval. Powerful special interests, like a big employer, can often shift the direction of concessions, requiring tax abatements and other give-aways to stay in town.¹⁰⁹ This does not change the nature of the political dynamic. Whether through bribes or extortion—exactions or threats to leave—special interest groups must still secure local homeowner approval or they will not find a responsive local government.

Homeowner control over local governments satisfies one of the central preconditions for the traditional economic account of the Takings Clause. Majority control alone is not enough, however. For compensation to work the way the traditional economic account of the Takings Clause suggests it does, the majority must also internalize both the costs and the benefits of a government action. As the next sections demonstrate, local government actions are funded by property taxes and capitalized into property values.

2. *Property Taxes Fund Local Governments*

Critics of takings law's traditional economic account have frequently questioned how governments, as opposed to private firms, internalize the costs of their actions. The answer at the local level is, simply, that homeowners must pay for those actions through their property taxes or through local bond issues. Local governments therefore internalize the costs of their actions when they pass those costs along to local homeowners.

This claim is intuitive but surprisingly more complex than it might appear because of the changing role of property taxes in local government finance. In 1902, almost 70% of local government revenue came

to further their common interests . . . influenc[ing] local governments to enact zoning policies that effectively deny many individuals their choice of residence.”); *cf.* Rose, *supra* note 54 (describing local majoritarianism).

¹⁰⁸ Fischel refers to developers, in particular, as applicants at the local level instead of as their own dominant political force. FISCHEL, *supra* note 11, at 16.

¹⁰⁹ See James Surowiecki, *It Pays to Stay*, NEW YORKER, Dec. 13, 2004, at 40, 40.

from local property taxes.¹¹⁰ Today, however, the figures are much different. As of 2001, the date of the most recent U.S. Census for which data are currently available, property taxes on average accounted for only 27% of all local governments' total budgets.¹¹¹ Increasingly, intergovernmental support—from the state and federal governments—and other kinds of taxes and fees provide a greater share of local revenues. Table 1 summarizes the data.

*Table 1: Summary of Local Government Finances*¹¹²

Description	Amount in Millions (\$)
Revenue	1,068,151
Intergovernmental revenue	375,977
From federal government	35,725
From state government	340,252
General revenue from own sources	579,451
Taxes	354,439
Property	253,259
Sales and gross receipts	62,199
Individual income	18,254
Corporate income	3609
Motor vehicle license	1306
Other taxes	15,813
Charges and miscellaneous general revenue	225,011
Current charges (e.g., hospital, sewage, highways)	146,435
Miscellaneous general revenue	78,576
Utility revenue	88,676
Liquor store revenue	762
Insurance trust revenue	23,285

Taken at face value, the relatively small percentage of local government revenue from property taxes suggests that homeowners will not, in fact, have to internalize most budget outlays. If homeowners

¹¹⁰ John J. Wallis, *A History of the Property Tax in America*, in PROPERTY TAXATION, *supra* note 77, at 123, 123.

¹¹¹ U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2004–2005, at 272 tbl.429 (124th ed. 2004) (listing total local government revenue in 2001 as \$1,068,151,000,000, of which only \$253,259,000,000 came from property taxes). For a similar summary of the evolution of property taxation, see Arnold H. Raphaelson, *The Property Tax*, in MANAGEMENT POLICIES, *supra* note 78, at 201, 201–06.

¹¹² U.S. CENSUS BUREAU, SUMMARY OF STATE AND LOCAL GOVERNMENT FINANCES BY LEVEL OF GOVERNMENT: 2000–01, at tbl.1, <http://www.census.gov/govs/estimate/01sl00us.html> (last visited Sep. 15, 2006).

only fund 27% of local government expenses, then every dollar a local government spends costs its homeowners only \$0.27.¹¹³ To put this in economic terms, homeowners would discount the cost of a government action by close to 73%.¹¹⁴ These figures call into serious doubt any general claim about a tight fit between government costs and property taxes.

Of course, the relevant question for takings law is not whether intergovernmental aid is available generally but is instead whether intergovernmental aid is available for specific takings of private property. If a local government chooses to regulate property in a way that requires compensation, how much of that compensation will have to come from local property taxes? The answer, it turns out, is much higher.

Intergovernmental aid is generally earmarked for specific purposes, either in the form of outright or matching grants.¹¹⁵ Unconditional grants—those that local governments can use for any purpose—are relatively rare. When it comes to compensating burdened property owners, then, the money would still have to come from local property taxes. In short, property taxes remain “the single most important local revenue source for local governments.”¹¹⁶ Whatever the other sources of money available for other budget items, most compensation for takings—with the possible exception of compensation for eminent domain¹¹⁷—will come directly from homeowners.

¹¹³ See Span, *supra* note 11, at 44 n.146 (“If, instead, compensation were to be paid from state or federal tax revenues . . . costs would be externalized on to others who had no voice in determining them, in this case the general taxpayer.”).

¹¹⁴ This number slightly downplays the importance of property taxes to local governments’ budgets. The supporting data do not differentiate between cities and smaller local governments. Cities, in contrast to towns and suburbs, are more likely to raise a greater proportion of their tax revenues through sales taxes and other alternatives to property taxes. See, e.g., U.S. CENSUS BUREAU, *supra* note 111, at 294 tbl.449 (listing sources of revenue for nation’s 35 largest cities, indicating that property taxes provide far smaller percentage of revenue for those cities than for local governments generally). Data lumping together cities and smaller local governments will therefore understate the role of property taxes in funding the takings of private property that are this Article’s focus.

¹¹⁵ See generally David F. Bradford & Wallace E. Oates, *The Economics of Political Decentralization: Towards a Predictive Theory of Intergovernmental Grants*, 61 AM. ECON. REV. 440 (1971) (comparing choices made in response to matching grants with those made in response to lump sum grants).

¹¹⁶ Alvin D. Sokolow, *The Changing Property Tax and State-Local Relations*, PUBLIUS, Winter 1998, at 165, 167.

¹¹⁷ Greenport, New York, for example, received significant state funding for a large new park on that town’s main street, including a merry-go-round and skating rink. The land acquisition for the park, accomplished in part through eminent domain, was funded primarily by the state, so that Greenport’s taxpayers ended up paying only a tiny fraction of the project’s total cost. Press Release, New York State Office of the Governor, Governor Announces \$1 Million to Improve Mitchell Park (Oct. 2, 2002), <http://www.ny.gov/gov->

The close connection between local government costs and local property taxes is therefore easier to support in the particular context of just compensation for takings than it is more generally.

3. *Property Values Respond to Local Government Actions*

In addition to questioning how governments internalize the costs of their actions, Daryl Levinson has recently posed a provocative question: How do governments internalize benefits?¹¹⁸ With homeowner control over local politics, there is no mystery. If homeowners are willing to pay for some government action—through their property taxes—then the benefits necessarily outweigh the gains.

The claim that homeowners constitute a meaningful political group is in tension, however, with the possibility of truly idiosyncratic homeowner interests. The more diverse and subjective homeowner interests are, the more the category “homeowner” loses its internal cohesion, the prerequisite for local political control. Instead of a single constituency that local officials seek to appease, different factions of homeowners would devolve into separate interest groups, and local government politics would again become largely indistinguishable from the interest group politics at the state and federal level.¹¹⁹

Nevertheless, within any local government, homeowners’ preferences for government land use regulation are likely to be more homogenous than one might initially expect, fundamentally because homeowners share the common goal of wanting to maximize local property values. Here again, however, the story may not be quite as neat as it seems. The problem, as Fischel himself has observed, is that property owners sometimes object to proposals that are likely to increase their property’s market value.¹²⁰

ernor/press/02/oct2_1_02.htm (describing state funding); Julie Lane, *More of Mitchell Park*, SUFFOLK TIMES ONLINE, May 2, 2002, <http://www.timesreview.com/st05-02-02/stories/news2.htm> (describing use of eminent domain to acquire land for park). Intergovernmental aid for condemnations does not undermine the descriptive claim about compensation for regulatory takings and is, in fact, entirely consistent with this Article’s ultimate proposals. See *infra* Part IV.B.

¹¹⁸ Levinson, *supra* note 6, at 350 (“If government does not fully internalize the costs of takings unless it must spend its revenues to pay compensation, then why should we expect government to fully internalize the benefits of takings when it does not receive them in the form of revenues?”).

¹¹⁹ For a discussion of interest group politics in higher levels of government, see the text accompanying notes 145–46 *infra*.

¹²⁰ New developments trend toward the upper end of existing property values and will usually have a positive impact on property values. Homeowners understand this and yet still object to many new developments. FISCHEL, *supra* note 11, at 9 (describing chairing zoning board meeting and encountering neighbor resistance to new development that was likely to raise property values).

Fischel's explanation is that homeowners seek to avoid the *variance* in property values that comes from any changes in land use.¹²¹ Since homeowners are not well situated to spread risk and are unable to insure against changes in property value arising out of government actions, they have a strong preference for the status quo, thereby minimizing the risk of changes in the value of their property.¹²² The problem with Fischel's explanation is that maintaining the status quo comes with its own risk to property values, especially where surrounding neighborhoods are changing. Both change and stasis present risk, so risk aversion alone cannot sufficiently account for homeowners' interests.

Instead of risk aversion, then, a more likely explanation is individual homeowners' interest in maximizing the *subjective use* value of their property, instead of just its *market* value.¹²³ Homes embody more than a substantial financial investment; they incorporate aspects of their owners' lives and identities.¹²⁴ An account that focuses exclusively on market values or risk aversion misses important interests like the commitment members of a community may have to preserving its character, independent of any effect on property values. In fairness, Fischel acknowledges these forces, but he also quickly dismisses them as ancillary to homeowners' central concern of minimizing variances in market value.¹²⁵ He may have dismissed them too quickly. An interest in preserving subjective value is a richer description of homeowners' motivation than simple market value.¹²⁶

This thicker version of homeowners' interests can account for more invidious goals, too. Some homeowners are motivated by an implicit or even explicit desire to exclude minorities or categories of "undesirable" neighbors. It can be hard to account for discrimination

¹²¹ FISCHEL, *supra* note 11, at 9.

¹²² Fischel makes the argument initially in the zoning context, arguing that any changes in land use have the potential to affect neighboring property values in unpredictable ways. *Id.* He goes on to argue that the same reasoning applies to all government services. Decreases in the quality of local schools can have as negative an impact on property values as would any locally undesirable land use. *Id.* at 11-12.

¹²³ Robert Ellickson made a similar suggestion, noting that one purpose of local growth controls is to preserve the character of a community. Ellickson, *supra* note 13, at 401.

¹²⁴ See Radin, *supra* note 3, at 965 (identifying property constitutive of its owner's personhood).

¹²⁵ FISCHEL, *supra* note 11, at 12 ("Maybe noneconomic attachments to neighborhoods and community are formed that quickly, but I suspect that the size of the down payment and the newly acquired mortgage make new homeowners especially watchful of local activity.")

¹²⁶ Komesar is more willing to acknowledge these additional interests, although he does so only briefly. As he notes, "[H]ome is where the heart is. Basic senses of security, indeed the most basic senses of self-definition are associated with one's home." KOMESAR, *supra* note 46, at 68.

by its effect on property's market value.¹²⁷ Even if the impact on property values of excluding particular groups were clear—and it is not¹²⁸—there is something darker and more visceral about many homeowners' interests than is captured by even a subtle account of rational economic actors expressing their risk aversion through wealth-maximizing choices. A positive description of homeowners' interests that emphasizes the value of their property *to them* does not suffer from the same problem.

But if homeowners are collectively concerned with the subjective value of their property, does this provide enough internal consistency in homeowner preferences to create a unified political force, or does it again devolve into interest group politics? Two separate forces interact to create a significant unity of interests among local homeowners within a particular local government.

First, because people's homes represent a significant portion of their net worth, the use value of a home includes both its value as a place to live and its value as a financial investment. Therefore, even this richer account of homeowner preferences contains a large measure of concern for property's objective market value. Indeed, in most instances, market value alone may be a close proxy for subjective use value, with the added advantage of comprising a single and easy-to-read barometer.¹²⁹ Where use value and market value diverge, however, homeowner interests are still likely to align thanks to the Tiebout Hypothesis, the second force unifying local homeowner interests.

¹²⁷ Fischel gestures to the concerns in an interesting but ultimately *sui generis* anecdote about the Alabama Rotary Club preventing a lynching of local black men in the 1930s in order to protect property values. FISCHEL, *supra* note 11, at 16–17. Sometimes, of course, the effect on property values is clear, as with the exclusion of poor families with school-age children who increase the costs of education without adding substantially to the tax rolls. See Ellickson, *supra* note 13, at 452 (“The normal profit-maximizing strategy of a suburb dominated by a homeowner majority is to discourage construction of modest-priced housing suitable for occupancy by families with school-age children.”); Jerry Frug, *The Geography of Community*, 48 STAN. L. REV. 1047, 1083–84 (1996) (identifying property values as one reason property owners seek to exclude “the wrong kind of people”).

¹²⁸ On the one hand, discriminatory restrictions exclude classes of potential purchasers, which would tend to reduce market value. On the other hand, property might be more valuable to members of the included groups precisely because of the exclusionary measures and the homogeneity of the community. See Lior Jacob Strahilevitz, *Exclusionary Amenities in Residential Communities*, 92 VA. L. REV. 437, 451–52 (2006) (noting that market might not discipline people for excluding minorities because of premium some people will pay for such exclusion).

¹²⁹ As with a barometer, the direction that property values are moving may be more important than the absolute values themselves. If property values are increasing compared with other towns, it means that local officials are doing a good job of getting the right mix of services and property taxes.

Tiebout's pathbreaking work, as refined by many others but perhaps most prominently by Wallace Oates, Bruce Hamilton, and William Fischel, suggests that local governments should be seen as competing with each other for residents.¹³⁰ One result of this competition is that homeowners will sort themselves into local governments that share their particular taxing and spending priorities.¹³¹ To take the simplest example, towns provide different quality schools pegged to different levels of taxation.¹³² Homeowners wanting to take advantage of one town's better schools must also pay the higher taxes. Those who value education less will choose a town that spends less on its schools.¹³³ The form of the competition, therefore, is in the particular mix of public services and property taxes provided.

¹³⁰ Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956); Wallace E. Oates, *The Effects of Property Taxes and Local Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. POL. ECON. 957, 959 (1969) (applying Tiebout model and concluding that "[i]t is the present value of the future stream of benefits from the public services relative to the present value of future tax payments that is in this case important"); Wallace E. Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: A Reply and Yet Further Results*, 81 J. POL. ECON. 1004, 1005-06 (1973) (refining statistical analysis); Bruce W. Hamilton, *Zoning and Property Taxation in a System of Local Governments*, 12 URB. STUD. 205, 205 (1975) (developing "a model of the behaviour of economic agents in a system of local governments . . . very much in the spirit of the well-known Tiebout Hypothesis"); FISCHEL, *supra* note 11, at 59-60 (defending Tiebout's assumption of mobility).

¹³¹ As one leading local government theorist describes the Tiebout Hypothesis: [S]ince persons differ in their preferences for governmental revenue and expenditure patterns, any potential resident will gravitate to a locality that offers the package providing him with the greatest net benefits. Some persons may prefer that local revenues be devoted to open space for parks and recreation. Others might favor additional police and fire protection, and proximity to the workplace. A third group might prefer expenditures for education or for government-supported care for children and the elderly. As long as the variety of local governments is sufficient to accommodate these diverse interests, nurturing local preferences will generate a more efficient arrangement of local public goods as persons are able to reside where they can obtain the service packages they desire and can avoid paying for services they disfavor.

Clayton P. Gillette, *Fiscal Federalism and the Use of Municipal Bond Proceeds*, 58 N.Y.U. L. REV. 1030, 1073-74 (1983); see also William Fischel, *Municipal Corporations, Homeowners and the Benefit View of the Property Tax*, in PROPERTY TAXATION, *supra* note 77, at 33, 34 ("[Tiebout] supposed that municipal managers offer a menu of public services and potential residents select the prix fixe menu that best fits their demands.").

¹³² Bahl, *supra* note 78, at 77 ("For example, the share of current expenditures devoted to education is 24 percent in Nashville but 37 percent in Reading; the share of local expenditures for police is 2 percent in Reading and 6 percent in Las Vegas. Average effective property tax rates also vary widely.").

¹³³ This choice does not require implausible assumptions about perfect information. Indeed, housing consumers can rely on heuristics to choose a town with a desirable mix of services and property taxes. See generally Kenneth N. Bickers & Robert M. Stein, *The Microfoundations of the Tiebout Model*, 34 URB. AFF. REV. 76 (1998) (providing empirical support for Tiebout model by relying on consumer heuristics).

Notice that this vision of interjurisdictional competition results in rough sorting among property owners; people with similar preferences will tend to gravitate together.¹³⁴ By choosing carefully, homeowners can pay only for those public services that they really want, and can forgo paying for those they do not. Given an infinite supply of jurisdictions and total elasticity in the housing market, the Tiebout Hypothesis predicts perfect sorting by homeowners and, thus, a perfectly efficient system. Obviously, the sorting is not perfect in the real world. We are not all surrounded by neighbors whose views and preferences are identical to our own (fortunately!).¹³⁵ Nevertheless, it is effective enough to generate relatively consistent core interests within a given community, and that, in turn, is enough for property's subjective use value to provide meaningful content for a community's preferences, especially around land use issues.¹³⁶

While this model may sound quite theoretical, it provides a straightforward set of goals for local officials. Homeowner control over local governments means that local governments will seek to maximize the use value of people's property.¹³⁷ This usually means maximizing market values, but where it does not, community preferences will still tend to align. The fundamental point is that property owners capture the benefit of government actions that increase property values, as broadly understood, and suffer the harm from government actions that do not.¹³⁸

¹³⁴ See Vicki Been, "Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 COLUM. L. REV. 473, 525 n.249 (1991) (explaining how willingness to pay for public services leads to more homogeneous communities, and citing sources providing further support for hypothesis).

¹³⁵ See Frug, *supra* note 127, at 1048–49 (identifying tendency towards homogeneity implicit in Tiebout-style sorting, and criticizing it as contrary to broader sense of "community").

¹³⁶ Needless to say, this claim comes with a number of important caveats, some of which are explored in greater detail. Agreement about core issues and interests does not create immediate consensus. Some issues also generate competing homeowner factions that start to look more like fragmented special interest groups than a unified political force. Nevertheless, these divisive issues are more rare at the local level than at higher levels of government, and the breadth of competing interests is narrower, so that the fundamental claim about local governments' majoritarianism remains, if not perfect, more true than not.

¹³⁷ See PAUL E. PETERSON, CITY LIMITS 24 (1981) ("[U]nless it can alter [its] land area, through annexation or consolidation, it is the long-range value of [its] land which the city must secure—and which gives a good approximation of how well it is achieving its interests.").

¹³⁸ According to one article, "There is . . . the uniquely local or community character of the [property] tax, one that is associated with popular control of government." Sokolow, *supra* note 116, at 167; see also John R. Bartle et al., *Beyond the Property Tax: Local Government Revenue Diversification*, 15 J. PUB. BUDGETING, ACCT. & FIN. MGMT. 622, 623 (2003) (noting that property taxes have beneficial characteristic of "taxing landowners . . . who benefit from certain locally provided services").

For local government and public finance mavens, the account so far is relatively standard fare, but it adds an important and previously unrecognized dimension to the takings debate. Just as a local investment in roads and schools is capitalized into property values, so are zoning and other land use regulations.¹³⁹ Looking either at market value or use value, a desirable zoning ordinance will increase property values, while an undesirable one will decrease them. Similarly, denying a building permit for a noxious use will increase neighboring property values, while denying a building permit for a positive use may decrease them.

There is, of course, no way to know in the abstract whether land use regulations or growth controls will increase property values. It depends on a variety of factors. Where demand in the relevant housing market is strong and relatively inelastic, restricting residential development is more likely to increase the market value of existing homes by curtailing supply.¹⁴⁰ But where there is greater elasticity, restricting growth may create stagnation or even precipitate an exodus. Other factors include the economic conditions in the area, the nature of the uses being encouraged or restricted, and the particular preferences of existing and potential residents.¹⁴¹ Land use regulations require precisely the same judgment that local politicians must make in all aspects of local governance, deciding whether or not some action will make the town a more or less desirable place to live, with the attendant impact on local property values.

If the government can act for free—that is, if the government does not have to pay compensation—then the calculation local officials must undertake is one-sided, although by no means simple. They must decide only whether the regulation will be better or worse for the town. Add compensation to the mix, however, and the calculation

¹³⁹ Fischel notes that zoning and land use controls are a way for local governments to control the housing supply in a community to protect the community's desirable characteristics and thereby existing home values. FISCHEL, *supra* note 11, at 51–52. Capitalization studies have shown that zoning classifications affect property value. *Id.* at 56.

¹⁴⁰ Lawrence Katz & Kenneth T. Rosen, *The Interjurisdictional Effects of Growth Controls on Housing Prices*, 30 J.L. & ECON. 149, 158 (1987) (demonstrating that house prices are 17% to 38% higher in communities in San Francisco Bay Area with growth controls than in those communities without growth controls); Timothy J. Choppin, Note, *Breaking the Exclusionary Land Use Regulation Barrier: Policies to Promote Affordable Housing in the Suburbs*, 82 GEO. L.J. 2039, 2055 (1994) (observing that restrictive development policies may raise value of existing homes).

¹⁴¹ Cf. Christopher S. Brown, *Blinded by the Blight: A Search for a Workable Definition of "Blight" in Ohio*, 73 U. CIN. L. REV. 207, 214 (2004) ("Conditions causing economic blight include factors such as: (1) areas with stagnant property values, abnormally high vacancies or abandoned lots; (2) areas lacking necessary commercial facilities . . . ; (3) areas with residential overcrowding; (4) areas with an excess of liquor stores, bars, or 'adult businesses'; and (5) areas having safety or welfare problems . . .").

becomes even more complex, since the money must ultimately be raised from the taxpayers.

B. Local Governments and Larger Governments Compared

Return, for a moment, to the controversy surrounding an economic account of takings law. The Takings Clause's compensation requirement has traditionally been seen as a mechanism forcing governments to internalize the costs of their actions, but critics have responded by questioning how governments actually internalize those costs.¹⁴² The result of the controversy has been to call into doubt the most fundamental assumptions about forcing governments to pay, including even whether compensation will make it more or less likely for the government to take property.¹⁴³

As we have now seen, however, a relatively straightforward story emerges at the local level. Local government land use decisions are controlled primarily by homeowners who internalize costs and benefits through property taxes and property values. This relationship between property taxes and property values relies on some particularly strong assumptions—problematized in Part III below—but it is important to pause at this preliminary conclusion and focus on how much the discussion so far contributes to the current takings debate.

Here, then, in a nutshell, is how the Takings Clause works in this (still somewhat stylized) model of local governments: Given any government proposal that requires compensating burdened property owners, the local government will have to decide—under the control of local homeowners—whether the proposal will cost more in property taxes than it will generate in gain through increased property values. This is precisely the kind of efficiency-maximizing decision that the traditional economic account of the Takings Clause assumes governments will undertake.¹⁴⁴

Higher levels of government do not even theoretically face the same kind of calculation. Recall that a necessary precondition for takings liability to create efficient regulatory incentives is a government politically responsive to the same people who pay for the compensation. At the local level, homeowners are both the dominant political force and, through property taxes, also provide the bulk of local government funding for takings compensation. The same is not true at

¹⁴² See *supra* Part I.B.

¹⁴³ See *supra* text accompanying notes 56–58.

¹⁴⁴ There is evidence, too, that this is precisely the kind of cost-benefit calculus that local governments in fact make. See Ellickson, *supra* note 13, at 451 & n.187 (“Municipal politicians . . . undertake revenue-expenditure analyses of various types of land uses to see which are apt to pay their own way and which are likely to become fiscal parasites.”).

the state and federal levels, where revenue comes from income and other forms of non-property-based taxation and there is no single issue around which voter preferences will consistently coalesce.

Well-funded, well-organized special interest groups also have a greater relative advantage in larger governments, where participation in the political process requires more sophistication and expertise. For example, while neighbors can, and often do, participate in local zoning decisions, it is another matter entirely to arrive at the state legislature's steps and participate in a meaningful way in its decision-making.¹⁴⁵ Similarly, larger governments' actions have less of an impact on property values because there is much less elasticity in interstate housing markets than between towns or suburbs clustered around a larger municipality. With exit less of an option, the decreased elasticity means less competition between larger units of government.¹⁴⁶ Larger governments are therefore far less responsive than local governments to residents' implicit peripatetic voting.¹⁴⁷

Organizing majority groups in larger governments will also be much more difficult than in smaller governments. The collective action problems facing large groups are often used to explain the disproportionate power that special interest groups wield within a political system.¹⁴⁸ There is, however, a useful but often overlooked *intergovernmental* comparison to be made too. A majority of voters in a smaller jurisdiction has a relative organizational advantage over a majority of voters in larger jurisdictions. It is, in short, easier for a smaller majority to organize than for a larger majority. These inter- and intragovernmental comparisons reinforce each other to increase the power of special interest groups as governments grow. Thus, in larger governments, the natural advantage special interest groups

¹⁴⁵ See KOMESAR, *supra* note 46, at 61 (describing high costs of political participation resulting from issue complexity, difficulty of organization, and intricacy of decisionmaker's agendas).

¹⁴⁶ Inman & Rubinfeld, *supra* note 23, at 84 ("A few large governments (counties) are not sufficiently competitive to ensure efficiency."). Some might object that decreased ability to exit will lead to an increase in political participation. See generally Been, *supra* note 134 (discussing exit and voice). There is no suggestion, however, that any tendency to increased political participation will offset the decrease in power through the loss of exit as a viable option. Indeed, common sense suggests otherwise.

¹⁴⁷ Although the phrase "vote with their feet" does not actually come from Tiebout himself, it is ubiquitously associated with him in the literature. Todd E. Pettys, *The Mobility Paradox*, 92 GEO. L.J. 481, 482 n.10 (2004).

¹⁴⁸ Farber & Frickey, *The Jurisprudence of Public Choice*, *supra* note 50, at 900 (proposing "less ambitious" version of public choice in which special interest group power is disproportionate but not exclusive).

enjoy is heightened by the increased costs associated with mobilizing the larger majority.¹⁴⁹

The complexity of most state and federal regulation and legislation also makes it difficult for the majority of voters to monitor a regulation's effects. Not only do monitoring costs for majority coalitions increase as the size of the government increases, they also increase as government regulations become more technical.¹⁵⁰ Whereas the content of local government land use restrictions are readily apparent to most local voters—they are, in fact, largely reflected in property values—the same is seldom true of state and federal laws. This phenomenon helps to explain why special interest group pressure is at its greatest when the legislation at issue is narrow or technical, and also means it is at its greatest in larger units of government.¹⁵¹

This same dynamic is exacerbated by the fact that regulatory agencies are actually responsible for most state and federal takings.¹⁵² Unlike local governments, which do not delegate implementation of local regulations to specialized agencies, larger governments rely on agencies to carry out their policies. Indeed, agencies are frequent defendants in nonlocal takings cases.¹⁵³ Literature in the field of

¹⁴⁹ There is some empirical support for this point. *See id.* Some exceptions come to mind. It is at least arguably true that New York State's political process is more dominated by special interest groups than the federal government's. *Cf.* Michael Cooper, *Report Cites State's Laxity on Donations in Campaigns*, N.Y. TIMES, Mar. 7, 2006, at B6 (reporting that under New York campaign finance laws, which permit candidates to accept "soft money" and corporate contributions, statewide candidates receive donations from less than one percent of New York residents). Moreover, there may be a size cutoff above which the marginal cost of organizing the majority does not substantially change, at which point other factors, like the quality of the decisionmakers, become increasingly important. In other words, this comparison may work better between small, local governments on the one hand, and state and federal governments on the other, than between states and the federal government.

¹⁵⁰ For this reason, special interest group pressure in larger levels of government usually comes through a largely professional and bureaucratized lobbying industry. *E.g.*, Ernest F. Hollings, Editorial, *Stop the Money Chase: A Constitutional Amendment Could Let Senators Be Senators*, WASH. POST, Feb. 19, 2006, at B7 (describing power of K Street lobbyists in Washington, D.C.).

¹⁵¹ Hovenkamp, *supra* note 72, at 88 ("The influence of special interests is strongest when the statutory provision at issue is narrow or merely technical, the legislator feels that her constituency will not care one way or the other, and the provision does not ultimately conflict with the legislator's own ideology.").

¹⁵² As one important article notes, "[T]he cost-internalization argument . . . is undermined by the fact that regulatory agencies often do not directly bear the cost of takings judgments." Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 89 (2003).

¹⁵³ *E.g.*, *Sharp Land Co. v. EPA*, 956 F. Supp. 691 (M.D. La. 1996); *Dullea Land Co. v. Minn. Pollution Control Agency*, No. A05-127, 2005 WL 1950248 (Minn. Ct. App. Aug. 16, 2005).

administrative law has examined the relationship between agencies and legislatures, agencies and the special interests they regulate, and agencies and the democratic process.¹⁵⁴ The complexity of these relationships means that agencies create yet another layer of insulation between the decisionmakers responsible for takings and the political pressures exerted by burdened property owners and taxpayers.¹⁵⁵ Even without rehearsing this literature here, it is clear enough that the ubiquity of agencies provides another reason that the traditional economic account is wanting at the state and federal level.¹⁵⁶

In short, special interest groups' comparative advantage in larger governments is greater than in smaller governments. It is more difficult for majorities to organize effectively in larger governments, and the critical option of exit is less available.¹⁵⁷ The conditions are ripe, then, for well-organized and smaller interest groups to exercise more influence than in smaller governments. This is confirmed by the frequent observation about land use regulations that while homeowners dominate local politics, developers dominate state politics.¹⁵⁸ This is not to suggest that larger governments are entirely indifferent to compensation, but that the mechanisms by which compensation translates into political costs are much less apparent and, at the very least, far less direct than at the local level.¹⁵⁹

Having identified how local governments, as distinct from larger governments, internalize costs and benefits, it is now possible to take the next step and identify much more precisely when those mecha-

¹⁵⁴ E.g., Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 133–34, 134 n.7 (1996) (citing Sam Peltzman, *Towards a More General Theory of Regulation*, 19 J. LAW & ECON. 211 (1976); Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22 (1971); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971)).

¹⁵⁵ As Komesar argues, “[T]here is more reason to fear minoritarian bias at the less observed, more complex administrative level than at the more exposed (publicized) legislative level” KOMESAR, *supra* note 46, at 72.

¹⁵⁶ See FISCHEL, *supra* note 12, at 329–31 (arguing that agencies suffer from democratic deficit).

¹⁵⁷ Rose, *supra* note 54, at 1133–35.

¹⁵⁸ See Dana, *supra* note 39, at 1274 & n.137 (citing sources arguing that developers are more successful in state politics).

¹⁵⁹ Empirical evidence exists showing some responsiveness by larger governments to fiscal costs. See Joseph J. Cordes & Burton A. Weisbrod, *Government Behavior in Response to Compensation Requirements*, 11 J. PUB. ECON. 47, 47 (1979) (concluding that compensation requirements can affect output decisions of public agencies); William A. Fischel, *The Political Economy of Just Compensation: Lessons from the Military Draft for the Takings Issue*, 20 HARV. J.L. & PUB. POL’Y 23 (1996) (concluding that replacement of military draft with all-voluntary military is example of efficient compensation for taking of property). This should come as no surprise. It does not, however, demonstrate that larger governments internalize monetary costs with any of the precision implicit in the traditional economic account of the Takings Clause.

nisms will work well and when they will not. This, in turn, provides an important opportunity to move beyond the all-or-nothing terms of the current takings debate. Already, however, this much is clear: The relationship between homeowners, property values, and property taxes at the local level means that requiring local governments to pay just compensation will force them to internalize at least some of the costs of their actions. How much, and precisely how, is the subject taken up next.

III

LIMITS ON LOCAL GOVERNMENT EFFICIENCY

When the model of local governments sketched in Part II applies, forcing local governments to pay for land use regulations will, in fact, force them to internalize both the costs and benefits of their actions. The close relationship between property taxes and property values—whether use value or market value—places both the burdens and benefits of government actions on local homeowners. The public choice critique of the Takings Clause therefore loses much of its bite in small local governments.

In the real world, however, local governments face systemic pressures on both the cost and benefit side of this equation, distorting regulatory incentives. These peculiarly local pressures need to be incorporated into the takings calculus if the compensation requirement is to promote efficient regulatory incentives. This Part identifies limits on the extent to which local governments internalize the costs and benefits of their actions, thus setting the stage for Part IV to provide specific recommendations for dealing with them.

First, local governments' risk aversion will distort efficient decisionmaking. Because local governments discount the benefits and put a premium on the costs of their actions, they will tend to underregulate as compared to risk-neutral governments. An efficient compensation regime should account for this difference. Second, the kinds of local government actions that give rise to takings claims can also generate significant and uniquely local positive and negative externalities. Having identified property taxes and property values as the mechanisms by which local governments, through homeowners, internalize costs and benefits, it is now possible to identify more precisely the nature and magnitude of those externalities. Significant positive externalities will lead local governments to underregulate, and negative externalities will have the opposite effect.

Even for local governments, then, where the traditional economic account of the Takings Clause applies, compensation rules need to be

modified in order to promote efficient regulatory incentives. It is simply not the case that requiring more compensation in more cases will lead necessarily to greater efficiency, as advocates of heightened private property rights often claim.¹⁶⁰

A. *Local Governments' Risk Aversion*

Local governments are far more risk averse than larger governments, and this results in their discounting the benefits and placing a premium on the costs of their actions.¹⁶¹ An otherwise efficient takings regime indifferent to government risk aversion will overdeter local governments. The intuition here is straightforward. The effect on a small town of having to pay \$500,000 is quite different than the effect on a risk-neutral large government of having to pay the same amount.¹⁶²

1. *Why Governments Are Risk Averse*

But why would local governments be risk averse? It is easy to anticipate the objection that the diversity of governments' economic interests makes them essentially neutral to risk and not risk averse at all.¹⁶³ Indeed, many economic accounts of government decision-making assume risk neutrality.¹⁶⁴ More realistic treatments, however, acknowledge that governments sometimes exhibit risk-averse behavior. The sources of government risk aversion are far more likely to be present in local governments.

According to Lawrence Blume and Daniel Rubinfeld, governments can be risk averse for two reasons: (1) The government has limited funds available and diversification is not possible—govern-

¹⁶⁰ See *supra* note 6.

¹⁶¹ In a heavily theoretical piece, Kenneth Arrow and Robert Lind explored and sought to quantify governments' risk aversion. See generally Kenneth J. Arrow & Robert C. Lind, *Uncertainty and the Evaluation of Public Investment Decisions*, 60 AM. ECON. REV. 364 (1970).

¹⁶² While governments themselves, as abstract legal entities, may not be risk averse, this Article uses the term "government risk aversion" as shorthand for the risk aversion of government decisionmakers. Blume and Rubinfeld make the same decision in their brief discussion of government risk aversion. See Blume & Rubinfeld, *supra* note 92, at 616.

¹⁶³ Cf. *id.* ("Assume for the moment that the possibility of some diversification allows the government to act in a less risk-averse manner than its constituents.")

¹⁶⁴ See R. PRESTON MCAFEE & JOHN McMILLAN, INCENTIVES IN GOVERNMENT CONTRACTING 14 (1988) (assuming risk neutrality in government behavior while acknowledging that governments sometimes exhibit risk-averse behavior); Michael Abramowicz, *Perfecting Patent Prizes*, 56 VAND. L. REV. 115, 151 (2003) (describing government as risk neutral); Loren Brandt et al., *Banks and Enterprise Privatization in China*, 21 J.L. ECON. & ORG. 524, 528 (2005) (including risk-neutral government leader in heuristic model); Lewis A. Kornhauser, *On Justifying Cost-Benefit Analysis*, 29 J. LEGAL STUD. 1037, 1042 n.13 (2000) (assuming government risk neutrality because of size of government).

ments are in the businesses they are in, and can neither expand nor contract that range; and (2) governments represent the will of their constituents, who themselves are likely to be risk averse.¹⁶⁵ One more reason should be added to their list: the risk aversion of individual government decisionmakers who face real political consequences if projects go wrong.¹⁶⁶ The robustness of all three of these explanations for government risk aversion varies with the level of government.

First, local governments' budgets are smaller than those of larger governments, and they have even less opportunity to diversify their interests.¹⁶⁷ Second, while the riskiness of a government action is often difficult for voters to assess beforehand, monitoring costs will be lower at the local level than at higher levels of government, making it easier for voters' risk aversion to impact government decisionmakers.¹⁶⁸

The last point requires slightly more discussion. Some scholarship suggests that local politicians can maximize their political capital by exposing the local government to considerable financial risk.¹⁶⁹ The idea is that an ambitious local politician may stand the best chance of career advancement by running up large municipal debts that will not have to be repaid during her tenure in office.¹⁷⁰ Here again, though, this disconnect between political objectives and budgetary concerns is much more likely with larger governments, including

¹⁶⁵ Blume & Rubinfeld, *supra* note 92, at 616.

¹⁶⁶ See MCAFEE & McMILLAN, *supra* note 164, at 14 (examining sources of risk aversion in government decisionmakers).

¹⁶⁷ This point is analogous to a wealth effect. At its most fundamental, the wealth effect is the familiar phenomenon in which the marginal value of a dollar is not the same for everyone but varies depending on wealth. Bailey Kuklin, "You Should Have Known Better," 48 U. KAN. L. REV. 545, 561 n.53 (2000) (defining wealth effects). It is as if the marginal value of each dollar is greater to local governments than to larger governments, and local governments will therefore find the prospect of any given payment to be *more* expensive than will larger governments.

¹⁶⁸ The discussion of monitoring costs can be found in the text accompanying notes 150–51 *supra*.

¹⁶⁹ See Gillette, *supra* note 40, at 372 (noting potential disconnect between local politicians' incentives and interests of constituents they serve); Clayton P. Gillette, Kelo *and the Local Political Process*, 34 HOFSTRA L. REV. 13, 15 (2005) ("[T]he assumption that the compensation requirement is an effective check on abuse of the eminent domain power is itself fraught with difficulties. . . . [A]s long as the benefits to [officials] of a particular condemnation proposal outweigh their personal costs, not the public costs, they have little personal incentive not to proceed.").

¹⁷⁰ See Lisa M. Fairchild & Nan S. Ellis, *Municipal Bond Disclosure: Remaining Inadequacies of Mandatory Disclosure Under Rule 15c2-12*, 23 J. CORP. L. 439, 462 (1998) ("The politician may focus on a short-term goal, such as re-election, and spend money on highly visible, but suboptimal, projects in order to achieve this short-term goal."). According to Gillette, this concern offers one justification for state constitutional provisions that limit the amount of debt a local government is allowed to incur. Gillette, *supra* note 40, at 372.

cities, than it is with the kinds of small, local governments to which this discussion is confined. Politicians in local governments, as this Article uses the term, are less likely to be politically ambitious—indeed, many are volunteers with no aspirations toward higher office.¹⁷¹ Moreover, lower monitoring costs of local decisionmaking minimizes the threat that officials will engage in financial risk-taking activities to maximize their personal political advantage.¹⁷²

An interesting corollary of governments' responsiveness to the risk aversion of their constituents is that the greater the number of constituents, the less risk averse the government will be.¹⁷³ It is as if governments diversify their exposure to risk through the sheer number of their constituents. The greater the number of taxpayers, the smaller the per-taxpayer stake in any government action. The possibility of a \$500,000 takings judgment spread over 500 people presents a far greater risk to each taxpayer than the same judgment spread over 50,000 people. Government risk aversion therefore correlates more to the size than to the wealth of the tax base, and it is inversely related to the number of taxpayers over whom the risk is spread.¹⁷⁴

In addition to this theoretical story, evidence from real-world planning decisions also supports the claim that local governments are risk averse.¹⁷⁵ In a report for the California Research Bureau, for

¹⁷¹ PETERSON, *supra* note 137, at 125.

¹⁷² This is another form of the insight that legislators trade in the commodity of political capital whereas taxpayers are concerned about money. Levinson, *supra* note 6, at 347.

¹⁷³ MCAFEE & McMILLAN, *supra* note 164, at 15–16 (acknowledging that “small municipalities” may be risk averse when project “represents a large fraction of the municipality’s budget”); Arrow & Lind, *supra* note 161, at 366 (arguing that governments are risk neutral “because the government distributes the risk associated with any investment among a large number of people” and that governments with smaller numbers of constituents are less able to spread risk).

¹⁷⁴ See Arrow & Lind, *supra* note 161, at 370–71 (explaining how risk associated with government investment is borne by each taxpayer). There is a countervailing consideration. Larger governments have professional planners who may suffer from their own form of risk aversion. As one commentator has noted, “The prospects for career advancement of [a local planner] would not be enhanced by decisions that cost the employer millions of dollars.” Corwin W. Johnson, *Compensation for Invalid Land-Use Regulations*, 15 GA. L. REV. 559, 594 (1981).

¹⁷⁵ The academic literature has also weighed in on the effects of takings liability on local planning decisions. See Michael M. Berger, *Happy Birthday, Constitution: The Supreme Court Establishes New Ground Rules for Land-Use Planning*, 20 URB. LAW. 735, 740–42 (1988) (discussing cases in which parties argued that expanded takings liability would chill local planning decisions); Dana Clark & David Downes, *What Price Biodiversity? Economic Incentives and Biodiversity Conservation in the United States*, 11 J. ENVTL. L. & LITIG. 9, 77 (1996) (“Cases such as *Lucas* and *Dolan* threaten to chill efforts by local legislators to enact land use regulations due to fear of facing costly takings lawsuits.”); Sandra Zellmer, *A Preservation Paradox: Political Prestidigitiation and an Enduring Resource of Wildness*, 34 ENVTL. L. 1015, 1022 (2004) (“[P]anning commissions hesitate to

example, Daniel Pollak reported that “local governments are responsive to the threat of litigation,”¹⁷⁶ and concluded that “the best way to reduce the distorting influence of takings litigation is to avoid disputes over takings altogether.”¹⁷⁷

Interestingly, this observation runs counter to some claims about local officials’ incentives surrounding, in particular, economic redevelopment plans.¹⁷⁸ Commentators have observed a tendency by local officials to overestimate the benefits of many community redevelopment projects and underestimate the risks. The infamous case of *Poletown Neighborhood Council v. City of Detroit*¹⁷⁹ is just one example of local planners adopting economic predictions that, in retrospect, turned out to be wildly exaggerated.¹⁸⁰ Risk aversion and excessive optimism are not inconsistent, however, because they focus on different points in the decisionmaking process. Risk aversion will factor heavily into a local government’s decision whether to undertake a particular plan. But once that plan has been set in motion, local

exert stringent controls on development for fear of takings claims.”). Dissents in *Lucas* voiced this precise fear. *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1070 (1992) (Stevens, J., dissenting) (“The Court’s categorical approach rule will, I fear, greatly hamper the efforts of local officials and planners who must deal with increasingly complex problems in land use and environmental regulation.”).

¹⁷⁶ DANIEL POLLAK, CAL. RESEARCH BUREAU, HAVE THE U.S. SUPREME COURT’S 5TH AMENDMENT TAKINGS DECISIONS CHANGED LAND USE PLANNING IN CALIFORNIA?: EXECUTIVE SUMMARY 8 (2000); see also Barton & Frug, *supra* note 20, at 282–83 (identifying local government officials’ risk aversion in attempts at regional cooperation).

¹⁷⁷ DANIEL POLLAK, CAL. RESEARCH BUREAU, HAVE THE U.S. SUPREME COURT’S 5TH AMENDMENT TAKINGS DECISIONS CHANGED LAND USE PLANNING IN CALIFORNIA? 12 (2000); see also *Private Property Rights Implementation Act of 1999: Hearing on H.R. 2372 Before the Subcomm. on the Constitution of the H. Comm. on the Judiciary*, 106th Cong. 14 (1999) (statement of Joseph Barbieri, Deputy Att’y Gen. of California) (“[L]ocal governments faced with . . . expensive Federal litigation will make decisions [that protect] their finances, rather than the . . . best . . . land use [decisions]. . . . [I]t’s not unusual . . . for local governments to be [very distant] from Federal courthouses where they would have to employ expensive outside counsel . . . to defend themselves against . . . takings claims.”); *id.* at 26 (prepared statement of Diane Shea, Associate Legislative Director, National Association of Counties and National League of Cities) (offering examples).

¹⁷⁸ E.g., Ilya Somin, *Overcoming Poletown: County of Wayne v. Hathcock*, *Economic Development Takings, and the Future of Public Use*, 2004 MICH. ST. L. REV. 1005, 1011 (“[F]ailure to require new owners of condemned property to actually provide the economic benefits that justified condemnation in the first place . . . creates an incentive for . . . public officials . . . to rely on exaggerated claims of economic benefit that they have no obligation to live up to.”).

¹⁷⁹ 304 N.W.2d 455 (Mich. 1981). The Michigan Supreme Court affirmed the City of Detroit’s power to condemn a vast swath of residential and commercial property for retransfer to General Motors. *Id.* at 457.

¹⁸⁰ Detroit had predicted the project would create 6000 jobs. In fact, it produced only 2500. Somin, *supra* note 178, at 1012–13. These figures, however, are the subject of some dispute. Fischel, for one, has argued that *Poletown* was less of a bad deal for Detroit than many people believe. Fischel, *Political Economy*, *supra* note 80, at 946.

officials have a strong incentive to sell it to the public—and perhaps even to themselves now that the path is set—and therefore tend to be overly optimistic in their predictions. The result is risk-averse behavior when first assessing the anticipated value of a regulation or project. Even if excessive optimism takes over later, risk aversion will still powerfully affect local government decisionmaking.

2. *Locating the Risk in Regulating*

Takings liability presents risks on both sides of local governments' cost-benefit calculation. On the gain side, the risk is clear. It is very difficult for a local government to predict exactly, or even approximately, how much of a gain some regulation or public project will produce. Recall that gains are internalized primarily through increases in property values. In order to evaluate the benefits of a proposed action, the government will have to evaluate its likely impact on local property values. This is no easy task, and it often requires high-stakes gambles. For example, will progressive land use controls actually make the town a more desirable place to live, and thus increase property values, or will they simply drive out businesses and create a death spiral of reduced employment? The answer, as discussed above, may turn on complex factors such as elasticity in the local housing market and the strength of people's preferences about local land uses.¹⁸¹ Local governments make these choices all the time—often with uncanny accuracy—but there is no doubt that such decisions involve a significant amount of risk.¹⁸² If a local government guesses wrong, and the benefits of a new regulation do not materialize, property owners may find themselves paying compensation and getting nothing—or at least less than they expected—in return.

The occasion for risk on the cost side of the equation is, surprisingly, more difficult to identify. At first blush, there appears to be little place for risk in assessing some government takings liability.¹⁸³ Consider condemnations first. The process by which governments condemn property has a predictable form. The government first

¹⁸¹ See *supra* text accompanying note 141.

¹⁸² Compounding this risk is a long-recognized cognitive bias: People are more risk averse about gains than losses. See Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 *SCIENCE* 453, 453–54 (1981). Psychological factors like framing effects might not seem to apply to governments, but so long as local governments generally reflect property owners' risk preferences, there is no reason why cognitive biases should not also appear.

¹⁸³ This may explain, at least in part, the absence of theoretical work in this area. Louis Kaplow has discussed risk aversion in the disutility property owners experience in the absence of compensation, but he does not discuss government risk aversion. See Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 *HARV. L. REV.* 509, 561 (1986).

announces its plan to acquire property and offers the property owner a sum of money as just compensation. If the property owner objects to the government's offer, the parties can litigate the damages issue in court.¹⁸⁴ Once a dollar value is established, the government faces the choice whether to proceed with the action and pay the adjudicated compensation, or withdraw its condemnation action, paying only for the property owner's attorneys' fees.¹⁸⁵ The choice the government faces after a trial on the compensation issue is simply whether the proposed action is worth the amount it will have to pay to compensate the burdened property owner. On its face, this is consistent with the traditional economic account of the Takings Clause, as it forces the government to decide whether the condemnation at a given price is worth more to the government than it will cost. There is no obvious place for risk aversion in this analysis, however, because there appears to be no risk. The government knows the price of the condemnation before it must decide whether to go ahead.

Risk aversion's place in regulatory takings analysis is similarly opaque.¹⁸⁶ Whenever damages are available as a remedy for a regulatory taking, whether through a state inverse condemnation proceeding or through some other procedural mechanism, the risk of liability is clear.¹⁸⁷ The threat of a takings judgment can trigger risk-averse behavior. However, in some states, and in specific situations in federal court, the remedy for a regulatory taking resulting from the kinds of growth controls that give rise to local takings claims is exclusively injunctive relief.¹⁸⁸ In these cases, at least, there is no obvious place for risk aversion to enter into the government's decisionmaking.

¹⁸⁴ See 6 JULIUS L. SACKMAN, *NICHOLS ON EMINENT DOMAIN* § 24.04 (rev. 3d ed. 2006).

¹⁸⁵ Cf. *id.* at § 26D.01[1][a]–[c]; MODEL EMINENT DOMAIN CODE §§ 213, 1303 (1974).

¹⁸⁶ See Ellickson, *supra* note 13, at 490–93.

¹⁸⁷ Some states require compensation instead of an injunction. See, e.g., *Olympic Pipe Line Co. v. Thoeny*, 101 P.3d 430, 436 (Wash. Ct. App. 2004) (“In general, Washington courts have followed the rule that remedy for [takings of private property] is the payment of damages, not injunction . . .”). Some states permit a plaintiff to choose which remedy to receive. E.g., *Keck v. Hafley*, 237 S.W.2d 527, 529–30 (Ky. Ct. App. 1951) (recognizing land owner's option “to either seek injunctive relief or to recover damages for the permanent taking of his property”).

¹⁸⁸ Ellickson once criticized this property rule remedy for takings claims, labeling it the “*Nectow* fallacy,” after *Nectow v. City of Cambridge*, 277 U.S. 183 (1928), and proposing that compensation should instead be the remedy for takings challenges to local growth controls. Ellickson, *supra* note 13, at 490–93. The law has since changed, allowing damages in more cases, but his insight remains important. See *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 318–20 (1987) (permitting damages for regulatory taking).

The Supreme Court case *First English Evangelical Lutheran Church of Glendale v. City of Los Angeles*,¹⁸⁹ however, changes this analysis. Now, compensation is available as a remedy for regulatory takings and, even where the ultimate remedy is an injunction, courts can also award damages for the temporary taking that occurs between the time a regulation goes into effect and its repeal.¹⁹⁰ Usually valued by the fair rental value of the property during the relevant period, the damages for temporary takings can be quite high.¹⁹¹ Any time a government enacts some regulation that might be an impermissible deprivation of a property right, the government must consider the possibility of money damages, and this can lead to risk-averse behavior.

Attorneys' fees are the other important source of local government risk aversion. Prevailing property owners are entitled to attorneys' fees for takings claims, whether they are brought as inverse condemnation actions under Section 1983¹⁹² or brought directly under the Takings Clause. Even in a straight condemnation proceeding, if the government withdraws the action—perhaps because a court valued the property at a higher amount than the government wanted to pay—the government is statutorily required to pay the property

¹⁸⁹ See generally *First English*, 482 U.S. 304 (holding that landowner could recover for damages during time prior to ruling that city's regulation constituted taking).

¹⁹⁰ See, e.g., *SDDS, Inc. v. State*, 650 N.W.2d 1, 13–14 (S.D. 2002) (awarding damages for temporary taking); *Yuba Natural Res., Inc. v. United States*, 821 F.2d 638, 640–41 (Fed. Cir. 1987) (same); see also Frank Michelman, *Takings, 1987*, 88 COLUM. L. REV. 1600, 1617 (1988) (“What the Court decided in *First English* . . . was that, in such a case of judicial termination of a regulatory restriction that . . . would have forever denied economically viable use of affected land, the state must compensate the landowner in money for this interim of compelled compliance with the unconstitutional regulation.”).

¹⁹¹ See Cullen Christie Wilkerson, Comment, *Just Compensation for Temporary Regulatory Takings: A Discussion of Factors Influencing Damage Awards*, 35 EMORY L.J. 729, 729–30 (1986) (observing that damages for temporary takings claims can amount to significant percentages of local government's entire budget).

¹⁹² 42 U.S.C. § 1988(b) (2000) (providing court with discretion in awarding attorneys' fees in civil actions filed pursuant to 42 U.S.C. § 1983 (2000)); see also *Goss v. City of Little Rock*, 151 F.3d 861, 865–66 (8th Cir. 1998) (awarding attorneys' fees under Section 1988 despite plaintiff's failure to include Section 1983 in complaint); *N.Y. State Ass'n of Realtors v. Shaffer*, 27 F.3d 834, 845 (2d Cir. 1994) (remanding claim for attorneys' fees pursuant to Sections 1983 and 1988); *Thorstenn v. Barnard*, 883 F.2d 217, 218 (3d Cir. 1989) (finding that plaintiff was entitled to invoke Section 1983 once violation was found, thus triggering applicability of Section 1988); Serkin, *supra* note 4, at 699–700 (describing courts' discretion in assessing greater or lesser attorneys' fees). Some state courts require the complaint to include a demand for fees. *Burton v. Clark County*, 958 P.2d 343, 358 (Wash. Ct. App. 1998).

owner's attorneys' fees.¹⁹³ Attorneys' fees, by themselves, can be astronomical.¹⁹⁴

When considering some new regulation, then, the government may not be able to anticipate its actual costs. Even the procedural protections in condemnation, preserving the government's right to walk away, come at a potentially substantial cost in the form of attorneys' fees. The government will therefore be unable *ex ante* to balance the benefits of a plan with its costs, at least in any precise way. Instead, the government must factor in the possibility that it will be forced to pay—either just compensation for the entire property, fair rental value, or attorneys' fees—and this, in turn, creates different incentives for the government to act depending on its relative risk aversion.

3. *The Effects of Risk Aversion on Regulatory Incentives*

According to the traditional economic account of the Takings Clause, a properly calibrated takings regime should encourage governments to undertake those actions that create more gain than harm and discourage the opposite. Compensation supposedly accomplishes this goal by forcing the government to compare the expected gains from a proposed action with its expected costs. Risk aversion, however, undermines the effectiveness of any one-size-fits-all approach to compensation. The same monetary award will have a different impact if the government is risk averse than if the government is risk neutral.

Instead of the world the public choice theorists depict, where governments are largely unresponsive to budget outlays, local governments may be *too* responsive. Imagine, for example, a local government considering a new land use regulation that restricts development in large parts of town. The government may expect the regulation to confer substantial benefits by improving the quality of life in town, reducing sprawl, preserving scenic beauty, and ultimately making the town a more desirable place to live. On the other hand, there are risks that the regulation will not create these benefits but will instead stifle growth or create clusters of blighted areas.¹⁹⁵ On

¹⁹³ 42 U.S.C. § 4654(a) (2000); *see also* *United States v. Bodcaw Co.*, 440 U.S. 202, 204 (1979) (discussing awards of litigation fees in takings cases); *Shaffer*, 27 F.3d at 845 (same).

¹⁹⁴ *E.g.*, *Preseault v. United States*, 52 Fed. Cl. 667, 684 (2002) (entering judgment for landowner in sum of \$234,000, but granting nearly \$900,000 in attorneys' fees); *Foster v. United States*, 3 Cl. Ct. 738, 745 (1983) (entering judgment for landowner in sum of \$28,000, while granting \$186,279 in costs and attorneys' fees); *see also* *City of Rancho Palos Verdes v. Abrams*, 544 U.S. 113, 123 (2005) (noting potential impact of attorneys' fees on local governments).

¹⁹⁵ For a discussion of the relationship between land use controls and blight, see Span, *supra* note 12, at 15–16.

the cost side, the government may hope the regulation will be cost free. It believes that the regulation will not trigger a compensation requirement at all, but it cannot be sure. Chances are the government has it right: The regulation will generate substantial benefits and will not require compensation. Nevertheless, faced with some degree of uncertainty about both benefits and costs, a local government might be deterred from undertaking what would otherwise be an efficient regulation.

Simplifying this example, and adding some stylized numbers, makes the point even more clearly. Consider a condemnation for a new park—or perhaps for a new road, or to restore blighted property—that has an 80% chance of creating a \$100 benefit and a 20% chance of creating no benefit at all. The present value of condemning the property is therefore \$80 (reflecting the benefit of the condemnation discounted by the probability of achieving it). If condemning property for the park is expected to cost something less than \$80, for example \$75, then the park will generate a positive gain and a well-calibrated compensation regime should encourage the government to act. Risk aversion, however, changes this calculus. Now imagine that the government disfavors risk at a rate of 1.5. The \$20 discount taken from the value of the condemnation is therefore multiplied by this factor, resulting in a discount of \$30.¹⁹⁶ The present value of the park is now only \$70, and the government may forego the project. Factoring risk aversion into the cost side of the equation, too, will amplify this effect, as with all regulatory takings. Again, the unknowns on the cost side include the extent of compensation due, if any, as well as attorneys' fees and damages for temporary takings.¹⁹⁷ The result: Because of the uncertainty of costs and benefits, risk aversion can change the incentives of local government officials.

B. Local Externalities

Externalities have long been identified as a source of inefficient government decisionmaking.¹⁹⁸ Economists calling for greater takings liability have done so by reasoning that uncompensated harms to

¹⁹⁶ $\$100 - \$100(.2)(1.5) = \$70$.

¹⁹⁷ See *supra* notes 189–94 and accompanying text.

¹⁹⁸ See Henry N. Butler & Jonathan R. Macey, *Externalities and the Matching Principle: The Case for Reallocating Environmental Regulatory Authority*, 14 YALE J. ON REG. 23, 31–32 (1996) (noting that imperfection of local regulation is likely consequence of real world's lack of purely local externalities, perfect markets, and perfect governments); Rose, *supra* note 15, at 840–41 (cataloguing extralocal spillover effects); see generally R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

property owners present a persistent externality problem.¹⁹⁹ Likewise, objections to current compensation practices often focus on the criticism that they do not force the government to internalize all of the real costs of a regulation.²⁰⁰ Even where compensation is due, advocates of expanded property rights point out that compensation based on the property's fair market value excludes compensation for consequential damages, moving expenses, and the like, to say nothing of a property owner's subjective harm.²⁰¹ Lee Ann Fennell, too, has identified what she calls the "uncompensated increment" in assessing compensation for condemnations.²⁰² In the traditional economic account, these real but uncompensated harms are an invitation for abuse; they are costs a government can impose on property owners without having to include them in its own cost-benefit calculation.

All of these externalities are well known in the takings literature. But these are only a subset, and perhaps even a narrow subset, of both the negative and positive externalities generated by local governments, and particularly by local land use regulations and growth controls.²⁰³ Having identified in Part II the specific mechanisms by which local governments internalize both the costs and benefits of their actions, it is now possible to develop a richer picture of the externali-

¹⁹⁹ Abraham Bell & Gideon Parchomovsky, *Takings Reassessed*, 87 VA. L. REV. 277, 290 (2001) ("[W]hen the external effects of takings are not taken into account, we can never be sure that the actions of government promote economic efficiency.").

²⁰⁰ James Geoffrey Durham, *Efficient Just Compensation as a Limit on Eminent Domain*, 69 MINN. L. REV. 1277, 1301 (1985) ("Many of the causes of inefficient and inequitable eminent domain actions could be eliminated by requiring governments to compensate owners and the public for all external costs that should enter into a government's cost/benefit calculus.").

²⁰¹ See Serkin, *supra* note 4, at 679 n.5 (describing frequent objections to current compensation rules). In a new article, Nicole Garnett has pointed to federal relocation assistance as providing unexpectedly high compensation for some of these costs, meaning that the federal government, at least, may not be escaping all of these additional costs that takings regularly impose. See Garnett, *supra* note 59, at 25–26 (noting federal Uniform Relocation Assistance and Real Properties Acquisition Act requires compensation for moving, closing, and other consequential damages).

²⁰² Fennell, *supra* note 59, at 962–67.

²⁰³ See Jerry Frug, *Decentering Decentralization*, 60 U. CHI. L. REV. 253, 280 (1993). Frug states that:

Localities cause unemployment by attracting businesses from neighboring cities; they generate pollution that harms their neighbors as well as themselves; they zone for office complexes and shopping malls that change the lives of employees and customers in other towns; they educate people who move elsewhere in the area; they enact crime control policies that victimize people who live across the border.

Id.; see also Daniel R. Mandelker & A. Dan Tarlock, *Shifting the Presumption of Constitutionality in Land-Use Law*, 24 URB. LAW. 1, 30–32 (1992) (focusing on extraterritorial effects of local governments).

ties subject to takings liability that might generate skewed regulatory incentives.

1. *Positive Externalities*

Local governments often generate a variety of gains that they cannot easily capture. Recall that, at the local level, positive externalities include any locally generated benefits that are not fully captured by local homeowners, such as benefits that are conferred on neighboring towns.²⁰⁴

Land use controls, in particular, generate significant positive externalities that are often overlooked. Limits on factories and other sources of airborne pollution benefit property owners in neighboring towns as well as in the regulating town. If a homeowner lives downwind of a smelly dump, she will suffer whether the dump is in her own town or in a neighboring town. Cleaning up the dump, or limiting it in the first place, creates a real benefit regardless of which local government is responsible for the regulation. While the benefits may be focused on the site of the regulation, they can ripple outwards for miles. This is also true of almost all forms of environmental protection, like preserving open space and wildlife habitats. Aesthetic zoning and historic preservation also generate positive externalities. The aesthetic zoning prevalent in parts of the Southwest, for example, preserves the area's historic heritage, to the benefit of residents and nonresidents alike—and sometimes more to the latter than the former.²⁰⁵

These kinds of positive externalities predictably lead to underregulation by local governments, as judged by a net increase in the welfare of all affected people.²⁰⁶ Imagine a local government deciding whether to forbid some disfavored use in the face of a requirement to compensate the burdened property owners. According to the model developed in Part II, the local government will weigh the benefits to local property owners of prohibiting the use with the costs in increased taxes that come from compensating burdened property owners. If, however, enough of the benefits actually spill across town

²⁰⁴ These benefits include both increases in neighboring property values as well as reductions in neighboring property taxes.

²⁰⁵ Landmark designations can impose substantial costs on property owners and decrease the value of property. Cf. *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 130–31 (1978) (discussing diminution of value resulting from New York's Landmark Law).

²⁰⁶ There is a strand of economics that has also addressed this issue. See George R. Zodrow & Peter Mieszkowski, *Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods*, 19 J. URB. ECON. 356, 356 (1986) (citing sources).

lines and go uncaptured, then the government may decide not to act even when, viewed through a wider lens, it should.

2. *Negative Externalities*

Of course, in addition to these positive externalities, local governments generate significant negative externalities. Since local governments internalize the costs of their actions through property taxes, negative externalities consist of costs not borne by local property taxpayers. Predictably, each of the positive externalities identified above comes with a negative variant. Unrestrained growth in an area might have dire consequences, from increased traffic to water pollution.²⁰⁷ Similarly broad but less tangible harms include permitting the destruction of historically or culturally sensitive sites, or even ruining beautiful scenery. All of these are real costs that are not captured through property taxes. In addition to these well-known externalities, however, there are also costs that local governments purposefully shift to outsiders. The possibility of local governments intentionally shifting costs to their neighbors means that negative externalities are not simply the mirror image of positive externalities but require a slightly different analysis.

Most obviously, a local government can site its locally undesirable land uses close to the border of another town. This allows a town to capture the benefits (often in the form of fees or increased tax revenues) while imposing some, if not most, of the costs on its neighbors. Costs might include smells from a landfill, noise from a factory, or ugliness.²⁰⁸ Any government compensation due under a land use regime forcing these uses to the outskirts of town—for example, restrictive zoning in the center of town or actual condemnations to spur development—will not include compensation for harms done to neighboring communities. Imagine, for example, a local government considering a plan to condemn and retransfer property for a new fac-

²⁰⁷ Cf. Bahl, *supra* note 78, at 79. Examples of local externalities include:

[A] community may overuse water from the local river, depriving adjacent communities of an adequate supply; unbridled growth in a suburban community may increase the number of commuters to the central city, placing an undue burden on central city services; and one community's failure or inability to provide adequate primary and vocational education may lead to another community's crime problem.

Id.; see also Barron & Frug, *supra* note 20, at 280 (reporting on interviews with local officials in Massachusetts in which "they [repeatedly] made reference to the traffic problems in their communities caused by the zoning decisions of neighboring municipalities").

²⁰⁸ Cf. Barron & Frug, *supra* note 20, at 265 (identifying placing of industry on edge of town as one source of extralocal pressure over which local government has little or no control); Daniel E. Ingberman, *Siting Noxious Facilities: Are Markets Efficient?*, 29 J. ENVTL. ECON. & MGMT., at S-20 (1995) (discussing considerations for siting landfills).

tory, in order to stimulate the economy.²⁰⁹ In considering the relative costs and benefits of the factory, the ability to shift some of its more immediate costs on to a neighboring town might transform it from a net loser to a net winner for the community and directly impact the government's willingness to undertake the project.

Growth controls—meaning, simply, all regulations that restrain growth, like restrictive zoning, denials of variances, and denials of building permits, to name a few—also impose costs not borne by existing homeowners. Growth controls can raise the price of housing locally by restricting supply.²¹⁰ Large minimum lot sizes, in particular, make towns effectively off-limits for poorer families that cannot afford to buy a large lot.²¹¹ This, in turn, imposes a cost on potential residents who choose not to buy into the town because of the increased prices, as well as on residents who do buy into the town at the higher prices.²¹² Systemically, too, pricing low-income homeowners out of the local housing market imposes real costs on neighboring towns that may therefore bear a disproportionate share of the costs that low-income families tend to impose.²¹³ In suburbs surrounding a central city, this has resulted in the familiar phenomenon of increasing disparities between central cities and wealthy outer-ring suburbs.²¹⁴ Even where a local government is required to compensate

²⁰⁹ These condemn and retransfer cases frequently implicate the public use requirement in the Takings Clause. For an examination of this recently revitalized area of law, see generally Krier & Serkin, *supra* note 59.

²¹⁰ Michelle J. White, *Fiscal Zoning in Fragmented Metropolitan Areas*, in *FISCAL ZONING AND LAND USE CONTROLS: THE ECONOMIC ISSUES 73-74* (Edwin S. Mills & Wallace E. Oates eds., 1975).

²¹¹ Robert L. Liberty, *Abolishing Exclusionary Zoning: A Natural Policy Alliance for Environmentalists and Affordable Housing Advocates*, 30 B.C. ENVTL. AFF. L. REV. 581, 584 (2002). Interestingly, Liberty also argues that large lot sizes impose environmental costs that are often overlooked in the cost-benefit analysis of zoning and growth controls. *Id.* at 586.

²¹² Ellickson, *supra* note 13, at 402. Ellickson identifies two other groups harmed by growth controls: (1) “current tenants who like [the town] too much to want to move out,” and (2) “tenants who subsequently leave the municipality because their rents go up.” *Id.*; see also Mandelker & Tarlock, *supra* note 203, at 31 n.118 (identifying groups harmed by growth controls); Richard C. Schragger, *The Limits of Localism*, 100 MICH. L. REV. 371, 422 (2001) (same); Michelle White, Commentary, *Redistribution of Income Through Regulation in Housing*, 32 EMORY L.J. 745, 758 (1983) (“The impact of . . . no-growth zoning, if adopted on a widespread basis, is to raise the cost of housing for everyone, with existing owners of housing incurring capital gains.”).

²¹³ See Frug, *supra* note 203, at 284 (“A locality’s zoning policy . . . affects not only its own identity but also the identity of other cities within the region. Suburban exclusiveness is dependent on the neighboring cities’ refusal to exclude; some places have to be open for others to be closed.”).

²¹⁴ Sheryll D. Cashin, *Localism, Self-Interest, and the Tyranny of the Favored Quarter: Addressing the Barriers to New Regionalism*, 88 GEO. L.J. 1985, 2014-15 (2000) (describing flight from inner cities). As Neil Komesar notes: “[G]rowth control ordinances . . . when

burdened property owners for restrictive growth controls—often by paying compensation for development restrictions that violate the Takings Clause—there are additional and very real costs imposed both on neighboring towns and excluded property owners that the local government will not have to bear.

Just as positive externalities are likely to lead to underregulation, negative externalities are likely to lead to overregulation. Even in the face of a compensation requirement, some of the costs of local growth controls are not translated into local property taxes and can therefore be ignored by local decisionmakers. There are, in short, a number of thumbs putting extra pressure on both sides of local governments' cost-benefit scale.

There are undoubtedly other obstacles, too, that prevent compensation from translating directly into political costs, even at the local level. Term-limited politicians, in particular, might over-discount future benefits. Nonuniform regulatory benefits might impede efficient decisionmaking, as could wide discrepancies in home values within a particular town.²¹⁵ It is no surprise that theoretical economic models do not apply perfectly on the ground. The problems identified in this part—risk aversion and externalities—are pervasive, however, and their specific application at the local level is new in the takings literature. Fortunately, these specific problems lend themselves to concrete solutions, which are the subject of Part IV.

projected across a region like the San Francisco Bay Area can have drastic, detrimental effects outside the jurisdiction itself. Impacts on the regional housing supply can be severe, resulting in income and racial segregation as well as adverse effects on the poor.” KOMESAR, *supra* note 46, at 60.

²¹⁵ Even a majoritarian political system will not necessarily result in efficient government incentives if unanimity is not required and the benefits of a government action are not spread homogeneously among constituents. See Levinson, *supra* note 6, at 364–67. Compensation will not necessarily result in efficient regulatory incentives if the people who benefit from a government action do not have to bear the full costs of the action. See Christopher Serkin, *Valuing Interest: Net Harm and Fair Market Value in Brown v. Legal Foundation of Washington*, 37 *IND. L. REV.* 417, 426 (2004). This is closely related to the public choice theory critique of takings, now applied even to majoritarian political systems. Here, too, the result can be inefficient overinvestment of local government resources. While the theoretical argument applies to all levels of government, small governments tend toward homogeneity more than larger units of government and therefore have less opportunity for slippage between benefits and burdens. This is true both because the numbers are smaller in absolute terms and because of the Tiebout Hypothesis. See *supra* notes 131–137 and accompanying text (discussing Tiebout Hypothesis).

IV UPDATING LOCAL GOVERNMENTS' REGULATORY INCENTIVES

Having identified the limits to local governments' efficient cost-benefit determinations, what remains is to propose specific responses to those systemic distortions. Some are more radical than others, requiring genuine changes in the substantive law of takings or legislative reform. Others, however, would require no great doctrinal change and could even be adopted by lower courts. At the root of the proposals that follow, however, is a new understanding that the traditional terms of the takings debate contain troubling oversimplifications. An expanded compensation requirement will not necessarily lead to greater efficiency. True, local governments today can avoid some of the costs of regulating, but they are also unable to capture all the benefits. Without taking both sides of the equation into account, the goal of legislative efficiency will remain elusive.

A. Accounting for Risk Aversion

Local governments' risk aversion poses a substantial and previously undiagnosed hurdle for the creation of efficient regulatory incentives. Each source of government risk aversion, identified above, requires its own solution.

1. Reducing the Expected Costs of Government Actions

Risk aversion threatens to deter local governments from undertaking actions or enacting regulations that would, in fact, generate more benefits than costs. Specifically, risk aversion will cause a local government to discount benefits at a greater rate than would a risk-neutral government, as well as place too high a premium on the costs of takings liability. This, in turn, will weight the scales of local governments' cost-benefit calculations. In other words, the expected value of a regulation will be lower when the government is risk averse than when the government is risk neutral. To correct for this effect on local governments, either the expected benefits of a regulation need to be increased or its expected costs need to be decreased. There is no readily available mechanism to achieve the former. Compensation for takings, however, turns out to be surprisingly flexible and provides a relatively straightforward mechanism for ratcheting down the expected costs of takings liability.

The notion of flexible compensation for takings is not as foreign as some might expect. In an earlier Article, I argued that the fair market value standard for compensating takings is far more flexible

than courts and commentators have recognized and, in fact, can accommodate a wide array of valuation decisions.²¹⁶ Certain compensation practices systemically reduce compensation and so reduce the cost to the government of taking private property. These include offsetting compensation with the reciprocal benefits of government actions, allocating all development risk to the property owner, and reducing the burdened property's value to reflect permissible but unenacted regulations, i.e., regulations the government could have enacted without taking the subject property.²¹⁷ At the most general level, all of these valuation mechanisms involve similar substantive judgments, necessarily embedded within the fair market value determination, about the extent of private property rights as against the government.²¹⁸ The more freedom the government has to regulate without paying compensation, the lower the compensation should be when it does have to pay. Or, to put it differently, an expansive view of government power comes with consequences for compensation, too. Weaker private property protection means that when the government takes property it is quite literally taking less than it would be taking from someone with stronger private property rights.²¹⁹

It is the first of the three compensation practices identified above, offsetting compensation with reciprocal benefits, that turns out to be particularly appropriate for valuing takings by local governments. Under current law, if a property owner receives benefits from a government regulation—including nonfinancial benefits—in excess of the harm imposed, compensation is unnecessary. In its most familiar form, this is referred to as “average reciprocity of advantage” and serves as a complete defense to a takings claim.²²⁰ Even Richard

²¹⁶ See generally Serkin, *supra* note 4. Some Supreme Court Justices have recently expressed some interest in revisiting the standard for Just Compensation. See Linda Greenhouse, *Justices Appear Reluctant to Increase Land-Use Oversight*, N.Y. TIMES, Feb. 23, 2005, at A14 (describing oral arguments in *Kelo v. City of New London* and noting that “several justices suggested that the longstanding rule, that the eminent domain price reflects the current market and not any expected appreciation from the project itself, was unfair in this context and should be revisited”).

²¹⁷ Serkin, *supra* note 4, at 687–703.

²¹⁸ Serkin, *supra* note 215, at 419 (“Ultimately at stake in these kinds of fundamental valuation decisions is the extent of protection provided by the Takings Clause.”).

²¹⁹ See Serkin, *supra* note 4, at 682 (“[T]he same disagreements over the amount of protection the Takings Clause should afford private property are replayed in the compensation analysis. Stronger protection for private property, for example, means not only finding more governmental actions to be takings, but also awarding relatively higher compensation.”).

²²⁰ See *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 147 (1978) (Rehnquist, J., dissenting) (discussing average reciprocity of advantage); *Fla. Rock Indus., Inc. v. United States*, 18 F.3d 1560, 1570 (Fed. Cir. 1994) (stating that existence of “reciprocity of advantage” works against any claim that government has improperly taken pri-

Epstein, one of the primary proponents of radically expanded property rights, acknowledges that the existence of these implicit, in-kind benefits provides an appropriate defense to a takings claim.²²¹ But in-kind benefits can also apply to compensation in what is sometimes called the “benefit offset” rule.²²² Government-conferred benefits to property should be subtracted from the explicit monetary compensation the government is required to pay. If the government takes a slice of property for a new road, but in the process increases the value of the remaining property because of the new road, that increase in value can be subtracted from the compensation due.

It is no simple task deciding whether and how to offset just compensation with implicit, in-kind benefits. It poses difficult line-drawing problems about the benefits to include.²²³ Valuing the benefits, too, can be conceptually and practically difficult.²²⁴ These problems are well developed in the takings literature and do not need to be rehashed here. The important point, instead, is that, for all its difficulties, this approach to compensation is easier to apply at the local level than at higher levels of government where benefits become increasingly diffuse. Courts are much more likely to recognize benefits conferred by local regulations, like Euclidian zoning and other land use regulations, than by state and federal regulations.²²⁵ This

vate property); *Colo. Springs Prod. Credit Ass'n v. Farm Credit Admin.*, 967 F.2d 648, 654 (D.C. Cir. 1992) (“The notion of . . . average reciprocity of advantage . . . pervades the cases rejecting takings challenges.” (internal citations omitted)); see also Joseph L. Sax, *Takings and the Police Power*, 74 *YALE L.J.* 36, 73–74 (1964) (noting that “[r]eciprocal benefit” cases are those “in which a restriction clearly enhances the resource value of a government enterprise, but where compensation is properly denied on the ground that the ‘victims’ received benefits which equal or exceed the detriment imposed”).

²²¹ EPSTEIN, *supra* note 3, at 195–215.

²²² See *Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171, 1180 (Fed. Cir. 1994) (stating that “mere diminution” in value occurs where decreases in property value result from “shared economic impacts . . . in which the property owner has in a sense been compensated by the public program”); see also Mark W. Cordes, *Leapfrogging the Constitution: The Rise of State Takings Legislation*, 24 *ECOLOGY L.Q.* 187, 236 (1997) (noting that gains and losses of specific reciprocity can be “taken into account by the before and after valuation approach of compensation statutes”).

²²³ The determination of what benefits and harms should be cognizable when evaluating takings is an aspect of the broader question, provocatively identified by Daryl Levinson in *Framing Transactions in Constitutional Law*, 111 *YALE L.J.* 1311 (2002), of how to frame constitutional disputes between government and citizens.

²²⁴ For a full discussion, see Serkin, *supra* note 4, at 694–96.

²²⁵ In *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926), the Court justified zoning regulations on the grounds that the property owners received an average reciprocity of advantage. *Id.* at 391 (finding notable benefits to residents, including promotion of “health and security from injury of children . . . suppression and prevention of disorder; facilitating the extinguishment of fires, and the enforcement of street traffic regulations and other general welfare ordinances”). The term has been invoked in other local land use cases. See *R & Y, Inc. v. Municipality of Anchorage*, 34 P.3d 289, 300 (Alaska 2001);

may be precisely contrary to Epstein's view that implicit, in-kind benefits are more likely to result from general regulations that affect a large number of people.²²⁶

Additionally, because the benefits of local regulations are capitalized into property values, these government-conferred benefits are easier to value and use to offset compensation. Appraisers are expert at valuing property in light of the general regulatory environment, as well as a regulation's impact on a specific piece of property.²²⁷ Consider, for example, a new height restriction on buildings in a particular part of town. While the regulation may, in fact, impose some costs on property owners by limiting the value of air rights, it will also create reciprocal benefits in the form of increased light and decreased development by neighbors and, ultimately, increased property values. Appraisers may disagree about the value of the benefits—or even whether they are net benefits or costs in a particular case—but these kinds of disagreements are regularly resolved through litigation.²²⁸

In order to reduce compensation for local takings, then, courts should expand the offsetting benefits they will include in valuing compensation. In particular, they should be willing to include more of the benefits created by local regulations. Determining where, exactly, to redraw these lines may require empirical testing of local governments' risk aversion. That is a refinement reserved for future work. It is enough at this point to recognize that accounting for risk aversion requires systemically reducing local government compensation and to identify the principal mechanism for reaching this result.

One objection to the proposal is easy to anticipate. Adjusting local governments' compensation downwards might seem unfair. From the property owner's perspective, compensation for takings based only on the property's fair market value is already seen as inad-

HFH, Ltd. v. Superior Court of L.A. County, 542 P.2d 237, 246 (Cal. 1975); First English Evangelical Lutheran Church v. County of Los Angeles, 258 Cal. Rptr. 893, 905 (Ct. App. 1989); Grupe v. Cal. Coastal Comm'n, 212 Cal. Rptr. 578, 596–97 (Ct. App. 1985); Krahl v. Nine Mile Creek Watershed Dist., 283 N.W.2d 538, 543 (Minn. 1979). Courts have also offset benefits conferred by higher levels of government, but always more controversially. See Shanghai Power Co. v. United States, 4 Cl. Ct. 237, 244–46 (1983), discussed in Levinson, *supra* note 223, at 1340.

²²⁶ EPSTEIN, *supra* note 3, at 196.

²²⁷ See generally Richard J. Roddenwig & Christopher J. Duerksen, *Responding to the Takings Challenge*, C431 A.L.I.-A.B.A. 276 (1989) (outlining method for valuing property in light of regulatory takings).

²²⁸ Litigation around takings tends to be heavily fact-intensive and to focus on valuation issues. See Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. ENVTL. L.J. 110, 117 (2002).

equate.²²⁹ Systemically reducing compensation threatens to compound this perceived unfairness. Even though fairness concerns are ostensibly outside the scope of this Article's narrow focus on efficiency, this potential objection is trenchant enough to demand at least a preliminary response.

First and foremost, it is not at all settled that the adequacy of compensation must be viewed from the property owner's perspective, or at least exclusively from her perspective. Instead of asking how much the property owner has been harmed, some of the compensation case law seems to focus on what the government has taken.²³⁰ The two are not necessarily symmetrical. Moreover, any perceived unfairness to a burdened property owner should be weighed against the fairness of the entire system. This will include the unfairness to the public if the government is deterred from undertaking beneficial regulations. The standard by which the adequacy of compensation should be judged is more complicated than it might seem.²³¹

Moreover, property owners may, in fact, experience the content of their losses differently depending on the government doing the regulating. This is true for a number of reasons—including base political reactions to federal, state, and local governments²³²—but also because of differences in the opportunity for exit and voice in different levels of government.²³³ The higher the level of government, the less chance an individual property owner has to express her views to the relevant decisionmaker, and the less opportunity she has to leave and choose a different jurisdiction. The ability to have participated in any local government decision can reduce the actual harm that the property owner experiences, where harm is defined more broadly than just the economic loss imposed on the property. This can be phrased in terms of minimizing demoralization costs, or in broader psychological terms.²³⁴ Notice, too, that proponents of expanded property rights

²²⁹ Fennell, *supra* note 59, at 963–65 (discussing subjective premium); Serkin, *supra* note 4, at 678–79 (discussing perceptions of inadequate compensation).

²³⁰ See Serkin, *supra* note 4, at 678–79 (identifying harms to property owners that are excluded from compensation and cases in which courts formally focused on government's gain instead of property owner's harm).

²³¹ *Id.* at 679 (“Criticisms about the adequacy of compensation have too often elided the difficult prior question, ‘adequate for what?’”).

²³² Because of people's background political beliefs, some may object more to federal legislation than to the same legislation enacted by a state. Think, here, of the states-rights movement, or of even more radical antifederal government militias.

²³³ For a comprehensive treatment of the importance of exit and voice, see generally Been, *supra* note 134.

²³⁴ Michelman, *supra* note 3, at 1214 (discussing demoralization costs); see also Bruno S. Frey et al., *Introducing Procedural Utility: Not Only What, but Also How Matters*, 160 J. INSTITUTIONAL & THEORETICAL ECON. 377, 381, 389–91 (2004) (describing importance of

have also pushed for expanding what counts as compensable harms.²³⁵ This proposal is simply acknowledging that these additional harms may vary depending on the level of government that has imposed them.

2. *Insurance for Litigation Costs and for Temporary Takings*

The proposals to account for local governments' risk aversion on the cost side of the equation take a more familiar form. In general, insurance provides the best response to risk aversion.²³⁶ Insuring local governments for the costs associated with both takings litigation and temporary takings²³⁷—but not any compensation ultimately due for a permanent taking—would eliminate most of the risk of regulating.²³⁸ This applies equally to litigation surrounding regulatory takings, where the ultimate remedy may be an injunction instead of damages, as to outright expropriations of private property, where the only litigated issue is the amount of compensation due.

Private insurance of this kind may not be generally available to local governments.²³⁹ Accordingly, the state or federal government

perceptions of fairness); Douglas A. Kysar, *Preferences for Processes: The Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 525, 604–09 (2004) (same).

²³⁵ Fennell, *supra* note 59, at 993 n.115 (citing sources).

²³⁶ See Bruce Babbitt & Jonathan Rose, *Building a Better Mousetrap: Health Care Reform and the Arizona Program*, 3 YALE J. ON REG. 243, 246 (1986) (describing insurance as market response to risk aversion).

²³⁷ An alternative but more controversial approach for temporary takings would be to eliminate such liability for local governments altogether. The limits of the temporary takings doctrine remain obscure, and courts could severely curtail local governments' temporary takings liability. Temporary takings liability is already uncertain, to say the least. See *generally* Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302 (2001) (muddying already complex question of temporary takings); see also David L. Callies & Calvert G. Chipchase, *Moratoria and Musings on Regulatory Takings: Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 25 U. HAW. L. REV. 279, 281 (2003) (examining state of doctrine).

²³⁸ In fact, it is commonplace to think of takings law as providing a form of public insurance against government interference with private property so as to stimulate efficient levels of investment. See Steve P. Calandrillo, *Eminent Domain Economics: Should "Just Compensation" Be Abolished, and Would "Takings Insurance" Work Instead?*, 64 OHIO ST. L.J. 451, 499–505 (2003) (discussing pros and cons of takings insurance); William K. Jones, *Confiscation: A Rationale of the Law of Takings*, 24 HOFSTRA L. REV. 1, 6 n.17 (1995) (noting numerous scholars who have concluded as much). The proposal here acknowledges that governments require insurance, too.

²³⁹ There are any number of reasons why this might be true. The familiar adverse selection problem provides one reason. Governments more intent on closely regulating private property would opt into the insurance, either requiring subsidization from governments that regulate less, or simply polluting the insurance pool. Cf. Colin S. Diver & Jane Maslow Cohen, *Genophobia: What Is Wrong with Genetic Discrimination?*, 149 U. PA. L. REV. 1439, 1457–58 & n.59 (2001) (discussing familiar insurance death spiral). But see Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113

should either defend takings claims against local governments itself or pay for the defense. The higher-level government should also pay for liability for any temporary takings. Spreading the costs of takings litigation over a much broader community would permit greater risk spreading and mitigate local governments' risk aversion. Alternatively, more horizontal risk pooling between local governments could spread risk through a form of collective self-insurance, although this kind of interlocal cooperation is less likely to occur.²⁴⁰ Either way, this system could be conceptualized as local taxpayers contributing to a mandatory insurance regime protecting them from both the risk of a significant increase in local property taxes to fund local takings litigation and any local liability for temporary takings.

Interestingly, Blume and Rubinfeld considered and rejected a broader form of this proposal in their seminal work on compensation for takings.²⁴¹ They questioned the orthodox view that the government doing the taking should pay, pointing out that larger governments have a greater opportunity to spread risk.²⁴² They ultimately rejected their own suggestion, however, because in their view, insulating local governments from the costs associated with compensating property owners would likely lead to distorted regulatory incentives.²⁴³ The proposal here, in contrast, is only to insure local governments for the costs of temporary takings and takings litigation, and not the ultimate compensation due. Under this approach, local gov-

YALE L.J. 1223, 1254–58 (2004) (questioning whether death spirals are inevitable result of adverse selection and information asymmetries). Anecdotal evidence suggests that local insurance may sometimes be available. Cf. *Horry County v. Ins. Reserve Fund*, 544 S.E.2d 637 (S.C. Ct. App. 2001) (affirming judgment that insurance company must indemnify municipality for inverse condemnation damages); Constance E. Roberts, *Groundwater Contamination and Its Effects on a Small Municipality: A Case Study of Lindsay Olive Growers and the City of Lindsay*, 5 SAN JOAQUIN AGRIC. L. REV. 251, 265 (1995) (noting reduction in municipal insurance policies).

²⁴⁰ Insurance pools have become increasingly common for local governments but are usually used to cover such run-of-the-mill risks as liability for accidents. David S. Arnold, *Purchasing and Risk Management*, in *MANAGEMENT POLICIES*, *supra* note 78, at 365, 381–82. The possibility of the kind of large-scale liability created by takings litigation is difficult to cover through local insurance pools. *Id.*; see also Barron & Frug, *supra* note 20, at 285–86 (identifying impediments to interlocal cooperation).

²⁴¹ Blume & Rubinfeld; *supra* note 92, at 623 n.154.

²⁴² They write:

[W]e should consider the trade-off involved in compensating at the local as opposed to the state or federal level. Compensating at the state or federal level presents the compensating body a greater opportunity to diversify risk, and therefore to lower the premium associated with the provision of insurance. Other things being equal, federal government insurance is cheaper than local government insurance from a risk-spreading point of view.

Id.

²⁴³ *Id.*

ernments would still internalize those costs relevant to efficient regulatory incentives: the costs imposed on burdened property owners. This, however, presents its own moral hazard problems, distinct from those identified by Blume and Rubinfeld. The way that takings litigation works, a local government faced with a high—or just higher than expected—compensation award could withdraw a challenged action and walk away.²⁴⁴ Full insurance therefore raises three particular concerns that need to be treated separately.

The first, and perhaps most problematic, is that insurance might leave unconstitutional land use regulations unchallenged. Even deep-pocket developers, let alone homeowners, might not be willing to litigate against the even deeper pocket of the state or federal government. Put another way, providing insurance to local governments might not only affect their decisionmaking—increasing efficiency—but also affect the conduct of developers and the subjects of local land use regulation—decreasing accountability. The result could be a willingness by local governments to push the regulatory envelope without sufficient discipline from takings challenges. In short, it could lead to overregulation.

The solution is to create a risk-spreading regime that does not completely insulate local governments from the costs of their actions. Forcing local governments to internalize some but not all of the costs of takings litigation and temporary takings is best achieved either by charging local governments the equivalent of an insurance premium that tracks the substance of their land use regulations in terms of the likelihood of litigation, or the equivalent of a co-pay for actual litigation costs incurred. Ideally, in either case, the extent of any particular local government's contribution to litigation costs—whether *ex ante* through the equivalent of premiums or *ex post* through a kind of co-pay—should depend on its relative risk aversion. But even where such a fine-grained solution is administratively prohibitive, some rough approximation will still help. For example, forcing all local governments to pay some fixed percentage of actual costs will still avoid the kind of crippling losses that are possible in the current regime, while limiting the risk of a moral hazard.

The second potential moral hazard problem is that a local government might seek to tie up developers in litigation in order to create a *de facto* development moratorium. By enacting overly prohibitive land use restrictions, a local government can tie up property for

²⁴⁴ See *supra* note 185 and accompanying text.

years.²⁴⁵ When one regulation is struck down, the government can simply withdraw it without paying compensation, only to reenact it in a different form, starting the litigation process all over again.²⁴⁶ The ability to walk away without providing any compensation incentivizes bad faith, especially if local governments are excused from paying litigation costs. Sometimes, then, local governments should internalize the costs imposed by excessive litigation and temporary takings.

In order to counter this specific danger, insurance for takings litigation and temporary takings should only be available in the absence of bad faith. Where the local government seeks to achieve the benefits of a permanent regulation with the free pass of overlapping temporary regulations, the local government should have to pay its own way. This reintroduces the potential for risk-averse behavior, because a local government cannot know with absolute certainty whether it will be found to have acted in bad faith. Nevertheless, this rule will still dramatically ratchet down the risk of liability and, therefore, greatly reduce the distorting effects of temporary takings and litigation costs, if not eliminate them altogether. Practically, too, the line between good-faith and bad-faith government actions is easier to administer than it might seem. Many courts are already sensitive to a government's motivation in both liability and compensation decisions.²⁴⁷ Making this inquiry explicit will increase consistency and accuracy in findings of bad faith, and make local governments aware of the stakes of bad behavior. In the absence of bad faith, local government decisionmaking will be more efficient without liability for temporary takings.

²⁴⁵ *Del Monte Dunes at Monterey, Ltd. v. City of Monterey*, 95 F.3d 1422, 1425, 1433–34 (9th Cir. 1996) (illustrating problem where more than fifteen years had passed between defendant city's numerous denials of plaintiff's development applications and termination of subsequent litigation); Ellickson, *supra* note 13, at 490–93 (discussing problem).

²⁴⁶ A similar problem has arisen in the use of "holding districts," where a local government would not permit rezoning of property it had reserved for a specific use. Only after the government's action was deemed a taking would it consider alternate uses. At no point would it have to provide compensation, however. *See, e.g., Petersen v. City of Decorah*, 259 N.W.2d 553, 555 (Iowa Ct. App. 1977) (finding city's refusal to rezone property was attempt to "take" it without compensation by preventing other uses, but only requiring city to revisit issue); *see also Morris County Land Improvement Co. v. Twp. of Parsippany-Troy Hills*, 193 A.2d 232, 243–44 (N.J. 1963) (holding that zoning ordinance prohibiting all use constituted taking, but withholding entering of judgment until government could provide "new and proper regulations for the area").

²⁴⁷ *See John C. Cooke & Christine Carlisle Odom, Judicial Deference to Local Land Use Decisions and the Emergence of Single-Class Equal Protection Claims*, 30 ENVTL. L. REP. 11049, 11050–51 (2000) (identifying cases in which courts focused on governmental bad faith); Serkin, *supra* note 4, at 731–33 (identifying cases in which courts appear to have increased compensation in presence of governmental bad faith).

The final concern is that insurance for litigation costs will lead local governments to low-ball property owners when exercising eminent domain. If the litigation process itself is costless to local governments, they will have little incentive to offer compensation that will deter litigation. This proposal, then, may necessitate an additional reform, requiring the state or federal government—whoever picks up the tab for litigation—to approve the offer of compensation. This will realign incentives to provide offers designed to minimize litigation costs.

Even in the absence of some kind of risk-spreading device, courts also have recourse, albeit limited, for dealing with litigation costs. When a local government is forced to pay a successful plaintiff's litigation costs in a takings claim, courts have a surprising amount of discretion in deciding how much to award.²⁴⁸ By minimizing the amount the government has to pay, courts can reduce the risks associated with the costs of litigating takings claims.

B. Accounting for Local Governments' Externalities

By limiting the traditional economic account to local governments and identifying the specific means by which local governments internalize the costs and benefits of their actions, we can see more clearly what externalities might prevent compensation from creating efficient regulatory incentives.

A global response might simply be to leave it to higher levels of government to act whenever externalities threaten efficient decision-making.²⁴⁹ While a town will not internalize all the costs of a factory's pollution, the federal government will, and the federal government therefore becomes a more likely source of regulation. This kind of shifting of responsibility happens all the time.²⁵⁰ Nevertheless, some government programs and regulations are inevitably local in their

²⁴⁸ I have previously discussed this point in greater detail. See Serkin, *supra* note 4, at 699–700.

²⁴⁹ Cf. Ellickson, *supra* note 13, at 434 (suggesting that solution to problem of conspiring suburbs is higher level of government that can function like cartel manager). At least some scholars have proposed replacing local governments with regional governments. See David J. Barron, *Reclaiming Home Rule*, 116 HARV. L. REV. 2255, 2270–76 (2003) (describing this approach). Though I introduce the idea again, see *infra* note 276 and accompanying text, it would require a sufficiently radical departure from the existing state of affairs that it merits no further direct attention here.

²⁵⁰ Thomas S. Ulen, *Economic and Public-Choice Forces in Federalism*, 6 GEO. MASON L. REV. 921, 943–44 (1998) (discussing appropriateness of federal regulation for problems like acid rain). Early in the 1970s, Oregon, for example, adopted a statewide land use plan that sought to overcome common local externalities by centralizing the governing standards for land use in the state. For a description, see Liberty, *supra* note 211, at 589–95. Vermont also requires all towns to develop plans for providing affordable housing, thus

origin, and the question should be what kind of takings regime is likely to lead to an appropriate level of *local* government regulation.

Adjusting compensation could provide a judicial response to the problem of externalities, but it is more difficult to justify here than as a response to risk aversion. Viewed only as an incentive problem for efficient government decisionmaking, the presence of negative externalities suggests that governments should be forced to pay more in order to internalize those costs.²⁵¹ The presence of positive externalities suggests the opposite, but, because increasing benefits is not possible, governments should instead have to pay less to encourage efficient decisionmaking. An individual property owner will not care, however, whether a government regulation imposes positive or negative externalities, and it seems particularly unfair in this context to adjust her recovery because of these relatively abstract concerns—or so they would seem to her!—about regulatory incentives.²⁵²

One way to operationalize variable compensation, then, would be to disaggregate the amount of money the government has to pay from the amount the property owner receives. The property owner's recovery would remain constant, but the amount the government pays would vary depending on the presence of positive or negative externalities. This, in fact, was the provocative suggestion offered by Michael Heller and James Krier in response to a different problem.²⁵³ It is quite a radical solution, however, and focusing on the distinctive characteristics of local regulations reveals some more practical approaches to positive and negative externalities, respectively, like intergovernmental grants to subsidize some local government actions and interlocal liability to compensate for costs imposed by others.

seeking to overcome the externality problem facing local governments. VT. STAT. ANN. tit. 24, § 4345a(7) (2005).

²⁵¹ Clayton P. Gillette, Comment, *Interest Groups in the 21st Century City*, 32 URB. LAW. 423, 429 (2000) ("If externalization is the problem, then presumably we could address the issue by internalizing those costs."). A more radical proposal than this Article adopts would be to expand the range of property owners and consumers eligible to sue a local government for its growth restrictions. See Ellickson, *supra* note 13, at 450 ("To make local officials consider all the costs of their antigrowth policies, a suburb must be held prima facie liable for all substantial damages its growth controls inflict on consumers and landowners who lie beyond its boundary lines.").

²⁵² Unfairness is a more pressing concern here than above, because the variation depends only on the presence of positive or negative externalities, which have nothing to do with the harm suffered by the property owner. Adjusting compensation for local takings as opposed to state and federal takings at least arguably creates different harms. See *supra* notes 232–35 and accompanying text.

²⁵³ See generally Heller & Krier, *supra* note 31 (offering solution to competing concerns of creating efficient regulatory incentives for government and efficient investment incentives for property owners).

1. *Positive Externalities*

The existence of positive externalities means that a local government will undervalue the benefits of its actions. It might therefore require some extra inducement to make efficient regulatory decisions. In other contexts, that inducement already exists in the form of intergovernmental matching grants. When it comes to road maintenance, for example, states will often match some percentage of local government expenditures, because the benefits of good roads extend beyond local taxpayers.²⁵⁴ This same idea should be extended to takings of private property. Where a compensable land use regulation creates positive externalities, a higher level of government should pay part of any liability judgment against the local government, in effect to compensate the local government for the positive externalities it is creating.²⁵⁵

This proposal still requires difficult political judgments at the state level about how much to contribute to compensation by local governments. There is no single percentage that would take into account the various forms of positive externalities created by growth controls and land use regulations. Externalities will be quite heterogeneous even among a single class of regulations, like environmental protection. Some local regulations will be more or less effective at creating extralocal benefits. Preserving a wetland as a habitat may create far greater benefits than preserving a former parking lot, even if the size of the parcels is equivalent. But the extent of positive externalities will also depend on substantive judgments about the benefits of the externality. The value of preserving historical buildings, for example, is something about which reasonable minds can disagree.²⁵⁶

Admittedly, then, there are important valuation questions that must be addressed at the state level, where the political process is more complex.²⁵⁷ Nevertheless, intergovernmental grants offer a straightforward, if imperfect, way to incentivize those local regulations that generate positive externalities, even if such externalities prove

²⁵⁴ See DENNIS C. MUELLER, *PUBLIC CHOICE III*, at 217 (2003) (providing economic justification for claim that “[t]o achieve the Pareto-optimal supply of roads . . . a Pigouvian subsidy must be offered to a community per unit of roads purchased that equals the proportionate spillovers from its roads onto the other community”).

²⁵⁵ In the regulatory takings context, this proposal will apply wherever a damages remedy, as opposed to injunctive relief, is available. For a discussion of the remedies available to property owners, see text accompanying notes 187–91 *supra*.

²⁵⁶ E.g., Carol M. Rose, *Preservation and Community: New Directions in the Law of Historic Preservation*, 33 *STAN. L. REV.* 473, 484 & n.52 (1981) (describing debates around historic preservation and distinguishing it from “mere” aesthetic preferences).

²⁵⁷ For a discussion of potential political process failures at the state level, see *supra* notes 145–59.

hard to value with precision. Even if a state gets the pricing wrong, some compensation for positive externalities will often be better than none. The straightforward empirical question is whether compensating for positive externalities comes closer to reflecting the full range of benefits conferred by a local regulation than not compensating at all. The current no-compensation norm will only be better if compensation practices either vastly overstate the magnitude of positive externalities, thus creating a greater incentive to overregulate than the zero-compensation rule will create to underregulate, or if they flat out misidentify negative externalities as positive externalities to a similar effect. While both might sometimes occur, it is not too much of a stretch to think that some compensation will come closer to creating efficient incentives than a zero-compensation rule.²⁵⁸

The form of the grant, however, presents a more serious problem. Fischel has offered a compelling account of political failures that led to the infamous condemnation of Detroit's Poletown for retransfer to General Motors.²⁵⁹ He argues that Detroit engaged in what in retrospect turned out to be grossly inefficient land assembly precisely because of the form of intergovernmental aid for the project. He points out that most of the money came from the federal government in the form of grants earmarked for the specific project. If Detroit had not gone ahead with the plan, it would not have received this federal money at all. In Fischel's words, then, opposing the plan would have "looked like shooting Santa Claus."²⁶⁰ Or, less succinctly: As long as the grant was earmarked for a specific purpose, local decisionmakers did not have to face the opportunity costs of their actions. Fischel therefore suggests that an unrestricted grant would have been more likely to lead to better local decisionmaking.²⁶¹

²⁵⁸ Implicit in this claim is that overregulation and underregulation pose indistinguishable inefficiencies and that the goal of a compensation regime should be to come as close as possible to forcing the government to internalize the costs of its actions. A different model, call it the "Price Is Right" approach, might view the goal instead to be getting as close to full compensation as possible without going over. It is not at all obvious, however, what view of compensation could justify this approach.

²⁵⁹ Fischel, *Political Economy*, *supra* note 80, at 940-46; *see supra* notes 179-80 and accompanying text (discussing controversy surrounding *Poletown Neighborhood Council v. City of Detroit*, 304 N.W.2d 455 (Mich. 1981)).

²⁶⁰ Fischel, *Political Economy*, *supra* note 80, at 948.

²⁶¹ Fischel notes that:

The possibility of other uses for the money would have given those who objected to the Poletown project a leg on which to stand. . . . If the choice was to accept the money and then decide to do the project, Detroit would have thought much harder about the idea of clearing out the Poletown area.

Id.

An unrestricted grant, however, does not address the problem of positive externalities identified here, because it cannot ensure that the local government will actually create the positive externality that the intergovernmental aid is intended to stimulate. Imagine a proposed local regulation that would, in the state's judgment, create \$500,000 in positive externalities that a local government will not be able to capture. If the state gives an outright and unrestricted grant of \$500,000 to the local government, to compensate for the positive externalities, there is a chance that the local government may decide to forego the regulation, use the \$500,000 elsewhere, and never create the positive externality that the grant was intended to subsidize. On the other hand, if the state waits until the regulation has been enacted, local officials will not have been able to factor the grant into their decision-making, thus missing the whole point of such intergovernmental grants. Correcting for spillover effects therefore requires grants that are earmarked for the specific project.²⁶² Fischel's proposal of not earmarking intergovernmental funds only makes sense where the purpose of the intergovernmental aid is redistributive, as indeed it probably was in Poletown.²⁶³

When intergovernmental aid is offered to stimulate efficient local decisionmaking, requiring that the grants be earmarked for specific purposes has the added benefit of increased transparency. The amount of the grant is a straightforward expression of the state or federal government's judgment about the extent of the positive externalities a local project will create. This, in turn, may serve as at least something of a check on the political process failures that might otherwise be predicted at the state level.²⁶⁴

2. *Negative Externalities*

Negative externalities pose a more difficult problem for the creation of efficient regulatory incentives. Ratcheting up damages in the

²⁶² See MUELLER, *supra* note 254, at 220 (“[W]here matching grants are to be preferred to correct inefficiencies arising from intergovernmental spillovers, unconditional grants are optimal to eliminate the ‘interpersonal externalities’ that arise when the residents of wealthy communities contemplate the situation of people in poorer ones.”).

²⁶³ From the federal government's perspective, it did not care where General Motors's new plant was located, as long as it was somewhere in the United States. The substantial grants to Detroit to pay for the Poletown condemnations are easier to justify—to the extent they can be justified—as a redistributive program to help Detroit specifically. See Fischel, *Political Economy*, *supra* note 80, at 943 (noting that funding came from “federal programs designed to assist declining cities just like Detroit”).

²⁶⁴ Information costs are a significant impediment to meaningful political participation in state and federal decisionmaking. Cf. KOMESAR, *supra* note 46, at 181 (noting that Ronald Coase emphasized the importance of information costs in his “transaction cost approach” to institutional transactions).

face of negative externalities might reach the right result, but courts would have to tailor compensation to the magnitude of the negative externalities. Not only are the kinds of spillover effects that local governments create difficult for courts to measure, that difficulty is exacerbated by the fact that the people bearing those costs are not typically parties to the litigation.²⁶⁵

Nor is this a problem that can be addressed by neighboring towns' burdened property owners acting on their own. Individual property owners generally cannot recover for a mere decrease in the value of their property.²⁶⁶ In addition, the broader the harm imposed by a regulation, the less likely it is to be characterized as a taking, rather than a general burden of citizenship.²⁶⁷ This makes good sense where the costs of such regulations are imposed on voters. Their remedy is political—and the broader the burden, the higher the political cost. The story is quite different, however, where a local government imposes real costs on the voters of a neighboring town. The political remedy disappears, and yet there is no legal remedy to take its place.

The strange effect of current takings law is that a local government can escape takings liability where the burdens of its regulations are imposed broadly on residents of neighboring towns. Under the test derived in *Penn Central Transportation Co. v. City of New York*, as long as no single property owner suffers harms that go too far, then no private takings liability will lie, despite the fact that the magnitude of the combined harms greatly outweighs the benefits to the regu-

²⁶⁵ There is an additional fairness objection here. It is hard to justify the differences in awards that property owners would receive, as those differences would depend in part on whether or not some of the costs of the regulation are borne by other jurisdictions.

²⁶⁶ *Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal.*, 508 U.S. 602, 645 (1993) (“[O]ur cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking.”); see also *Cienega Gardens v. United States*, 331 F.3d 1319, 1340 (Fed. Cir. 2003) (finding “threshold requirement that plaintiffs show ‘serious financial loss’ from the regulatory imposition in order to merit compensation”). Indeed, a claim that one has lost the “best use” of his or her property has consistently been held insufficient because it states a claim for mere diminution, instead of the complete loss of all economic use. *E.g.*, *MacLeod v. County of Santa Clara*, 749 F.2d 541, 548 (9th Cir. 1984).

²⁶⁷ Mark W. Cordes, *The Effect of Palazzolo v. Rhode Island on Takings and Environmental Land Use Regulation*, 43 SANTA CLARA L. REV. 337, 385–86 (2003) (“[R]estrictions that are imposed pursuant to a broad regulatory program should require a greater economic impact Conversely, where a restriction singles out a relatively small number of landowners for regulation, then some lesser . . . economic impact might constitute a taking.”). But, in *Penn Central Transportation Co. v. City of New York*, the Court also noted that a law which has a more severe impact on some landowners over others is insufficient in itself to demonstrate a taking. 438 U.S. 104, 133–34 (1978).

lating town.²⁶⁸ Current takings law does not address these kinds of negative externalities.

What is really needed is a mechanism for local governments to recover the costs that they impose on each other directly or through decreased property values. One form would rely on class actions by potential property consumers.²⁶⁹ This option, however, comes with potentially massive transaction costs, primarily in the form of litigation expenses. A better solution would be to reconcile all costs on a single balance sheet, so that costs imposed by one local government can be offset against those imposed by another. This requires some form of liability between local governments themselves.

Intergovernmental liability would force local governments to internalize the extrajurisdictional costs of their actions, and it would also provide a remedy for burdened property owners in neighboring jurisdictions. If one locality can recover actual money damages for the costs its neighbors impose, it will need to raise less money from its own property taxes. This, in turn, translates into real savings for the burdened property owners, both in the form of lower property taxes and, less directly, in higher property values that come with the lower tax burden.²⁷⁰

What would this intergovernmental liability look like? Although there is precedent for interjurisdictional takings, something broader than takings liability, as it currently exists, would need to be available to account for the kinds of negative externalities that local regulations impose.²⁷¹ A local government would need to be able to represent all of its residents in seeking to collect for reductions in local property values, as well as for direct costs associated with a neighboring town's regulations, like increased road maintenance or burdens on local schools. Of course, costs imposed by a neighboring local government cannot be viewed in isolation, as a one-time interaction. There is a constant give-and-take (or, often, a constant take-and-take) that must be included in any assessment of extrajurisdictional costs. Imagine, then, some kind of comprehensive balance sheet. Costs imposed by

²⁶⁸ *Penn Central* liability becomes more common when the value lost is greater than 75%. See, e.g., *Yancey v. United States*, 915 F.2d 1534, 1539 (Fed. Cir. 1990) (finding diminution of 77% sufficient to constitute taking); *Fla. Rock Indus., Inc. v. United States*, 45 Fed. Cl. 21, 34–39 (1999) (finding that property devalued by approximately 75% constitutes taking).

²⁶⁹ This was Ellickson's provocative solution for creating efficient housing markets. See Ellickson, *supra* note 13, at 498–99 (describing hypothetical class participants and their prima facie burden).

²⁷⁰ For a discussion of the relationship between property taxes and property values, see FISCHER, *supra* note 11, at 40–42.

²⁷¹ See generally Schill, *supra* note 13 (discussing intergovernmental takings).

one government on another are offset by reciprocal costs flowing in the other direction. Only *net* costs need to be settled up periodically, say at the end of the fiscal year.²⁷²

There are a number of reasons to think that courts are not in the best position to oversee these balance sheets. The costs associated with litigating the impact of each regulation would likely distort regulatory incentives even more than the externalities themselves.²⁷³ Moreover, the content of the balance sheets would be quite difficult to assess on a case-by-case basis. Instead, then, this system of balancing interlocal costs and benefits would be better administered by the state, which could create uniform standards for assessing the value of each item on the balance sheet.²⁷⁴ Again, the question is not whether the state or federal government could get these costs exactly right but only whether imperfect assessments would come closer to generating efficient local decisionmaking than would ignoring negative externalities altogether. The guiding principal, however, must be to require local governments to compensate for the effect that their regulations have on neighboring property taxes and property values. As Part III demonstrated, these are the relevant costs for creating efficient regulatory incentives.²⁷⁵

There is a natural symmetry between the proposals for dealing with positive and negative externalities. Both require some form of interlocal redistribution, the former through intergovernmental grants by the state, the latter through state-imposed “taxes” for externalities (due to the neighboring communities). In fact, responses to both could be combined on a single balance sheet. Negative externalities

²⁷² Ellickson has given a compelling account of the different costs that local land use regulations can impose. Ellickson, *supra* note 13, at 392–402. Although by no means easy to measure in the real world, these costs provide a theoretical description of the substance of the proposed balance sheet.

²⁷³ Neil Komesar reminds us of the importance of including the costs of litigation in any serious proposal for reform. KOMESAR, *supra* note 46, at 19–22.

²⁷⁴ This, too, will lead to imperfect estimates. For a discussion of the difficulties associated with valuing externalities, see Dana, *supra* note 39, at 1267–69.

²⁷⁵ An alternative approach might require restitution for these kinds of interjurisdictional harms. If a local government were forced to pay for the gains it receives from exclusion, instead of the harms that exclusion imposes on others, local governments might be better deterred from undertaking such exclusionary measures in the first place. See HANOCH DAGAN, UNJUST ENRICHMENT: A STUDY OF PRIVATE LAWS AND PUBLIC VALUES 16–19 (1998) (arguing that compensation schemes reimbursing victims according to transgressors’ profits allow victims to recover surpluses they would have gained had transaction been voluntary). Deterring local governments from undertaking regulations that create more gain than harm requires some justification other than efficiency. Restitution might serve the interests of distributive justice, but that concern is outside the scope of this Article.

would be debits and positive externalities credits, perhaps even replacing the need for intergovernmental matching grants at all.

Notice, finally, that forcing local governments to take into account the full measure of the costs and benefits they impose resonates strongly with the local government literature advocating for regionalism—replacing local governments with broader regional governments.²⁷⁶ Instead of abrogating local sovereignty, however, this proposal would force local governments to consider the extralocal effects of their actions while still retaining explicitly local control. This Article's proposal is likely to come with higher administrative costs than true regionalism, but the benefits of retaining local control might justify the additional expense.

This Article's particular prescriptions aside, the problem of externalities at the local level is much bigger, and more evenly weighted between positive and negative externalities, than the current takings debate acknowledges. Externalities go far beyond the problem of uncompensated harms to burdened property owners. Indeed, the larger negative externalities are more likely to consist of smaller harms to a greater number of property owners, often in neighboring jurisdictions. These, in turn, will often be offset by concurrent benefits from any of a variety of positive externalities. If the goal of the Takings Clause is to force the government to internalize the costs of its actions, then all of these costs and benefits need to be taken into account. Dealing in isolation with any particular line item in the takings calculation will not advance the goal of creating efficient regulatory incentives. For example, forcing a local government to pay more property owners more often to compensate for regulatory burdens will not necessarily result in greater efficiency. In the face of positive externalities, increasing compensation may only further deter the government from enacting regulations that create a net gain.

CONCLUSION

There are differences between levels of governments that matter for the Takings Clause. While compensation's deterrent effect on state and federal governments has been problematized by recent public choice literature, its effect on local governments is relatively straightforward. Local governments are dominated by homeowners, and homeowners, through property taxes, foot the bill for most local government land use regulations. Making local governments pay

²⁷⁶ See Barron, *supra* note 249, at 2270–76 (describing “two-tiered” approach allowing local governments to retain authority in certain areas but to cede control over actions that create negative externalities).

does, indeed, force them to internalize the costs and benefits of their actions.

The traditional economic account of the Takings Clause does not apply perfectly to local governments, however, because it ignores risk aversion and the significant positive and negative externalities that come from local land use regulations and growth controls. To address the first problem, the expected cost of a regulation should be lowered for local governments. This means shifting compensation downward, limiting or eliminating litigation costs, and removing the threat of temporary takings. To address the problem of externalities, higher levels of government should contribute to local compensation, and local governments should be liable to their neighbors for a regulation's adverse impact on property values.

Whatever the willingness of courts and legislatures to adopt this Article's specific prescriptions, this much, at least, is now clear: Current criticisms of compensation as a cost-internalization mechanism cast too broad a net. It is, in fact, possible to identify the specific mechanisms by which local governments internalize the costs of their actions. With those mechanisms squarely in mind, we can see deeper limitations to the traditional economic account of the Takings Clause. There is more standing in the way of efficient regulatory incentives than ratcheting up the Fifth Amendment compensation requirement. This, in turn, calls into serious doubt the common refrain that the protection afforded by the Takings Clause needs to be increased in order to force the government to internalize the costs of its actions. Local governments generate both uncompensated costs and uncaptured benefits. Current compensation practices will not necessarily lead to overregulation. In fact, the opposite may be true. The stakes in the takings debate are so high that positions on both sides have become increasingly intractable. Recognizing that competing arguments do not apply with equal force in all situations is a first step to bringing a needed dose of reality to the discussion and, hopefully, some important new distinctions to the resulting takings doctrine.