PROPERTY RIGHTS: THE ESSENTIAL INGREDIENT FOR LIBERTY AND PROGRESS

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FOREWORD

IT was a pleasure to welcome our invited participants and guests for this conference to AIER's beautiful campus in Great Barrington to discuss something simple, yet often overlooked or taken for granted—that is, the right of individuals to be secure in their possessions.

Since its founding 72 years ago by Col. E.C. Harwood, AIER always has argued that the acquisition, enjoyment, and defense of private property is a fundamental right of man. We also have long embraced the fundamental dictum of equity justice, that no one has a right to take without compensation the fruits of another's efforts.

This conference was dedicated to a major pillar of AIER's educational mission: The study and promotion of property rights as a crucial ingredient for human progress. Our findings suggest that nations, regions, and localities that promote and preserve property rights tend to prosper over time, while those that give short shrift to the allocation and enforcement of property rights tend to lag behind.

The invited participants represented different backgrounds and viewpoints; their participation did not necessarily imply that they endorsed AIER's views. Rather, they kindly accepted our invitation to participate in this conference in a spirit of free inquiry aimed at expanding the supply of practical and applicable human knowledge, which was Col. Harwood's foremost goal.

Charles Murray
President

PROPERTY RIGHTS: THE ESSENTIAL INGREDIENT FOR PERSONAL LIBERTY AND DEVELOPMENT

Conference schedule

Thursday, November 4, 2004

Panel I: 9:00 a.m. to 12:00 noon
E.C. Harwood Library

Chair: Walker F. Todd, Conference Organizer, AIER

Tom Bethell, *American Spectator* and Hoover Institution, Stanford, CA
Private Property and Human Nature
Richard L. Stroup, Montana State University and Property and Environment Research Center, Bozeman, MT
Property Rights, Natural Resources, and the Environment
Hon. Richard A. Posner, Judge, U.S. Court of Appeals for the Seventh Circuit and University of Chicago Law School, Chicago, IL
The Importance of Property Rights in the Common Law Tradition [by telephone]
Walker F. Todd, AIER, *Discussant*
W. Lee Hoskins, Pacific Research Institute, Reno, NV, *Discussant*
Howard Segermark, Segermark Associates, Washington, DC, *Discussant*

Lunch: 12:00 noon to 2:00 p.m.
Helen F. Harwood Ballroom, Main Stone House

Panel II: 2:00 to 5:00 p.m.
E.C. Harwood Library

Chair: W. Lee Hoskins, Pacific Research Institute, Reno, NV

Panel on Development Finance:
Gerald P. O'Driscoll, Jr., Cato Institute, Reno, NV
Property Rights in Development Finance
Mary Anastasia O'Grady, Wall Street Journal, New York, NY
Property Rights in Latin America
Lord Robert Skidelsky, University of Warwick, UK, and House of Lords, London, *Discussant*
Ian Vasquez, Cato Institute, Washington, DC, *Discussant*
W. Lee Hoskins, Pacific Research Institute, *Discussant*

Presentation on Western Land Use:
E. Bruce Godfrey, Utah State University, Logan, UT

Property Rights and Public Land Management: What Have We Learned in the 200 Years Since Lewis and Clark?

Reception for all attending the conference: 5:00 to 6:00 p.m.
Living Room, Main Stone House

Dinner for all attending the conference who registered in advance: 6:00 to 8:00 p.m.
Helen F. Harwood Ballroom, Main Stone House

Friday, November 5, 2004

Panel III: 9:00 a.m. to 12:00 noon
E.C. Harwood Library

Chair: Gerald P. O'Driscoll, Jr., Cato Institute, Reno, NV

Discussion of the Godfrey Paper on Western Land Use:
Eugene Schroder, American Agriculture Movement, Campo, CO, *Discussant*
Howard Hutchinson, Arizona/New Mexico Coalition of Counties, Glenwood, NM, *Discussant*
Michael Nivison, Otero County Commissioner, Cloudcroft, NM, *Discussant [By recording, due to water shortage emergency]*
R. Russell Grider, Institute for Consumer and Rural Studies, Clovis, NM, *Discussant*

Panel on Eminent Domain:
Joyce Anagnos, Roetzel and Andress, Toledo, OH
Eminent Domain for Economists and the General Public: May the State Take Private Property for Public Use? For Private Use?
Patricia Salkin, Albany Law School, Albany, NY, *Discussant*
Bert Gall, Institute for Justice, Washington, DC, *Discussant [by telephone]*

Lunch: 12:00 noon to 2:00 p.m.
Helen F. Harwood Ballroom, Main Stone House

Conference adjourns

LIST OF PARTICIPANTS

Joyce Anagnos, associate, law firm Roetzel and Andress, Toledo, OH. Areas of concentration include eminent domain law, real estate, land use, zoning, and construction law; worked with Bechtel Corp. on the "Big Dig" road and tunnel project in Boston.

Tom Bethell, Washington correspondent, *The American Spectator*; Visiting Media Fellow, Hoover Institution, Stanford University, Stanford, CA; author of *The Noblest Triumph: Property and Prosperity Through the Ages* (1998), an intellectual history of property rights.

Bert Gall, staff attorney, Institute for Justice, Washington, DC. A noted property rights litigator, he currently represents New Hampshire homeowners challenging the state's mandatory home inspections law; worked on Lakewood, OH, eminent domain case.

E. Bruce Godfrey, professor of economics, Utah State University, Logan, UT; past president, Western Agricultural Economic Association (WAEA). Nationally known expert on the economics of using public and private lands.

R. Russell Grider, lives and farms in Clovis, eastern New Mexico; cofounder and president, Institute for Consumer and Rural Studies; former ethanol fuels coordinator for state of New Mexico.

W. Lee Hoskins, lives in Reno, NV; senior fellow, Pacific Research Institute, San Francisco, CA; former chairman and CEO, Huntington Bank of Ohio, Columbus; former president and CEO, Federal Reserve Bank of Cleveland; former member, Meltzer Commission for the study of international financial institutions.

Howard Hutchinson, lives in Glenwood, southwest New Mexico; executive director, Coalition of Arizona/New Mexico Counties; researcher and reviewer, Federal Lands Legal Foundation; nationally known consultant on county land planning issues.

Leonid Krasnozhon, AIER summer fellow in 2004, a native of Ukraine; prepared paper, "Lessons of Privatization: Property Rights on Agricultural Land in Ukraine;" graduate student in economics, Clark University, Worcester, MA.

Michael Nivison, lives in Cloudcroft, southern New Mexico; Cloudcroft village administrator; former Otero County Commissioner; retired San Diego fire captain, who moved back to his native New Mexico and found that, because of where he lived, he had to become an expert on western forest management issues and fighting forest fires.

Gerald P. O'Driscoll, Jr., lives in Reno, NV; senior fellow, Cato Institute, Washington, DC; former director, Center for International Trade and Economics, Heritage Foundation, and senior editor of annual Heritage *Index of Economic Freedom*, co-published with the Wall Street Journal; he was staff director of the Meltzer Commission.

Mary Anastasia O'Grady, senior editorial page editor, Wall Street Journal; writer and editor of Journal's weekly "Americas" column; leading expert on Latin American economic development.

Hon. Richard A. Posner, judge, U.S. Court of Appeals for the Seventh Circuit (Chicago); former senior judge of the circuit; lives in Chicago; senior lecturer in law, University of Chicago School of Law; prolific writer and holder of numerous honorary degrees; leading proponent of the law and economics movement and author of its most celebrated textbook, *Economic Analysis of Law*, 6th ed. (2003).

Patricia E. Salkin, associate dean, professor of law, and director of the government law center, Albany Law School, Albany, NY; currently teaches land use law, government ethics, housing law and policy, and issues in administrative law; noted author and expert on zoning, land use, and planning issues.

Eugene Schroder, trained large animal veterinarian, lives, farms, and ranches in Campo, CO. He and his father organized a "tractorcade" to Washington Mall in 1979; expert on the exercise of war and emergency powers derived from emergency actions in 1930s that never were terminated and their effects on western land use and agriculture.

Howard Segermark, president, Segermark Associates, a Washington, DC, government relations and association management firm; 18 years experience as congressional aide on Capitol Hill, culminating as economic affairs counsel to former U.S. Senator Jesse Helms (R-NC); senior trustee, American Motorcyclists Political Action Committee; member, Philadelphia Society, the Committee for Monetary Research and Education (CMRE), and the board of the National Civic Art Society. He is the author of "The Citizen Lobbyist."

Lord Robert Skidelsky, is best known to American audiences as author of monumental three-volume biography of John Maynard Keynes, 1983-2000. The third volume is *John Maynard Keynes: Fighting for Freedom, 1937-1946* (2000). He has written extensively on post-collectivism and other problems of development in transitional economies, with particular attention to the former Soviet Union; member, House of Lords, since 1991; former professor of political economy, Warwick University.

Richard L. Stroup, professor of economics, Montana State University, Bozeman, MT, and senior associate, Property and Environment Research Center (PERC) in the same city; leading advocate of reform of Endangered Species Act; one of the original proponents of New Resource Economics, currently known generally as free market environmentalism; author of several books on economics and the environment and public choice theory; former director, Office of Policy Analysis, U.S. Department of the Interior.

Walker F. Todd, visiting research fellow, AIER, organizer of the conference; lives in Chagrin Falls, Ohio, near Cleveland; attorney and economic consultant with 20 years' experience at the Federal Reserve Banks of New York and Cleveland; author of numerous publications on banking, central banking, and monetary topics; formerly taught Judge Posner's *Economic Analysis of Law* in law school.

Ian Vasquez, director, Cato Institute's Project on Global Economic Liberty; member, Mont Pélerin Society; term member, Council on Foreign Relations; author of numerous articles on the international financial institutions, development finance, and U.S. foreign relations.

INTRODUCTION

FOR two days in November 2004, the American Institute for Economic Research (AIER) hosted the conference "Property Rights: The Essential Ingredient for Personal Liberty and Development." The purpose of the conference was to review the origins of property rights and consider their importance in societies around the globe. Adam Smith and other classical economists had little to say about property rights, perhaps because they took private property for granted. The rise of collectivist theories in the nineteenth and twentieth centuries, however, led to a hard struggle to rediscover the importance of property rights. Since the 1960s, in particular, there has been a renewed interest in examining their role in law, economics, and society.

Examples from both history and recent experience around the world teach us that some forms of property work better than others. Properly defined and enforced, private property rights have been a key ingredient for promoting individual liberty and for creating incentives that lead to economic development and higher standards of living.

Yet there also is evidence the property rights alone are not sufficient. Efforts to reform property rights have faltered when they were not accompanied by other reforms, or when they failed to take into account the customs and institutions of each country. Moreover, some countries have achieved rapid economic growth in the absence of well-defined private property rights, China being a striking example. Whether this growth is sustainable is another subject of debate.

The issue of how best to define and enforce property rights is not a simple one. What works in one country may not work in others with different traditions, governments, and legal frameworks. Even in the United States, where property rights are more secure than in many parts of the world, defining and enforcing them is an ongoing challenge for legislators and the courts. The current legal debate over the appropriate use of the power of eminent domain—the right of governments to take private property for public use—is a case in point.

The conference participants included academic economists, law school professors, practicing attorneys, journalists, a Federal appellate judge, a former Federal Reserve Bank president, a member of the British Parliament, members of think tanks, and western farmers and ranchers dealing first-hand with land use issues.

Four panels of speakers provided historical perspectives and discussed current issues. One key insight was that even policymakers whom one

might expect to favor strongly the exposition, allocation, and enforcement of property rights often need some time and reflection to understand their importance and rise to their defense. One cannot expect Government automatically to defend property rights; too many special interests are continuously pressuring it to weaken them. Instead, informed individuals must lead the way and push Government to defend them.

First Panel: Background and Importance of Property Rights

The presenters in the first panel discussed the origins of property rights and how they achieved renewed importance in law and economics beginning in the 1960s. Tom Bethell said the need for private property originates in human nature rather than in philosophical arguments. Only three forms of property are possible, he said: private, communal, and state ownership. Communal property fails because it is at odds with reason and creates counterproductive incentives to be selfish. He gave the example of Plymouth Colony, where the communal approach led the Pilgrims to the brink of starvation, while the subsequent decision to give every family its own parcel of land led them to work harder and produce more food. State ownership reduces people to a state of serfdom, Bethell said, citing the Soviet Union and other failed experiments. Private property, he concluded, is the only arrangement that is conducive to both productive and moral society.

The next presenter, Richard Stroup, said that property rights reflect a society's prevailing ethical and moral norms. When properly defined and protected, they foster cooperation, mutually beneficial trade, and economic prosperity. Strong property rights also help to protect the environment, he said, by giving owners an incentive to properly care for what they own.

Pollution and overuse of resources become problems, Stroup said, when property rights are inadequately defined. In particular, common property with open access leads to overuse—a problem that Garrett Hardin famously described as "the tragedy of the commons." Stroup noted that privately negotiated and common-law solutions to environmental problems often work better than regulatory solutions, because they can more easily be adapted to changes in conditions, preferences, technology, and the like.

Participating by telephone from Chicago, Judge Richard Posner discussed the different approaches to property rights in the legal scholarship of recent decades. One strain, which goes back to John Locke, emphasizes the moral dimension of property rights. Another focuses on property rights as an instrument for promoting economic efficiency or economic welfare.

He addressed several current property rights issues, including eminent

domain, or the right of governments to take private property, with just compensation, for public use. The issue of what constitutes a public use is a difficult one; historically, he noted, governments have been allowed to use eminent domain to take property for the use of private companies (for example, railroads). More generally, property rights are not absolute. One challenge for the courts is to decide when a regulatory limitation on property becomes so damaging that it constitutes a taking. They must also figure out how to resolve conflicting property rights.

Judge Posner also spoke about the legal issues raised by intellectual property, such as copyrights and patents. He noted ground for concern that lawmakers increasingly are trying to transfer physical property rights to intellectual property. There is an economic argument, he said, for having a large public domain of intellectual property.

The discussants in the first panel agreed with much of what the presenters said. Walker Todd agreed with Mr. Bethell that the origin of property rights is the human faculty of reason itself. He observed that, in modern political economy, the competition is between state-centered theories of property rights derived from Thomas Hobbes and individual-centered theories derived from John Locke.

Lee Hoskins explained how, as a young economist at UCLA in the 1960s, in an atmosphere influenced by Armen Alchian, Harold Demsetz, and other noted economists, he discovered the importance of property rights both for economic analysis and for promoting the efficiency that is the driving force of economic growth. Howard Segermark described how collectivist ideas penetrated the policymaking apparatus of Washington in the 20th century and the intellectual battles waged by scholars, activists, and sympathetic politicians to turn that situation around.

Second Panel: Property Rights in Development Finance

The presenters in the second panel focused on property rights in development finance. Gerald O'Driscoll, for himself and his co-author, Lee Hoskins, presented a study on how development finance policymakers in Washington gradually discovered that the promotion and enforcement of well-defined property rights improved the prospects for sustainable development, in both poor and middle-income countries. He noted the influence of Peruvian economist Hernando de Soto in shifting the focus of official development efforts, away from lending money to governments and toward helping farmers and entrepreneurs by giving them clear titles to their land and reducing overly-bureaucratic licensing procedures.

Mary Anastasia O'Grady drew on her extensive travels and journalistic experiences in Latin America to observe that property rights, as we tend to

understand them in North America, do not exist there to any great extent. Whatever property rights do exist are undermined by governments, official corruption, and misguided land reforms that are often supported or forced upon Latin America by developed countries. Efforts to improve rights, such as De Soto's titling initiatives, have been hampered by bureaucracy and an inadequate legal framework.

Lord Robert Skidelsky, the eminent biographer of John Maynard Keynes, has devoted much study to the transitional economies of Eastern Europe and their experience since the fall of the Berlin Wall in 1989. He generated a fair amount of controversy by contesting the argument of O'Driscoll and Hoskins that well-defined and enforced private property rights are an essential ingredient of economic growth. He cited a study by Deepak Lal of developing countries that indicated that *stability* of property rights was more important than an efficient *distribution* of property rights. He also pointed to the Chinese model as another example that confounds the predictions of standard property rights theory. China has been growing rapidly for the past 25 years, he said, even though its property rights have remained famously "fuzzy."

Regarding the Godfrey paper (described below), Lord Skidelsky concluded that modern controversies about land use in the western United States arose from market failure. That is, not enough western land was sold to private owners before the Federal government intervened in 1933, because the economic incentives provided by earlier homestead acts were inappropriate for actual conditions in the West. He also addressed the question of whether nature, or land, is best preserved under private or public ownership.

Ian Vasquez, commenting on the O'Driscoll-Hoskins and O'Grady papers, said that Ms. O'Grady was correct in observing that property rights have never been respected in Latin America, and that limited efforts at reform, such as titling land efficiently, are not enough. Simultaneous reform of regulation and taxation are required. In Peru, for example, a lot of land has been titled in urban areas, but very little has been done in rural areas. In a general response to O'Driscoll and Hoskins, Vasquez said that successful long-term reform in Latin America would have to take greater account of actual conditions there. The institutions of one country are not easily transplanted to another, and the challenge is go out and see how people live in Latin America rather than draft programs in Washington.

Lee Hoskins commented on critiques by Lord Skidelsky and others of the effort to emphasize the role of private property rights in economic growth. He noted that planned economies sometimes seem to perform, in the short term, better than market economies, but, like the former Soviet

Union, they eventually crumble; it is too soon to tell whether China will make a successful and sustainable transition without introducing a system of strong private property rights.

Jerry O'Driscoll repeated a point made in the O'Driscoll-Hoskins paper, namely that, according to one study, property rights account for 70 percent of the international variation of per capita income. As he put it, property rights are both necessary and nearly sufficient for development: other factors, such as corruption, regulation, and the like, account for the rest of the variation. The contest in official Washington is between those who advocate "good public policy" (absence of corruption, enforcement of regulations, etc.) while downplaying property rights (a modification of this approach is what China supposedly is following), versus those who advocate the importance of property rights, understanding that they are a bundle of rights arrayed along a spectrum running from weaker to stronger enforcement.

He also commented on the role of primogeniture, the right of inheritance belonging exclusively to the eldest son. Although Lord Skidelsky said it was an important factor in strengthening private property rights in Great Britain, O'Driscoll said it played a less important role in the United States, where inheritances were more flexible.

During the development panel's discussions, Leonid Krasnozhon was introduced to the audience. A native of Ukraine, he is currently a graduate student in economics at Clark University and was a participant in AIER's Summer Fellowship program in 2004. His paper describes the evolution of property rights in Ukraine from the period of expansion of the Russian Empire more than 300 years ago through the Communist era to the present. Since the fall of the Soviet Union in 1991, various agricultural privatization initiatives have been attempted, but they have foundered or failed due to corruption, political interference, etc. Fourteen years after independence, Ukrainians living on rural lands still are not able to sell, transfer, or borrow against their land. Krasnozhon describes the factors that created this stalemate and outlines possible methods of resolving it. The Ukrainian experience is a useful case study of the kinds of problems that Lord Skidelsky has generally found in transitional economies, and that O'Driscoll, Hoskins, and Vasquez note with development finance in general.

Third Panel: Property Rights in Western Land Use

Bruce Godfrey presented a survey of land use in the western United States from the Lewis and Clark Expedition (1803-1806) to the present. He noted that Thomas Jefferson and all subsequent presidents until Theodore Roosevelt fully intended that newly acquired western lands would be sold

into private hands (or set aside as Indian reservations). The Homestead Act of 1862 began the wholesale private disposition of western public lands. However, beginning in the 1890s, Congress and the Executive increasingly were persuaded that unsettled lands in the West should be held permanently in Federal hands. Homesteading and other conveyances of Federal lands stopped in 1933, and all remaining Federal homestead laws were repealed in 1976. As late as the Clinton administration, new national monuments covering extensive tracts of land still were being created. Having come to own much of the American West, the Federal government still has difficulty allocating fair or efficient use of those lands.

Four fellow westerners commented on the Godfrey paper. Eugene Schroder of Colorado outlined emergency legislation and other policies in the 1930s that greatly expanded Federal regulation of land use, including grazing lands and the national forests. These laws effectively removed control of lands in the West from private, state, or municipal control. This arrangement, he noted, is seldom found in the East. Westerners, he said, are forced to deal with a remote Federal bureaucracy over issues that Easterners deal with at the local or the state level, including the control of grazing, forests, and water.

Howard Hutchinson of New Mexico reviewed Federal restrictions on forest use. He also compared the different forest management practices of a local Indian tribe with those of the Federal Government. The forests managed by the Apache Indians are healthy, comparatively free of wildfires, and serve as shelters for wildlife, while the national forests of New Mexico are overgrown, inhospitable to wildlife, and have been devastated by fire.

County and state initiatives are under way in New Mexico and Arizona to recover control of the forests, Hutchinson said. Recent Federal litigation in Nevada establishes that ranchers using Federal lands may acquire vested rights of access and water use. Litigation in New Mexico and Texas reopens the 1848 Treaty of Guadalupe Hidalgo, which guaranteed rights of land and water use to Indians and holders of Spanish and Mexican land grants when the United States acquired the Southwest from Mexico at the end of the Mexican War.

Michael Nivison, a municipal official in New Mexico, appeared by prerecorded message and described the devastating effects of forest fires on both the forests and water availability in the West. A former fire captain, he described how the overgrowth of forests in the last 25 years has created tinderboxes that have ignited into extremely intense fires (2,000 degrees Fahrenheit) that are much more difficult to fight than anything previously encountered. The proliferating trees in these forests also retain

water that might otherwise flow to watersheds serving local residents and larger urban areas of the Southwest, he added.

Russell Grider of New Mexico described recent efforts to regain local control of land use. For example, at the peak of the uncontrolled forest fires in New Mexico a few years ago, the state legislature passed a law allowing the state to take over control of the national forests in the event of an emergency. He also reviewed grass-roots responses to the negative economic impact of the North American Free Trade Agreement and to the Federal Government's role in agriculture, natural resources, and other areas. There is extensive interest in similar initiatives in neighboring states.

Fourth Panel: Eminent Domain and Takings for Private Use

The topic for the final panel proved to be especially timely. A few weeks earlier, the U.S. Supreme Court had agreed to hear a case involving the rights of state or municipal government to exercise the power of eminent domain, i.e., to "take" private property (with compensation) for the benefit of the public. The question for the Court is, what constitutes a valid "public use?" Specifically, may governments use eminent domain to transfer property from one private owner to another, if they believe that doing so will create jobs or generate more tax revenue?

AIER's interest in this matter was sparked by two controversial uses of the eminent domain power, in Lakewood, Ohio, and New London, Connecticut, to seize homes and transfer the land to private developers. The Supreme Court agreed to hear the New London case. Oral argument in *Kelo v. City of New London* was held on February 22, 2005; Scott Bullock, an alumnus of AIER's Summer Fellowship program who now works at the Institute for Justice, was the lead attorney for homeowner Susette Kelo. The case is undecided at this writing. The municipal officials who proposed the Lakewood taking were all voted out of office in the last municipal elections.

The first speaker on the panel was Joyce Anagnos, an attorney who became familiar with eminent domain matters through her work on the "Big Dig" road and tunnel project in Boston. She presented the general outlines of eminent domain law for the benefit of non-lawyers. On the narrow question of whether the U.S. and state constitutions prohibit governmental takings that are not for public use, she noted that the courts long have upheld takings for private use, including for rights-of-way and easements for railroads and utilities. The modern use of eminent domain to eliminate conditions of designated urban blight, she said, arose from a Supreme Court decision in the 1950s. Anagnos also said that any use of eminent domain raises a host of issues, such as how to determine "just

compensation" and compensation for damages.

Patricia Salkin, a noted academic authority in real estate and municipal planning law at Albany Law School, described the legal issues at stake in the Lakewood and New London cases, particularly the history of the *Kelo* case. Salkin predicted that the U.S. Supreme Court would not overturn the city of New London's exercise of eminent domain against Ms. Kelo, but thought the Court was likely to require compliance with a more exacting set of guidelines before such takings for private use could be undertaken in the future. A probable touchstone was language in the Connecticut Supreme Court's decision in *Kelo* to the effect that the availability of judicial review should deter municipalities from completely unwarranted takings and require fair compensation.

The last speaker, participating by telephone, was Bert Gall, an attorney for the Institute for Justice, a public interest law firm that frequently represents the interests of private property owners in eminent domain cases. (As noted, a colleague of Mr. Gall, Scott Bullock, was the lead attorney for Ms. Kelo in the Supreme Court's oral argument of the New London case. Gall himself was active in the defense of the homeowners in the Lakewood case.) He traced the beginning of the slippery slope of judicial language from the "public use" concept outlined in the Constitution to the modern "private use" concept. The latter can be traced, he said, to a 1954 Supreme Court's ruling which held that the slums in the District of Columbia were so bad that their mere removal would constitute a public use. Today, 50 years later, the concept of public use has been expanded by judicial decisions in roughly a dozen states to include purely economic benefit, like increased tax revenues.

However, Gall also noted that the courts in roughly an equal number of states have taken the opposite view and concluded that a purely economic taking is not a qualifying public use. It is that split of authorities that may have encouraged the Supreme Court to agree to hear the *Kelo* case. While hoping that the Connecticut Supreme Court's decision in *Kelo* would be reversed, he said that he believed that the Supreme Court would at least lay down firm guidelines for such takings.

AIER'S FOUNDERS AND ENVIRONS

Dinner Address by Fred Harwood in the Helen Fowle Harwood Ballroom on November 4, 2004 to Attendees of the Conference.

Thank you, Dr. Murray, and good evening.

This seemingly wild and remote part of Massachusetts became internationally famous for diverse economic reasons. Early in colonial times, both New York and Massachusetts briefly claimed the area between the Taconic Range to the west and the Berkshire Hills to the east. As any economist might predict, the economic openness created by that property rights dispute soon fostered enclaves of entrepreneurs. In that earlier and politically incorrect time, those entrepreneurs were known to be mostly horse thieves and tax evaders in hiding.

Still in colonial times, a goldsmith from Connecticut, Mr. Belcher, counterfeited the king's currency in a limestone cave adjacent to Main Street in Great Barrington. Today, Belcher's Square at the eastern intersection of Routes 23 and 7, in fine Yankee spirit, commemorates Mr. Belcher's silver cladding of small copper English coins.

More famous still and in the adjacent town of Egremont, Daniel Shays, a captain of the American Revolution, led Shays' Rebellion, which protested heavy property, poll, and whiskey taxes, compounded by judicial abuses, local depression, and extortionate rents paid to absentee landlords. The popular uprising began in August 1786, and its causes were debated at the summer 1787 Federal Constitutional Convention in Philadelphia. The negative reaction of property owners to Shays' Rebellion is credited with strengthening the role of central government, which would soon "establish justice and insure domestic tranquility." A limestone monument to Shays' Rebellion is in the town of Egremont, about four miles south of here.

Arising from such colonial chaos, the small town of Great Barrington garnered additional fame as the first in the world to enjoy alternating current street lights. William Stanley, chief engineer for George Westinghouse in Pittsburgh, moved to Great Barrington, where in 1886 he demonstrated the utility of his new electric power transformer by lighting offices and stores on the town's Main Street with an alternating current electric generator powered by water turbines on the local Housatonic River.

In 1902 Frederick Stark Pearson, an international hydroelectric and industrial engineer and a millionaire before age 30, attended an international electrical engineering meeting in Great Barrington, where he fell in love with the area and began acquiring property. By the time of his death by the German torpedoing of the Lusitania in 1915, he had acquired some

13,000 acres and built a large wooden English manor house atop this hill, right where this stone building now stands. He supported his manor with a nearby working farm, which included an extensive wild game preserve and prize-winning sheep.

Mr. Pearson was able to acquire his large property because, after the Civil War and the opening of lands west of the Mississippi, tenant farmers had voted with their feet and headed for free land. Absentee landlords in Worcester and Boston were happy to sell unproductive property to any taker.

Prentice Coonley, a Chicago stockbroker, purchased the idled farm, manor house, and some 500 acres in 1928. He burned down the manor house and began construction of this 35-room stone house. The husband of the Crane Plumbing heiress, he nonetheless speculated with and lost his fortune by 1932, when this house was about 90 percent complete. He, his wife, and two daughters never got to live in this Cotswold manor house or to enjoy their estate, which they appropriately had named Folly Farm. Fortunately, that's not the end of my story.

A 1920 West Point graduate stationed in Hawaii, Army Lt. Edward C. Harwood, began writing economics articles published in leading journals during the 1920s. He furthered his study of economics by reading most of the economics and philosophy books in the Schofield Barracks Library in Honolulu. He finally found coherence amid the jumble of opinions expressed in the various books when he read Henry George's *Progress and Poverty* (1879) and his explanation of the large difference between taxing labor and taxing land. At that time he also discovered that William James and John Dewey similarly had clarified a jumble of philosophical matters. Armed with the then uncommon economic weapons of George, James, and Dewey, he wrote broadly in the journals of the day. From several articles widely published in 1928 and 1929, he gained considerable economic reputation by predicting the coming stock market crash and subsequent Great Depression.

From 1923 to 1933, Dad published some 175 articles in various leading journals, including the *New York Times Analyst*, *Barron's*, *Bankers Magazine*, and others. Most of the articles dealt with the results of his continuing research into money and credit matters. While an associate professor in military science at Massachusetts Institute of Technology (MIT), in 1933 he published his *Cause and Control of the Business Cycle*, which was favorably mentioned by the Book-of-the-Month Club. (The reading public must have been quite different back then.) He also had personal correspondence with Lord John Maynard Keynes about Keynes's proposal to employ supposedly hoarded money as part of a cure for the Great Depression.

Those interested in his and Keynes's exchanges can find them in AIER's book, *Keynes vs. Harwood* (1985).

After turning down an invitation to head a Harvard brain trust assembled to end the Depression, with $200 and the encouragement of MIT's dean, Vannevar Bush, Dad assembled a small group in Cambridge in 1933 to conduct basic economic research, which Dad felt must precede economic policy recommendations. That group, which included my soon-to-be mother Helen Longfellow Fowle, formally associated as the American Institute for Economic Research, which finally incorporated in 1939 after AIER began to own property in its own name.

The Institute soon overburdened the MIT mail facility at 1200 Massachusetts Avenue in Cambridge and so moved to a refurbished building at 54 Dunster Street, near Harvard's main gate. After MIT, the Army assigned Dad as executive officer for the project of widening the Cape Cod Canal and overseer of the Corps of Engineers' Massachusetts Flood Control Program. His engineering studies proving no need for locks on the canal saved millions of dollars on the project and in 1935 won him a prize from the American Society of Civil Engineers.

AIER grew until World War II, when Dad was transferred to England and served with planners for the invasion of Normandy. He next was promoted to Colonel and transferred to Leyte with General Pat Casey to prepare for MacArthur's return to the Philippines. (Despite the war, Dad and Mother proudly claimed that AIER never missed an issue of its then weekly *Research Reports*.) For his war service, he was awarded the Legion of Merit and Bronze Star. While momentarily idled in New Guinea, Dad discovered the John Dewey-Eric Bentley collaboration on scientific method for the social sciences (*Knowing and the Known*, 1948). This discovery deeply influenced the rest of his life, leading to the writing of his and Rollo Handy's *Useful Procedures of Inquiry* (1973) and the adoption of Dewey's and Bentley's transactional approach to acquiring useful knowledge, a core aspect of AIER's scientific methodology.

During the war, Dad and Mother began a search for larger facilities, selecting for review three abandoned estates in western Massachusetts. In 1945 they purchased the core of Coonley's folly from a local lumberman. For just $25,000 they got this stone house, 110 acres of land to grow on, outbuildings, a pristine water supply, and views of three states.

In 1957 AIER added a small printing and mailing facility just to the east of this house and connected it by a convenient underground passageway to this building. From the lettershop the Institute recently printed in one year almost 9 million impressions, consisting of 6 million circulars, 300,000

Research Reports, and some 230,000 soft-cover books sent to subscribers and individual book buyers.

In 1963 the Institute moved into a new 10,000 square-foot research library, which in 1975 AIER's Board of Trustees formally dedicated as the E.C. Harwood Library. In 1968 three additional staff houses were built to the east of the library.

Over the past several years, the Harwood Library has been remodeled and now contains 20,000 square feet of offices, class rooms, and the auditorium filled yesterday and today with so many acclaimed critical thinkers dedicated to advancing property rights. Those interested in the details of our programs and research findings will find them in our publication, *AIER After 70 Years* (2003).

* * *

We here at AIER have long had great respect for the unique U.S. experience with individual freedom and property rights. In its May 1969 *Economic Education Bulletin*, "Can Our Republic Survive?" the staff presented its assumed conditions for survival, a portion of which I summarize here as Eight Requirements for a Progressing Civilization:

1. A progressive animal, the human supplements nature's bounty by applying the results of successful inquiry.

2. Humans advance foremost as they learn to cooperate in society.

3. The artifacts of petrified, decayed and decaying, and lost civilizations disprove any notion of inevitable progress.

4. Natural selection and its inheritance work too slowly to account for our progressing civilization. Moreover, no evidence exists that human mental capacity has improved over the past several thousand years.

5. Human progress advances from one generation to the next only as such progress adds to what we successfully can apply to the problems of society.

6. Associations within communities permit a division of labor and the economies of modern production.

7. Justice, individual freedom, and equality of opportunity facilitate voluntary cooperation, which avoids the large dissipation and utter waste of endless struggle for merely the basics of life.

8. When social adjustments promote justice, the equality of rights between people, and the perfect liberty that is bounded only by the equal liberty of others, civilization advances. When social arrangements fail in

these respects, the advance halts and even recedes.

The AIER Staff then concluded:

The U.S. Constitution states and implies four principal objectives, summarized as:

1. Society organized by Constitution, statute, and custom, so that each adult member continually will be influenced to cooperate with others. Such "rules of the game" are intended to preserve the maximum freedom for all persons, of large or small means, among the providers of goods and services.

2. Within society, equal freedom for individuals to plan and to choose their occupations, other activities, and goals.

3. For all, an equality of opportunity to seek their goals and their places in the economy.

4. To each person, the fruits of his own labors, not only as an incentive and reward, but also, and even more important for the nation, so that the person or business who demonstrates the most capacity to serve his fellow citizens will have increased means to become more and more effective on a larger and larger scale.

I add here, some 35 eventful years later, that abundant, diverse, and clear property rights, reaffirmed and lastingly protected by Constitution, statute, and custom, are essential conditions for more closely approaching those historic objectives.

Thank you.

PRIVATE PROPERTY AND HUMAN NATURE

Tom Bethell

Introduction: Natural and Philosophical Origins of Property Rights

THE need for private property in economic life originates in human nature. It does not depend on specific arguments that have been made for property, and is not weakened by arguments made against it. Whether we turn to Plato or Aristotle, John Locke or Karl Marx, and read what they say about property, their arguments pro and con have no effect on the underlying reality. Locke, for example, said that the privatization of common land could be justified if a man mixed his labor with it, as long as "there is as much and as good left behind." That gave rise to much criticism from political philosophers such as Jeremy Waldron and Alan Ryan.

Once upon a time I used to read their arguments with apprehension, lest I should find that my book was based on false premises.[1] Then I realized that it didn't make any difference what they, or indeed what anyone said. Even if no philosopher had ever come to its defense, the case for private property would be just as strong. That case is based on human nature, specifically on our ability to reason. We need private property because people can reason, not because certain reasons have been given for adopting private property.

How Property Rights Are Configured

Broadly speaking, three and only three configurations of property rights are possible: private, communal, and state ownership. In order to appreciate the case for private property, the best strategy is to contemplate its alternatives; of which as I say there are only two. That way, it can easily be shown that private property alone is consistent with the free exercise of the faculty reason.

To be sure, there are some goods with special properties that are best appropriated by the state. These are called "public goods." Military defense is the best example, and the police force is another. The justice system is a third. These goods have the peculiar property that it is difficult or perhaps impossible to prevent those who do not pay for them from sharing in their benefits. Modern technology can sometimes solve the problem of public goods, however. Roads are often considered to be public goods, but computerized toll-collecting devices attached to cars can allow fees to be collected from individual users with great efficiency.

It is striking, nonetheless, that the roles traditionally fulfilled by govern-

ment correspond precisely with the modern conception of public goods. Over the centuries, governments have provided defense, police and the machinery of justice; and it is difficult for markets to provide these goods. The obvious corollary is that when governments undertake to furnish those goods that markets are perfectly capable of providing, they do so badly, and expensively. Health care and education are preeminent examples, both much in the news today.

Inherent Problems of Communal Property, Illustrated by the Pilgrim Fathers

Let us consider the first alternative to private property—the communal arrangement. Visualize a commune. Its defining (and self-destructive) feature is that the rights to the use of goods produced by the commune are not defined. All communards may consume what they "need." A family is a (small) commune, but that usually works out well enough. In the first place, it is small enough to allow the parents to keep an eye on what is going on. And because they are bigger and stronger than the children, at the crucial stage, they are also able to enforce the rules that are needed to economize.

But consider what happens when the "family" consists of lots of individual families mixed in together. It will soon become difficult or impossible to enforce work and disciplinary rules. This happened at Plymouth Colony, when the Pilgrims arrived here from England in 1620. They adopted communal property at the outset and found it to be unworkable.

The property was held in common not for religious reasons, as some have supposed, but because the investors in England wanted it that way. They were afraid that if the colonists, 3000 miles away and unsupervised, had their own private houses and plots, they would spend all their time working for themselves, and not laboring to benefit the "common wealth." The investors were supposed to get half the proceeds or "dividend" at the end of seven years. Only with communal property could they be sure that they would get their share. At least that was the way they saw it.

It didn't work out, however, because by 1623 the Pilgrims were on the verge of starvation. Numbering about 150, they just couldn't get the communal arrangement to work, even though their lives depended on it. The same thing had happened 15 years earlier at Jamestown, where communal property had lead to death by starvation. It was called "the starving time." We know in greater detail what happened at Plymouth, however, because the governor of the colony, William Bradford, wrote it down in his journal. His key passage has become well known.

As hardship increased, the governor "assigned to every family a parcel

of land," according to the number of dependents. "This had very good success, for it made all hands very industrious, so as much more corn was planted than otherwise would have been by any means the Governor or any other could use," Bradford wrote. The change in ownership saved the Governor "a great deal of trouble and gave far better content. The women now went willingly into the field, and took their little ones with them to set corn; which before would allege weakness and inability; whom to have compelled would have been thought great tyranny and oppression."

With communal property, the community had been afflicted by an unwillingness to work, by a loss of mutual respect, and a prevailing sense of slavery and injustice. And this among "godly and sober men," Bradford reported. But after the land was divided, colonists immediately became responsible for their own actions, not for those of the whole community. Knowing that the fruits of his labor would benefit his own family and dependents, the head of each household was given an incentive to work harder. With communal property, he might reasonably suspect that any additional effort would merely substitute for the lack of industry of others. Communal arrangements practically guarantee that the industrious subsidize slackers.

Modern Illustrations of Communal Property Problems

We can see this in more detail in an apartment building where the utilities are "master-metered"—where there is a single meter for the entire building. Here the same problem arises but less conspicuously. The utilities bill for each unit is reached by dividing the entire bill by the number of units. In fact, this was the arrangement in the building where I was writing my book on property. Suppose I go away for a week in the summer. I leave the air conditioning on, because I know that if I turn it off the apartment will be hot when I get back and it will take a few hours to cool it down. Let's say the additional charge for my wasteful consumption is $15 and there are 300 units in the building. My bill at the end of the year will be 50 cents higher, but so will that of everyone else. The cost of my selfishness can be "exported" to everyone else in the building.

Now suppose that I am conscientious and frugal. Aware of my civic responsibilities, I turn off lights, turn down the heat in the winter and so on. Now I reduce the costs for everyone else in the building. In other words, the communal arrangement encourages me to behave badly. If I am selfish, others pay, if I am virtuous, others benefit. Now notice what happens when individual meters for each unit are introduced. If I use more electricity, my bill and only mine goes up. If I use less, I am rewarded with a smaller bill.

With individual meters, in other words, each unit owner has a bill that is

commensurate with his use. Each owner is "given his due." This is interesting, and important, because "rendering to each his due" is the classical definition of justice, found in Aristotle's *Nichomachean Ethics* (4th century B.C.), the *Institutes* of Justinian (6th century A.D.), St. Thomas Aquinas (13th century), and many others since. We have tended to lose sight of this in our own day, when the muddled and misleading concept of social justice has so often been substituted for justice proper.

We see, then, that private property itself goes some way towards institutionalizing justice. The boundaries of property can be compared to mirrors, which reflect back upon each individual owner the consequences of his actions. This, I believe, is the most powerful of all arguments for private property. But there are others. Without question, private property increases efficiency. Utility companies report that when individual meters are installed in large buildings, for example, electricity use will decline by as much as 20 percent. But the most corrosive feature of communal property, reported by William Bradford, and experienced by anyone who has ever lived in a commune, is that it generates a pervasive sense of injustice. The precautions that must be taken to minimize it are so costly that privatization turns out to be the logical and almost inevitable remedy.

The Free-Rider Problem and the Tragedy of the Commons

The problem of communes or communal ownership is sometimes called the free-rider problem. For about 100 years, it was rare to find any discussion of it in books about the foundations of economics. The person who did finally draw attention to it was Garrett Hardin in a famous essay called "The Tragedy of the Commons," published in *Science* in 1968. Common land to which all have access for grazing will become overused and denuded, he said. And at about the same time, we begin to find intelligent discussion of property among such economists as Armen Alchian (1965) and Harold Demsetz (1964) at UCLA and Ronald Coase (1960) at the University of Chicago.[2]

Garrett Hardin concluded his essay by pointing out that the problem could be solved "by private property or something formally like it." But it is striking that he was not interested in this solution. He saw the problem as one of overpopulation. In his later writings, he made it clear that he would rather curtail population by force than solve the tragedy of the commons with something as radical as private property.[3]

The free-rider problem is so severe and debilitating that communal arrangements for living and working more or less have to be ruled out from the start. There has been a widespread pretense that the Israeli kibbutzim do have communal property and that the kibbutzniks were able to make the

system work. What we are not always told, however, is that the kibbutz system (there were about 300 of these rural communes at one point, each with thousands of residents) was from the start heavily subsidized by the Israeli government.

To be sure, monasteries have been able to make communal property work; they are the rare exception. And some have endured for hundreds of years. But celibacy is a prerequisite. Families, as I said, are already communal, and parents must make considerable sacrifices to raise even their own children. This they are willing to do, but they will not do so to benefit the offspring of other parents who thereby enjoy a free ride. It is said that a Protestant community called the Hutterites have been able to combine communal property with child-rearing. But the descriptions of the severe communal discipline to which they must submit (no locks on doors, elders given ready access to the "private" dwelling places of other communards) only go to show how difficult it is to maintain a productive, non-celibate commune.

Inherent Problems of State Ownership and State Redistribution of Property

Now we come to the second alternative to private property. The free-rider problem can in theory be overcome by state ownership. If the state owns everything, including the people within its borders, a central planning agency can order people what to do and penalize them if they don't comply. "The theory of the Communists can be summarized by the single sentence: abolition of private property!" as Karl Marx said in the *Communist Manifesto* (1848). But as has been shown in practice, the problem of production is far too complicated to be solved in so extreme a way—one that involves reducing everyone to a state of slavery.

Nonetheless, a lengthy and pernicious experiment was conducted to put this remarkable theory to the test. The experiment was called the Soviet Union, and it endured for 74 years. The experiment was then extended to China, where it was abandoned after about 30 years in that country. It continues to this day in Cuba and North Korea. In the process, all these countries experienced tremendous privation, hardship and tyranny. Tens of millions of people died of starvation and tens of millions more died in concentration camps.

In 1991, the Russian president Boris Yeltsin had this to say about what had happened: "I think this experiment which was conducted on our soil was a tragedy for our people, and it was too bad that it happened on our territory. It would have been better if this experiment had been conducted in some small country at least, so as to make it clear that it was a utopian idea . . ."

The experiment was started, first and foremost, because it enjoyed strong support from many Western intellectuals. They relished the prospect of central planning because it meant that they would now be able to tell ordinary people what to do and how to live their lives. "A plan of production is a plan of consumption," as Walter Lippmann said in his trenchant and lucid criticism of central planning. "If the authority is to decide what shall be produced, it has already decided what shall be consumed." It followed that a plan of production was incompatible with voluntary labor. Lippmann's remarks were published in *The Good Society*, in 1937, seven years before Friedrich Hayek's *Road to Serfdom*. (Hayek made essentially the same argument.)

The communist experiments continued as long as they did for a variety of reasons, terror and coercion being uppermost. But let me draw attention to something else. There was a widespread pretense that these experiments were working—that they were achieving far higher levels of production than they were in fact. Western authorities collaborated in this deception. As recently as the 1989 edition of his famous textbook, Paul Samuelson said that "measured Soviet real GNP has grown more rapidly in the long run than have most of the market economies." Also in 1989, the *Statistical Abstract of the United States*, published by the U.S. Department of Commerce, claimed that GNP per capita in East Germany was higher than it was in West Germany—a manifest absurdity even at the time.

In edition after edition, Samuelson's textbook showed a graph of Soviet GNP, starting from a lower base but overtaking the GNP of the United States twenty years in the future. With each edition, the dates along the horizontal axis of the chart were updated, while the graph itself remained unchanged. Basically, the Commerce Department and the Central Intelligence Agency were getting their information from Moscow and not questioning it. The textbook writers were repeating the information, also without question, and the result was that throughout the entire period of the Cold War the leading economics textbooks in the Western world did not insist that private property was indispensable to economic development. The Soviet/CIA figures turned out to be greatly exaggerated, perhaps by a factor of ten.

One unfortunate consequence endures in the Third World today. The colonial empires in Africa and elsewhere disbanded at a time when the Western belief in the efficacy of planning was at a peak. To this day, it is rare to hear development experts in the Agency for International Development, the World Bank or the IMF say that what these countries need is not aid but secure, transferable private property rights. And until they really do have such rights, they will remain mired in poverty. Fortunately, some

large and populous countries, notably India and China, are figuring it out for themselves.

Meanwhile, in the Cold War period, a number of highly destructive land-reform experiments were carried out, overwhelmingly at the behest of the U.S. government. For a period of about 40 years, our national leaders were unwisely convinced that what was needed was the redistribution of property, not its privatization. Countries that were harmed by this folly included South Vietnam (which collapsed and was taken over by Communists within two years of the implementation of a very radical program), Chile (which also fell into Communist hands, if only briefly), Iran (where the Shah was destabilized and overthrown) and El Salvador (which survived as a free country only by the skin of its teeth).

The Classical Economists and Property Rights

It's worth noting that in the classical texts of political economy, private property was also neglected, but for a quite different reason: It was taken for granted. Adam Smith talked about "the sacred rights of private property," but did not analyze the issue. One might say that sacred things are deliberately not analyzed. There just was not any alternative to private property then on the table. In *The Wealth of Nations* (1776), Smith assumed the legal system that then prevailed in Great Britain. He did not think it was necessary to spell it out or identify its parts, and few people since have realized how difficult it is to achieve such a system.

Adam Smith gave pride of place (the first three chapters) to the division of labor, which the Nobel Prize winning economist George Stigler in 1976 identified as one of Smith's "regrettable" failures. The division of labor is not analytically helpful because it is involved in all conceivable production excepting only where Robinson-Crusoe conditions obtain. Stressing the division of labor does not help us to decide between one ownership arrangement and another.

David Ricardo (*Principles of Political Economy and Taxation*, 1817) likewise took private property for granted (and also called it "sacred"), as did Thomas Robert Malthus. But Malthus in addition gave us an important clue to his thinking. At the beginning of book 2 of his *Principles of Political Economy* (1820), he stipulated that property belonged to the province of "politics," not economics. Its security, he allowed, is among the "most important causes which influence the wealth of nations." But it depended on "the political constitution of a country, the excellence of its laws, and the manner in which they are administered." He did not intend to analyze these matters, he wrote. Ever since, economists have followed Malthus's example, and have been inclined either to neglect or take for granted the

institutional background of their subject. Knowing the structure of law on which an economy must be based if it is to function with any efficiency has not until very recently been regarded as an essential ingredient of economic analysis.

John Stuart Mill's *Principles of Political Economy* was published in 1848, and in the 19th century it exerted an influence comparable to that of Samuelson's text in the 20th. It turns out that his key chapter on property was rewritten at the behest of his radical wife, Harriet Taylor, to whom he was extremely submissive. The rewritten version appeared in all the numerous later editions of his book, and few people ever saw the original version. It did not become generally available until it was published (in 1965) as an appendix to the University of Toronto's 35-volume edition of Mill's *Collected Works*.

After Harriet Taylor died (in 1858), Mill wrote in his *Chapters on Socialism* (published posthumously in 1879) that "the very idea of conducting the whole industry of a country by direction from a single centre is so chimerical that nobody ventures to propose any mode in which it should be done." Actually, by then Karl Marx had proposed just that, along with the blanket expropriation of private property. Mill, to his credit, thought this both immoral and impractical. He countenanced only voluntary arrangements. (Marx and Mill lived in London at the same time but there is no evidence that Mill was aware of the fact or even knew of Marx's existence.)

The Classical Economists Confront Marx and the Notion of Progress

By the mid-19th century, all views on the desired institutional structure of society were increasingly colored by the idea of progress. This referred not just to progress as it applied to technology and science but to human nature. It was a general article of faith among intellectuals as diverse as Karl Marx and Herbert Spencer that people were getting better and better in their mental and moral makeup. Mill therefore argued that, although private property was essential for people "in their present state," they would in the future be more public spirited. In fact, the idea of progress seemed to reduce all criticism of socialism to mere pedantry. That criticism applied only to people as they were *now,* after all.

"All history," Marx said, "is nothing but a continuous transformation of human nature." *The Idea of Progress*, as J.B. Bury wrote in his book of that name (1920), was by the 1870s and 1880s becoming a general article of faith. There followed in the next quarter century a large literature of social science in which indefinite progress was "generally assumed as an axiom."

The Fabian socialists embraced the idea, and Darwinism was enlisted in

the cause of socialism. "The struggle for existence causes in the long run those races of men to survive in which the individual is most willing to sacrifice himself for the benefit of those around him," Alfred Marshall wrote. Marshall, the teacher of John Maynard Keynes, wrote a treatise entitled *The Principles of Economics*, published in 1890. It contains the remarkable statement that the need for private property "reaches no deeper than the qualities of human nature." And within a few years Leon Trotsky was asserting (in *Literature and Revolution*, 1924) that under collectivism:

"Man will become immeasurably stronger, wiser and subtler. His body will become more harmonized, his movements more rhythmic, his voice more musical. The forms of life will become dynamically dramatic. The average human type will rise to the heights of an Aristotle, a Goethe, or a Marx. And above these heights new peaks will rise."

I happened to be working at the Hoover Institution when I came across Alfred Marshall's remarkable comment about human nature. Exactly 100 years had elapsed since he had published it, and the Berlin Wall had recently fallen. I saw Milton Friedman going up the stairs in front of me and so I repeated the Marshall comment and asked him what he thought. "No deeper than human nature?" Friedman repeated. "I would say that goes pretty deep."

The socialist experiment was over. Reforming human nature had proved to be impossible, with or without the Gulag.

Reflections on the Russian Revolution

In his *History of the Russian Revolution* (1995), Richard Pipes wrote that the Soviet experiment had been "the most audacious and most determined effort in the entire history of mankind to reshape human nature and redesign human society. . . . It was something new in history both in conception and implementation: an attempt to launch humanity, by compulsion, on paths it had given no prior indication of wishing to tread."

Notice what had happened since the time of Adam Smith. Private property went from being "sacred" to being vilified without so much as an intermediate stage of analysis. It was certainly never studied by Marx before he launched his blazing attack. And by the time the great destruction of the Communist experiment was unleashed, the prevailing assumption was that private property was at best a necessary evil, and at worse a manifestation of human wickedness and greed.

I said at the beginning that private property was indispensable for economic production because human beings are endowed with the faculty of reason. When intellectuals in the 19th century dreamed that human nature

could be changed, or reformed, they did not realize that they were reposing their faith in the abolition of something so fundamental as the faculty of reason.

We have seen that only two ownership arrangements are possible other than private property. Communal property is directly at odds with the faculty of reason because people quickly learn in a communal environment that they are rewarded if they act selfishly and punished if they act selflessly. These immensely counterproductive incentives can only be overcome by dividing up the property. At that point, a proper ratio is established between effort and reward. This benefit brings with it the establishment of an institutionalized or "social" justice.

As to the remaining alternative, state ownership: From the time when it was first proposed, it was shown that it could only be made to work if a central planning agency was empowered to tell people what work they must do and what goods and services they must consume. State ownership therefore takes away from the people their ability to calculate and make their own choices, based on how the opportunities look from their individual perspective. They are therefore reduced by planning to a state of serfdom. Their faculty of reason must be suspended. Citizens become prisoners, which is why walls have always had to be built around Communist countries.

Conclusion: Private Property Rights Are the Only Viable Alternative

Private property is the only institutional arrangement that leaves the faculty of reason intact, in a way that is conducive to productive and moral outcomes. We may conclude that a productive society must be based on private property. No alternative exists, and we can safely assume that no alternative to it will be found in the future.

Endnotes

[1] Mr. Bethell's book is an intellectual history of property rights, *The Noblest Triumph: Property and Prosperity Through the Ages*, New York, NY: St. Martin's Press (1998). – Editor

[2] These classic articles are as follows: Armen A. Alchian, "Some Economics of Property Rights," reprinted in his *Economic Forces at Work*, Indianapolis, IN: Liberty Press (1977), pp. 127-149, reprinted from *Il Politico* (1965); Harold Demsetz, "The Exchange and Enforcement of Property Rights," *Journal of Law and Economics*, vol. 7 (October 1964), pp. 11-26; and Ronald Coase, "The Problem of Social Cost," *Journal of Law and Economics*, vol. 3 (1960), pp. 1 *ff*, reprinted in Avery Wiener Katz, ed., *Foundations of the Economic Approach to Law*, New York, NY: Oxford

Univ. Press (1998), pp. 69-79. – Editor

[3] On the 35th anniversary of this article's publication, *Science* commemorated Hardin's "remarkable essay." Nine articles and an editorial on "Sustainability and the Commons" covered 25 pages of the magazine; but still with barely a nod in the direction of private property. *Science*, December 12, 2003, pp. 1861, 1906-1929.

COMMENTARY

Walker F. Todd

I want to commend Tom Bethell for doing exactly what I wanted, which was to provide a broad overview in the opening paper of what this subject is all about. I think he did a marvelous job. And it's a harder job than many of you might imagine, pulling together the kind of intellectual history that Tom accumulated for his book. I know because I've tried doing some of that myself.

My introduction to the intellectual history of property rights was via teaching Judge Richard Posner's textbook on law and economics, *Economic Analysis of Law*, at Cleveland-Marshall College of Law, Cleveland State University, for a number of years. Around the time I began teaching there, in the late 1980s, Lee Hoskins walked into my life as my boss at the Federal Reserve Bank of Cleveland. Lee kept talking to me, and to anyone else who would listen, about property rights, but he created the phenomenon that Tom described in his remarks here today: None of the economists in the Research Department seemed to have a clue about what Lee was saying.

My own and my fellow economists' ignorance of the subject at the time reflected what Tom accurately, I think, described as the 100-year gap in the intellectual debate from the second half of the 19th century to fairly recent years on the whole question of whether property rights have any importance at all in economic policy discussions.

I worked for the Federal Reserve System for 20 years, and the Fed basically took a somewhat cavalier approach to property, as you know. Wage and price controls in 1971, or credit controls in 1980: Not a problem. The Fed went along with administering those programs just to carry out the policy whims of the moment. And it was always amazing to me to discover the comparatively light and transient, often purely political, grounds on which truly important principles of individual liberty, on the one hand, and necessary and fundamental economic principles, like respect for and defense of private property interests, on the other hand, were set aside.

At an even more important turning point in American economic history, 1933, there was a similar abandonment of what good and well-informed men in high places knew should have been defended, especially private property rights. An article that I originally drafted for the Federal Reserve Bank of Cleveland was published here by AIER in 1995 that covers that phenomenon: *The Federal Reserve Board and the Rise of The Corporate State: 1931-34*. It basically is a study of how a man like Herbert Hoover,

who had been trained by a good school, Stanford University, and who grew up in Iowa, where he acquired a common-sense view of right and wrong and respect for private property rights, could become isolated from his principles under the political pressures of the crisis of that time. Increasingly, influenced by people associated with the Federal Reserve Board at the time, Hoover made further and further inroads against the classical liberal understanding of how our government was suppose to work. By the time of the election campaign against Franklin D. Roosevelt in the fall of 1932, and as Roosevelt prepared to take office in the late winter and early spring of 1933, the groundwork had been pretty much prepared for the kind of thoroughgoing transformation in the treatment of property rights that occurred with the coming of the New Deal. In other words, it wasn't as though there was a night-and-day switch between the world of Calvin Coolidge up to 1929, on the one hand, and the world of the New Deal planners in 1933-1934, on the other hand. There was a transition, and it was not abrupt.

In May 2002, we here at AIER published an *Economic Education Bulletin* that I wrote, "Property Rights: Origins and Theories." I tried summing up there in about four pages what Tom Bethell wrote about in his full-length book. Also, since around 2000, we have been having lectures on or teaching a course on property rights in our summer fellowship program. The course has been taught since the summer of 2002.

I want to make a few more remarks on the importance of the study of the intellectual history of property rights. First, I admire and agree with Tom Bethell's remark that the origin of property rights is the faculty of reason itself. It is difficult to see how reasoning man could arrive at a system of government of society without eventually coming to grips with respect for individual property rights. Yet, as Tom's remarks indicated, men have tried to operate societies with few or no property rights throughout the ages.

You will note on the first page of the conference brochure that I reproduced the following quotation from James Madison's *The Federalist* No. 10 (1787): "The diversity in the faculties of men, from which the rights of property originate, is not less an insuperable obstacle to a uniformity of interests. The protection of these faculties is the first object of government." He's saying, "Get over it, folks. Property distributions are unequal. It is government's first duty to defend that unequal distribution of property because the diversity of property holdings originates in the diversity in the faculties of men." Some men can be comparatively intelligent but still have a very poor record of hanging onto the private property that has passed through their hands over the years. And others might not have much

in the way of book learning, but they can be very good at accumulating property over their lifetimes. Some people are better at it than others. Let us simply recognize that fact. And it is the duty of government confronting this situation to preserve and protect those diversities in both the faculties for acquiring and the acquisitions of property, much more than it is the duty of government to say, "Because we think that society would work better if we did so, we shall undertake to smooth off the rough edges and begin to equalize whatever property distributions that we encounter."

The modern political economy debate on the origins of property rights ultimately comes down to an intellectual history contest between the Hobbesian and the Lockean views of the origins of property rights. If you read *Leviathan* by Thomas Hobbes (1651), he has some interesting passages on the origins of property. I have always characterized his writings as the beginning point for modern, state-centered theories of property rights. Hobbes basically argues that you wretches out there are lucky to have any property at all. And you wouldn't have any property in the absence of a strong prince because the barbarians and pirates would take it from you by force if there were no strong prince, sword in hand, ever at the ready to defend your property interests. You'd be better off transferring all power to the prince for the purpose of defending your property. And therefore, when the prince does something to you that you don't like, you should not complain. He's essentially doing it for your own good in the long run. And besides, you consented to his having that power.

Now contrast that view of the origin of property rights with the one that John Locke set out a generation later. My variation of Tom Bethell's description of Locke's theory of property rights is basically as follows: If a man picks up some acorns out in the forest under an oak tree and takes them home and boils them and makes a soup from them, then consumes the soup, he has taken in nourishment from and fully made those acorns his own. Because he has consumed the acorns, how can anyone else argue that somebody else has any property in those acorns? They are already inside the man. Locke writes that it is by the infusion of man's labor with the things of nature that a person establishes a property right in them.

Locke's theory is the point of origin of an individually centered theory of property rights. I believe that the Lockean theory of the origins of property rights is more congenial to classical liberal doctrines about property rights generally than the Hobbesian theory. I also learned in doing my own research that the origins of property rights were sometimes (often? usually? perhaps nearly always?) historically tied up with military service. Often it was military service that established the distribution of property in a society, determining who had primacy in distributions or by what stan-

dard the property was to be parceled out.

There are a lot of writings on theories about the decline of the Roman Empire in particular that essentially would say that the origins of modern private property holdings, along the frontiers of the Roman Empire, basically grew out of the military service that Roman and barbarian soldiers performed for Rome, both as a condition of holding land and as the principal means of acquiring land. I believe that, even down to within the last century, in the Anglo-American legal tradition, at least, the concept of property transfers in exchange for military service is still present. This idea underlay the willingness of Anglo-American property holders to take up arms, if need be, to defend it. Not since the American Revolution, I suppose, have we had a general principle to the effect that, if you want to acquire land, then you should perform some military service, and then we'll give you land in compensation for it. Even since those initial distributions, the principle that seems to work here, I think, is that if you have private property, you should be prepared to take up arms to defend it.

Finally, I think that property rights and the holding of property always have been intertwined, in the Anglo-American legal tradition at least, with civic or civil rights: the right to vote, the right to hold public office, and things of that nature. Even as strong a civil libertarian as Thomas Jefferson, when he was drafting the outlines of his original Northwest Ordinance in the early 1780s, laid out minimum property requirements for holding public office.[1]

In documents of the era of the Framers of the Constitution, like the Northwest Ordinance and the original constitutions of several states, it was made quite clear that, if you wanted to vote in a community, you somehow had to resolve the dilemma of whom to admit to the franchise. Should it be only property holders, those who clearly have the greatest stake in defending the community, with arms if need be? Should it be property holders of only a certain qualification? That is, often you had to own so many acres or produce so much in dollar value of goods per year on your land before you could have the right to vote or hold public office.

Earlier, in 1647, during the English Civil War, members of Cromwell's army, middle-class soldiers, not noblemen, drafted a constitutional document and presented it to Parliament in 1649. The draft document was called the Agreement of the People. One of the main questions to be resolved in the Agreement was, who is allowed to vote? Should the franchise be restricted to property holders only? If a broader franchise were desired, should one include beggars? Indentured servants? How far down the line from freeholding property owners should one go in expanding the franchise? In the event, beggars and indentured servants were excluded.

In the American constitutional debates more than a century later, this issue was sidestepped by agreement that each state should prescribe the qualifications of the voters and the manner of conducting its presidential elections. There were different property ownership standards for voting from one state to another. How recently have you moved here? How tied to the community are you if you don't own any property here?

These are the kinds of issues that are raised by deliberation on themes like those that Tom and I have discussed and written about and taught over the years. If Lee Hoskins showed up in my life for the first time today, now I'd be able to understand why he thought property rights were important.

Endnotes

[1] The Northwest Ordinance of 1787, for those of us who live north and west of the Ohio River, is a very important fundamental document. It was enacted by the Continental Congress even before the Constitution was adopted (1788). It is the organic law of the territory northwest of the Ohio.

PROPERTY RIGHTS, NATURAL RESOURCES, AND THE ENVIRONMENT

Richard L. Stroup

A property right is a socially enforced right to select uses of an economic good. A private property right is one assigned to a specific person and is alienable in exchange for similar rights over other goods.

—Armen Alchian, "Property Rights"[1]

Introduction: Definitions of Property Rights

THE definition quoted above from Alchian captures the essence of how economists use the two terms: property rights and private property rights. A society establishes property rights, typically by recognizing what neighbors have worked out, and can help an owner enforce them in a number of ways. Government agencies, such as courts, are often important in specifying rights in specific situations and settling disputes about them, and the police force helps to enforce them. But government does not act alone. Informal actions, as when citizens shun a thief who has violated a property owner's rights, or refuse to deal with businesses of bad reputation, often play an important role also. A society's prevailing ethical and moral norms are a powerful influence on both the law and the informal actions in that society. Property rights are an expression of those norms.

We live in a world of scarcity, and scarcity guarantees that individuals will compete for scarce goods and resources, making it imperative that the rules of competition favor mutually beneficial cooperation—gaining by trading for example, and competing with better, more productive offers of exchange—rather than destructive competition—fighting for example. Property rights, when properly defined and protected, do exactly that. They enable mutually beneficial trade, encourage both conservation and production for trade, and outlaw violence and other destructive means of competition. To understand property rights, then, is to understand how a society can put itself on the road to internal peace, economic prosperity, and a protected environment as well. As we shall see, nations with strong property rights are doing just that, while those without them do far less for their citizens. We turn now to a discussion of how and why property rights work so well in the real world around us.

A strong private property right to a home, a bicycle, or a piece of land provides three things to the owner: (1) the right to exclusive use, (2) legal protection against invaders: those who would seek to use or harm the property without the owner's permission, and (3) the right to transfer to (exchange rights with) others on any terms that are mutually agreed upon.

Private owners can use their property as they wish, so long as they do not infringe on the rights of others. An owner cannot use property in a manner that invades or infringes on the property of another. I cannot throw the hammer that I own through the window that you own. That would violate your property right to the window. The same is true if I operate a factory that harms you or your land by spewing harmful air pollution. Because an owner has the right to control the use of property, the owner also must accept responsibility for the outcomes of that control. Policies that reduce any of these rights are said to weaken the owner's property right.

The Effects of Property Rights on the Lives of People

In national economies where private property rights are stronger, prosperity and growth are stronger, also. The evidence on this has been growing in the economics literature.[2] Since the collapse of socialist economies in the former Soviet Union and allied nations, few economists would disagree that economic growth and prosperity are furthered in an important way by secure and tradable private property rights. Furthermore, people live longer and have better access to clean water as well in regimes with established property rights. A study using international ratings on property rights and health-related data from more than 100 nations by Wheaton College economist Seth Norton finds that in nations with more strongly protected property rights, 93 percent of the population has access to safe drinking water, while in nations with weak property rights, only 60 percent of the population has that kind of access.[3] Similarly, in the nations with stronger property rights, 93 percent have access to sewage treatment, while only 48 percent do in countries with weak property rights. Longevity is affected in a similar way. Life expectancy is 70 years in nations with strong protection of property rights, while it is only 50 years in nations without that level of protection.

Some people attribute these differences to the fact that economically free nations are generally wealthier, and it is this wealth that makes the difference. However, similar results can be seen when focusing solely on poor nations. Among poor nations, those that offer relatively stronger property rights protection see 95 percent of their population live to age 40, while in the nations with weaker protection of rights, only 74 percent of the people live to age 40. In rich nations or poor, property rights make an important difference. These findings suggest that, in protecting water supplies and providing access to clean water, as with the provision of other goods and services, a system that protects private property rights is superior to one relying on direct government control.

How Private Property Rights Help an Economic System Perform Better

Clearly defined and enforced private property rights are a key to eco-

nomic progress and the welfare of individual citizens because of the powerful incentive effects that follow from private ownership of goods and resources. The following four factors are particularly important.

1. Private owners can gain by employing their resources in ways that are beneficial to others, and they bear the cost of ignoring the wishes of others. Home owners may have every right to use unusual paint colors and countertops in their houses, but most use neutral colors because that alienates the fewest potential buyers and improves the resale value of the home. A private owner bears the cost (in terms of a lower selling price) of ignoring the wishes of others who might be potential buyers. On the other hand, fixing up a house and doing things to it that others find beneficial give the owner the benefit of a higher selling price. The value of an asset depends on the value that *others* place on it.

Consider the private owner of a plot of undeveloped land near a university. The owner has many options. The land could be left undeveloped, made into a metered parking lot, or be sold as a site for a restaurant, office building, or rental housing. Will the wishes and desires of the nearby students and staff, who do not own the land, be reflected in the owner's choice? Probably so. Whichever use is more highly valued by potential customers will earn the most for the owner. If housing is relatively hard to find but there are plenty of restaurants, the profitability of using the land for housing will be higher than the profitability of using it for a restaurant. Private ownership provides a strong incentive to cater to the wishes of others as to the use of the owner's property. If the property is left totally undeveloped, withholding it from these potential uses that would benefit the nearby students, the owner will lose the potential income from the property.

Finally, consider Mary, the owner of an apartment complex near the same campus. She may not personally appreciate swimming pools, workout facilities, study desks, or green areas, for example. Nonetheless, private ownership gives her a strong incentive to provide these items if potential customers value them enough to cover their cost. Why? She will be able to lease the apartment units for more if they include amenities that are highly valued by others. Investment property owners have a strong incentive to consider the desires of others.

2. The private owner has a strong incentive to care for and properly manage what he or she owns. Ed owns a car. Will he change the oil in his car when it is time to do so? Will he take care to see that the seats do not get torn? Probably so, since being careless about these things would reduce the car's value, both to him and to any future owner. The car and its value—the sale price if he sells it—belong just to Ed, so he would bear the burden of a decline in the car's value if the oil ran low and ruined the engine, or if the

seats were torn. Similarly, he would capture the value of an expenditure that improved the car, such as providing a new paint job. As the owner, Ed has both the authority and the incentive to protect the car against harm or neglect, and even to enhance its value. Private property rights concentrate the owner's interest and attention, providing a strong incentive for good stewardship.

The incentive for good care and management by the individual extends also to private investments that yield income. The owner of a hotel does not want to neglect electrical or plumbing problems, if taking care of them now avoids large repair costs due to electrical fires or water leaks. The wealth of the owner, in the form of the value of hotel ownership, is a hostage to the owner's good management. Poor management will reduce the hotel's value, and thus the owner's personal wealth. The drop in value occurs as soon as a property appraiser can see the problems that will increase costs or decrease revenues in the future. Even the ability of the owner to borrow against the hotel's value is compromised immediately. Again, ownership concentrates the owner's interest and attention on good management of the asset owned.

3. The private owner has an incentive to conserve for the future if the property's value is expected to rise. Suppose our man Ed owns a case of very good red wine, which is only two years old. Age will improve it substantially if he stores it properly in his cellar for another five years. Will he do so? Well, if he does not, he will personally bear the consequences. He (and presumably his friends) will drink wine sooner, but they will sacrifice quality. Also, Ed will forgo the chance to sell the wine later for much more than its current worth. The opportunity cost of drinking the wine now is its unavailability later, for drinking or for sale. Ed bears that cost. Private property rights assure that Ed has the authority to preserve the wine and that he gains the benefits if he does so. If the greater quality is expected to be worth the wait, then Ed can capture the benefits of not drinking the wine "before its time."

In a similar way, if Ed owns land, or a house, or a factory, he has a strong incentive to bear costs now, if necessary, to preserve the asset's value. His wealth is tied up in its value, which reflects nothing more than the net benefits that will be available to the owner in the future. So Ed's wealth depends on his willingness and ability to look ahead, maintain, and conserve those things that will be highly valued in the future.

4. With private property rights, the property owner is accountable for damage to others through misuse of the property. Private ownership links responsibility with the right of control. Ed, the car owner, has a right to drive his car, but not in a drunken or reckless way that injures Alice. A chemical company has control over its products while it owns them, but,

exactly for that reason, it is legally liable for damages if it mishandles the chemicals. In a working system of private property rights, courts of law recognize and enforce the authority granted by ownership, but they also enforce the responsibility that goes with that authority. Once again, property rights hold accountable the person (owner) with authority over property, concentrating the owner's attention on avoiding the cost of liability for damage done.

The incentives provided by the private ownership of property encourage constructive action and discourage waste. As we shall see in more detail later, private ownership provides accountability, freedom, and the possibility of competitive markets. Thus, these incentives provide the foundation for cooperative behavior among individuals. Private property rights and the markets they enable provide each individual, however selfish or narrow-minded, with both the information and the incentive to engage in productive activities and cooperate with others. When private property rights are protected and enforced, permission of the owner is required for the use of a resource. The user of a good or resource must either buy or lease it from the owner. Each user, then, faces the cost of using scarce resources. Furthermore, an owner whose actions are directed by market price signals will have a strong incentive to consider the desires of others and to use and develop resources in ways that are valued highly by others. The resulting market exchanges generate what F.A. Hayek, the 1974 Nobel laureate in economics, called the "extended order." Hayek used this expression to describe the tendency of markets to direct individuals from throughout the world to cooperate with each other in mutually beneficial ways, despite the facts that they do not know each other and that they often have vastly different backgrounds, lifestyles, and cultural values.

In contrast, in a community that does not recognize private ownership rights, whoever has the power or the political authority can simply take command of an item, ignoring the wishes of both the person in possession and other potential users. Without private property rights, other methods must be found to provide the incentives for good stewardship of property and for proper concern for others by the users of property. For example, if the owners of a factory are not held responsible for damages their pollutants impose on the person and property of others, then other measures may be needed to control polluting behavior. The experience of socialist nations in the 20th century demonstrated that such measures seldom can match the effectiveness of private property rights.

Using the Property Rights Paradigm to Understand Environmental Issues

The economics of property rights can help us understand environmental

and resource issues. It is sometimes supposed that capitalism necessarily implies environmental degradation and the using up of natural resources. However, the dismal environmental legacy of the centrally planned economies belies this claim. Similarly, it is sometimes thought that environmental problems are necessary consequences of technological progress. However, the economics of property rights suggests that environmental problems and resource problems are generally problems of poorly defined rights; i.e., high transaction costs. This analysis further suggests that the solutions to these problems require addressing the structure of property rights.

We begin by exploring the central issue in environmental problems, the problem of open-access common property. We then discuss the links between property rights and environmental degradation, and property rights solutions to environmental and resource problems.

When Property Rights Are Undefined or Not Enforced: Transaction Costs and Pollution

Environmental problems generally fall into two categories: 1) pollution and 2) overuse (or exhaustion) of resources. As will be seen, both pollution and overuse of resources become problems when property rights are inadequately defined. Ecologist Garret Hardin argues that all environmental problems are, at the core, problems of open-access common property: i.e., problems specific to the absence of well defined, exclusive property rights (Hardin 1968). Our analysis agrees. Here's why.

Pollutants are undesired byproducts of human activity, such as production.[4] Disposal of pollutants, like any other aspect of production, is done in the way that generates the least cost for the party generating it. Pollution becomes a problem when disposal fails to take into consideration other parties and begins to inflict harm on them. But why should this ever occur?

Suppose a firm produces valuable goods and pollution. It sells the goods and dumps the pollution into the atmosphere. If some parties are harmed by this pollution, then either they can demand that the polluter cease inflicting this harm, if they hold the right to not be harmed, or, alternatively, if the factory has the right to use the atmosphere to dump pollution, then the injured parties can simply pay the factory to cease the harm. And if it should happen that the value of the production is so great that curtailing the pollution is unwarranted (because the harm from the pollution is minor compared to the value of the production), then the firm should not necessarily reduce its activity. Most likely, if either the firm or the injured parties take into account the damages caused by the pollution and the costs (in terms of production and abatement) of reducing it, then the amount of

production and pollution will be reduced to the extent that maximizes the total value of production, net of all costs. At this point, the total gains for all parties are maximized. It would benefit neither the injured parties to pay for further reduction of pollution nor the factory to pay for the right to inflict more damage.

Therefore, pollution problems should not exist. All parties involved have incentives to bargain to eliminate them.[5] Of course, there is an obvious problem with this "solution." It supposes that property rights are perfectly defined and completely transferable, i.e., that transacting is costless. We have seen that property rights are never perfectly defined; hence transacting is costly. In the case of rights to use of the atmosphere, property rights are very poorly defined, indeed. The atmosphere is an example of common property, access to which is open to all. Partitioning the atmosphere and defining exclusive rights over it is, at least at present, essentially impossible.

Similarly, consider the problem of exhaustion of a resource.[6] Because we are considering the complete exhaustion of a resource, it does not matter whether it is renewable or non-renewable.

It might be that simple analysis of benefits and costs suggests that the resource should be used. For example, if a particular barrel of fuel is used to power an engine, the alternative benefits of preserving that fuel for future use are forgone. Yet, the benefits of using the fuel may be greater than the expected future benefits from preserving the fuel—hence it is reasonable that it should be used. Similarly, the benefits from exhausting a particular resource, e.g., a mineral deposit, a pool of oil, or a stock of fish, might be greater than saving it for the future. Again, in such cases, it makes sense that they should be used. In these cases, use of the resources is a solution, not a problem.

However, resource exhaustion becomes a problem if future benefits, or other benefits of alternative uses, are not taken into account. In this case, the exhaustion of the resource means that more valued opportunities requiring the resource will be lost. But why should this ever occur? The existence of more valuable uses means that there is a profitable opportunity. Some entrepreneur could purchase the resource in question and profit by devoting it to the more valuable use, including preserving the resource for the future. In fact, this is exactly what happens in many cases. Where property rights are well-protected, lumber firms develop increased stocks of trees, oil and mining companies refrain from developing some known deposits, and conservation organizations purchase lands to preserve natural settings. However, such activity depends upon relatively well protected property rights. When rights are not well protected, then conservation for

more highly valued uses becomes difficult. Again, the problem is that exclusivity of rights is lacking; hence, bargaining to a better outcome may be prohibitively costly or simply impossible.

For example, assume for a moment that the rainforest of the Amazon basin is crucial for replenishing the oxygen levels of the atmosphere.[7] If so, cutting or burning this forest to the point at which the atmosphere begins to be threatened is a poor idea and would constitute an environmental problem. However, property rights to the atmosphere are poorly defined, as are contributions to the atmosphere of any particular piece of rainforest. Owners have little incentive to take such nebulous benefits—nebulous from their perspective—into account. (The problem is further compounded by property rights rules and related legal and economic institutions in Brazil that further encourage the destruction of rainforest: clearing the land is one way of better establishing one's claim to it.) Once again, the problem can be traced to poorly defined property rights, or to prohibitively high transaction costs. And again, the problem is one of common property with open access. In this case, the owners of the property in question ignore the forgone benefits because, were they to produce these benefits, they could not exclude others (i.e., the benefits would be open-access common property).

Common property with open access is equivalent to poorly defined property rights. It is costly to establish and protect property rights; so they are never perfectly defined. Environmental problems are therefore most likely to arise in connection with resources and assets over which it is extremely difficult to define property rights: the atmosphere, stocks of fish in the ocean, flows of subsurface water, etc. If environmental and resource problems are fundamentally problems of open-access common property, then to understand them it is important to understand the economics of open-access commons. This is the subject of the next section.

The Problem of the Commons

Garrett Hardin's seminal article on environmental problems (1968) was entitled "The Tragedy of the Commons." The "commons" refers to the English village commons. Each village in England had a commons, pastureland that any member of the village was entitled to use. Individuals kept livestock on both private land and on the commons as well. It was frequently observed that common property was overgrazed to the point of damage, while private land was not. Why?

When individuals graze livestock on private land, they take into account the amount of vegetation destroyed by grazing. In order to ensure good grazing in future years, they remove livestock from the land before the

animals begin to inflict damage and jeopardize future growth. This is so whether they own the land or simply rent grazing rights. The individuals involved stand to gain by preserving some resources for future use. They take into account potential negative effects of their activities and curtail them before the harm of more activity becomes greater than the benefit.

However, the incentive structure for common property with access open to all is quite different. The same individuals have no strong incentive to try to preserve the vegetation for future use in this case. Suppose Mr. A is one of many persons using the commons for grazing. If Mr. A decides to remove his livestock so as to preserve the grass, he is unable to exclude others from letting their livestock eat the remaining grass. He might try to persuade B, C, and D to withdraw their stock as well, but this simply permits E through Z to benefit from the remaining grass. Hence, A might just as well leave his sheep and cattle on the commons. Since each villager is faced with the same dilemma, each participates in the overuse of the commons, even when each takes care not to overgraze on private land. Hence, the tragedy—the commons is overused to the point of destruction, through no one's particular fault or desire.

Of course, it is possible that A might persuade the other members of the village to agree to limits on use of the commons, i.e., to restrict access, rather than permit open access. This is a step toward defining exclusive property rights over the commons. If the restrictions are well designed, they may be sufficient to prevent overuse and also provide incentives for each village member to follow them. Properly designed, such rules will be constraints that act very much the same as exclusive private property rights. In fact, they are a form of private property right, giving each party a well defined, limited right of use. But the costs of negotiating such a solution increase with the number of people involved.

Within a small village these costs are probably not trivial, and when one considers that common properties, such as the atmosphere, transcend national boundaries, the transaction costs implied are extremely high indeed. It already has been argued that environmental and resource problems are problems of open-access commons. Air pollution, water pollution, overuse of fishery stocks, deforestation, noise and light "pollution," human-caused extinctions of species—all of these can be seen as tragedies of the commons. Hardin went on to argue that overpopulation itself is an example: individuals bring excess numbers of children into the world because they treat the world as open-access common property. (It should be noted that in a system where food, clothing, and shelter for children must be provided by the parents, this last analysis is questionable.)

What are the characteristics of a solution to the commons problem? In

the case of an actual village commons, one solution might be simply to privatize the land, dividing it into plots and distributing them among the villagers. An alternative solution would be to restrict grazing rights in some way. This attenuation of rights could benefit all: the commons would be preserved as common property, and all villagers would derive a stream of benefits from it, rather than destroy these benefits. Because such a solution benefits all, it will be easier to implement and enforce than one which penalizes some and benefits others. Such a solution recognizes the (poorly defined) property rights of each individual and moves to strengthen them. The rights are attenuated—a limit is imposed on each villager—but also strengthened—each villager is assigned a well-defined right to graze up to a point. Rather than establishing property rights via privatization, such a rule establishes rights via regulation, a regulation that tries to duplicate the effects of private property rights.

The exact form that such a rule might take varies. It might arise from negotiation among members of the relevant group. In such an instance, the commons becomes a sort of club good, an example of mutually owned property. Community based arrangements for managing fisheries are an example of this. Or such a rule might be developed by means of statute law, by simply imposing rules. The degree to which such legally-defined rules approximate the effects of private property ownership vary considerably. Also, common law might develop rules that help to define property rights. These alternatives are examined in the next section.

When Property Rights Become Defined and Enforced: Trade Increases Welfare

The basic problem in the tragedy of the commons is twofold. First, in the absence of a means of commitment, it is in each individual's private interest to overuse the commons. Second, high transaction costs make it difficult or impossible to develop enforceable contracts that would limit the overuse. This second feature is important for understanding possible solutions to environmental problems.

In some instances, negotiation of rules among users can turn an open-access commons into the equivalent of mutually owned property—common property that is not open access. Users of the commons have a mutual interest in preserving it from overuse; hence, they have an incentive to develop such rules. Whether or not they will be able to do so depends on factors such as costs of negotiating an agreement and costs of enforcing it.

The cost of negotiating will tend to be lower for groups of people that are smaller and more homogeneous. As group size increases, and differences among members increase, so do the costs of negotiating. Developing

an agreement among members of a small village, who have common language, culture, lifestyle, and governmental system, will be much simpler than negotiating an agreement among, say, people of several different countries, where the costs might well be prohibitive.

Enforcement costs also are important. These costs similarly depend on the group in question. They also depend upon whether or not outsiders might attempt to use the commons and on the nature of the common property itself. Commonly owned land will be relatively easy to police relative to, say, a commonly owned section of ocean, a fishery, or the atmosphere above a piece of land.

The primary benefit of negotiated rules is that they restrict access and prevent overuse and abuse of the resource. As with private property, the owners have incentives to care for the resource because they bear the full costs of overuse and have the ability to control the amount of use. Such a solution appears to be more likely with relatively small, homogeneous groups because costs of negotiating and monitoring increase with group size and diversity. However, it is unlikely that negotiated rules would prove workable for problems at a national or international level. But for local problems, such rules have the added benefit of keeping control in the hands of local individuals, who tend to have better knowledge of local conditions as well as stronger incentives to correct problems than do far-removed decision makers in national government.

Donald Leal describes numerous cases in which negotiated solutions have been used successfully in managing ocean fisheries (Leal 1996). A fishery—a particular stock of fish—is common property. If the fishery is open-access, permitting anyone to fish in it, it is likely to be depleted to such a point that reproduction would be harmed and the stock would dwindle. Also, competition in catching open-access fish would lead to overcapitalization—developing more and bigger boats and equipment than actually are needed to catch a given quantity of fish—because the goal is to be *first* to catch the fish when access is open. Leal documents successful instances of fishermen's groups in the United States, Canada, Scotland, United Kingdom, Norway, Brazil, and Turkey developing and enforcing restrictions that restrict access to fisheries. In each case, the result is an end to overfishing, stability of fish populations, and higher incomes for fishermen. In some instances (Canada, United States, and Brazil), the fishing restrictions are (or were) purely private arrangements. In others, they were developed with support from government and legal institutions. In one negative example in Brazil, the national government actually intervened and re-established open access (for wealthy individuals who further received subsidies to develop large fishing operations!), which ultimately

destroyed the fishery.

Another possible solution to the problem of the commons is to develop and enforce laws regulating use. Environmental regulations are sometimes thought to be the only solution to problems of pollution, particularly in cases such as the atmosphere, where property rights can be extremely difficult to establish. As will be seen shortly, statute law and regulation are not the only possibilities in these cases. Furthermore, the effectiveness of regulation can vary immensely, depending on the characteristics of the regulation.

Some regulations simply restrict or prohibit certain activities, with little or no regard for consequences and no ability to adapt to changing circumstances. For example, a law might specify the maximum amounts of pollutants any factory might put into the air, without regard for other relevant matters, such as the harm actually done (which might vary by factory location) or the value of the output that might be lost (possibly sacrificing a great deal of value to avert a small amount of harm) or alternative remedies (e.g., if harm were caused to an identifiable nearby party, it might be less expensive simply to compensate that party). Regulation of this sort tends to resemble central planning. Government officials determine the extent to which common property will be used. As with central planning in general, there is no systematic means for government officials to weigh benefits and costs accurately. And as with all government activity, there is a chance that rent-seeking would dominate the governmental decision making process. However, such regulation does define rights over the commons. The problem is that the definitions tend to be relatively arbitrary, inflexible (and hence not transferable so as to maximize wealth and minimize harm), and subject to political interference.

Regulation of this type can even be counterproductive. In some cases it creates incentives that *increase* the environmental harm. In New Zealand, a law was enacted to ban cutting of rare hardwood trees, prized for their wood. These trees tended to be located in private lands that were used for grazing cattle. Because the trees were quite valuable, landowners took measures to protect the trees from cattle, because cattle would trample the ground around trees, harming or killing them. When the law banning harvest of the trees was enacted, landowners lost incentive to protect the trees, and the destruction of the trees actually accelerated.

Similarly, in the United States the Endangered Species Act of 1973 (ESA) is a law passed to give protection to animals and plants deemed in danger of extinction. One provision of the law places restrictions on the use of land where endangered species are found. In the case of private land containing endangered species, a private landowner essentially loses rights

to any activity the government deems harmful to the species. As a result, landowners do not want endangered species to be found on their land. If they fear that some endangered species might be on their land, they frequently take measures to destroy the habitat so that they do not lose most of their rights to the land. The ESA works in exactly the wrong way, if the goal is to protect endangered species. It destroys incentives to provide habitat and through the use of highly inefficient requirements, chosen because they are freely imposed without payment by the regulator, can impose an enormous burden on individuals who have land containing endangered species. Paying nothing, the regulator has little incentive to "shop around" to find the low-cost techniques of habitat enrichment—bird boxes, for example—or the low-cost providers of habitat. The landowner is expected to bear the full costs of providing a public good—protection for the species. Because these costs are not borne by the public or by environmentalists, environmental advocates do not hesitate to argue for increasingly draconian restrictions.

However, statute law and regulatory solutions may be designed with characteristics that are closer to a property rights regime. Laws can create incentives and opportunities for private decision makers to maximize net value in using the commons. For example, in the case of air pollution problems, one possible solution is to establish a system of tradable emission permits. Under such a system, the government decides upon a total amount of some pollutant that may be emitted into the air. This limit is presumably set at a level that avoids harm from the pollutant. The government next creates permits that allow the holder of a permit to emit a specified fraction of the total limit. In essence, these permits specify a property right to issue a certain limited amount of pollution, and no more. The permits create, by fiat, rights over use of the commons.

These permits are then distributed, perhaps by auction, by giving them to currently operating factories, or by some other method. The crucial feature is that owners of permits can trade them. This means that the rights to emit pollutants will be held by whoever values them the most. The factories that produce the greatest net value of output, per unit of pollution, will obtain the permits. Or if someone, such as a citizens' group, believes that a lower total amount of pollution is preferable *and* is willing to pay the costs of reduction, he or it may purchase the permits and simply not exercise the right to pollute. Similar permits are used in some states of the United States successfully. (In some cases, citizens' groups indeed have purchased and retired the permits.) Tradable pollution permits also have been proposed as a method of allocating international greenhouse gas limits across nations.

Richard Stroup (2003) outlines some of the benefits of the auctioning of permits approach in the context of the Clean Air Act Amendments of 1990. Such a regulatory system avoids some of the problems of a regulatory approach that would set a per factory pollution limit. First, the permit auctioning method sets a total limit. In general, total emissions may be the correct variable to target, rather than individual behavior. Second, having set the limit, this method provides a mechanism for individual decision makers to minimize the costs of the solution. Total wealth in society would be greater if each gram of sulfur dioxide put into the air were accompanied by output with $10,000 net value instead of $1,000 net value. If the permits were tradable, the most highly valued uses would be the ones ultimately pursued. Furthermore, this method does not require regulators to determine the least-cost method of keeping within the targets. Individuals trading within markets would find the least-cost resolutions, including technological solutions (abatement equipment) and reallocations of rights to buyers with higher valuations.

At the same time, approaches like auctioning of permits do have problems. First, such approaches assume that government officials and scientists are both able and willing to establish limits that are roughly correct. But their ability might be questionable—the lack of knowledge is a fundamental problem in resolving environmental issues. A standard set too stringently might reduce economic output needlessly, for little or no corresponding benefit. Unfortunately, a tough standard might benefit regulatory agencies, which gain political constituencies by appearing to be tough on pollution. Political support means power and greater budgets, so regulators have some incentive to set unnecessarily tough standards. The subsequently issued regulations reduce economic productivity, with little real benefit in return. Reaching a destination at least cost is not a benefit if the destination turns out to be farther from the desired location than when we began.

Also, rights involved in permit auctions might be less than secure: because they are established by governmental fiat, they can be changed by governmental fiat. If potential purchasers of permits feared that government arbitrarily would either increase the limit or decrease it (in the first case reducing the value of a permit, in the second case nullifying a permit entirely), their willingness to invest in permits would be reduced. Additionally, any permit method requires costly enforcement activities. The pollution output of participants in the permit system must be measured, and monitoring must occur to prevent non-participants from polluting. Still, such a method suggests how regulatory solutions might establish property rights by fiat in cases where rights are otherwise extremely difficult to define. Leal (1996) outlines a case in which the government of the United Kingdom established quotas for certain ocean fisheries and then

allowed an organization of fishermen to assign quotas and manage the fisheries, with good results.

There is still another sort of solution to the problem of open-access common use that can be applied. Common law—the law developed from legal rulings in English and American courts—typically protects individual rights from infringements by others. Roger Meiners and Bruce Yandle have shown that in the United States and Britain, the common law concerning nuisance and trespass has been used successfully to stop air and water pollution (Meiners and Yandle, 1998). Nuisance refers to interference with others' use rights (either private or public rights). Trespass refers to invasion of another's property. Meiners and Yandle document numerous cases where common law was used to protect individuals from harm by air pollution and by pollution of surface and sub-surface water. Under common law, individuals who can show they have been harmed (a violation of their property rights) can obtain compensation, punitive damages, and injunctions (legal prohibitions against offending activities) when victimized by pollution. Meiners and Yandle also show that the common law evolved increasing sophistication over time as scientific understanding of pollution problems increased. The common law solution works by protecting established property rights. Individuals with rights to their lives, health, and property can take legal action when these are harmed (or in some cases, merely threatened by unreasonable risk) by inappropriate use of the commons.

There are several advantages to common law resolutions of problems regarding use of the commons. First, this method reinforces property rights, rather than weakening them. This helps to preserve the beneficial social characteristics of a system of private property rights. Second, the common law method generally requires that actual harm be evident—either actually and already inflicted or likely to be inflicted imminently. Consequently, the common law does not impose restrictions on activities that are harmless, which may occur with blanket regulatory actions. Third, the common law provides incentives for parties involved to negotiate a least-cost solution to a problem. Fourth, it does not require regulators or lawmakers to know anything about potential problems. Instead, it makes use of the knowledge of those most directly affected.

Meiners and Yandle point out that despite these desirable characteristics, common law solutions to environmental problems have been displaced by regulatory ones in the United States. In many cases, this seems to have been done for political reasons because politicians and regulators can gain increased power by politicizing environmental decision making. Meiners and Yandle also document that, in some cases, replacing common

law protections with regulations actually *reduced* protection against violation of pollution standards.

In addition to being less desirable for those who wield political power, the common law has some weaknesses that make it difficult to apply in certain kinds of situations. The common law approach requires a plaintiff to show that harm has been inflicted. For some kinds of harms, this is simple—one need only document a crop damaged by pollution, for example. But some kinds of harms may be difficult to demonstrate. It is currently impossible to show how a cancer was contracted, for example, under current legal standards for proof of causation, and therefore it is impossible to show that any one cancer was caused by any particular instance of pollution. Also, the common law approach requires that the defendant be found. But it is often impossible to identify a particular source of pollutants dumped into the air or water, in many cases. In these kinds of situations, the preferable solution might be a properly designed regulatory response.

Of course, therein lies the problem. The situations in which the common law solution is least likely to work also are those in which it will be most difficult to develop optimal regulations. Regulatory and statute law responses will likely be developed in such situations, but there is no systematic way to assure that these approaches will increase overall well-being. Such responses are more likely to work well when they define transferable rights that can be allocated to minimize costs and that allow for responses to changing conditions and knowledge.

Changing Knowledge and Preferences: Property Rights and Innovation

There are other possible solutions to environmental problems. Technological innovation reduces the amount of input needed to produce output and also increases the substitutability of inputs. Consequently, natural resources generally have become less scarce, rather than more scarce, as evidenced by declining relative prices over time. (Simon 1996) Also, better technologies are reducing byproducts such as pollution by developing improved abatement equipment and by developing uses for byproducts that previously were considered useless waste. Evidence suggests that the rate of technological improvement is increasing, rather than slowing. Similarly, innovations in organizational and institutional design can reduce environmental problems. In the western United States, environmental groups have begun compensating owners of cattle and sheep for any livestock killed by grizzly bears or wolves in order to reduce the opposition to having free-ranging populations of these animals.

Any environmental problem is, at the core, a failure of some sort of transactions to be undertaken, i.e., a failure of some effects of human actions to be taken into account, due to high costs of transacting. Any entrepreneur who can discover a solution can find a profitable opportunity—whether the profit be measured in money or, for environmental groups, in environmental amenities.

One important consideration in analyzing an environmental solution is the likely effects on subsequent innovations and new solutions. Privately negotiated solutions and common law solutions tend to be responsive to changes in knowledge, preferences, technology, and the like. Thus they can be adjusted to develop solutions that are the least costly, given the latest information, technology, etc. And they can readily be adapted again to meet subsequent changes. Regulatory solutions tend not to be so responsive. Because they are imposed by government, and usually by higher levels of government, they tend to be relatively unresponsive to changes in technology, economic conditions, etc. The purely regulatory approach usually provides no systematic means for new information to be imparted to government decision makers. Under private negotiation and common law solutions in a market setting, on the other hand, prices communicate new information, and each individual participant has a strong incentive to seek out any relevant information not communicated by prices.

Regulatory responses, therefore, tend to be less responsive to new developments, and as time progresses, may actually discourage innovations that could solve a given problem with less cost. This undesirable feature of regulation has led some to suggest that regulations contain "sunset" provisions, that a regulation should expire at some particular date unless a determination is made that it should be renewed. Alternatively, it has been suggested that regulations be reviewed from time to time and abolished if evidence warrants it. However, given that regulations are frequently the result of many political competitions and compromises among competing groups, it is not clear that such provisions systematically would help to ensure that least-cost solutions to commons problems were found. A better remedy might be simply to design regulations that help to develop tradable property rights that would generate least-cost solutions and permit innovations. But this raises again the unsolved problem: how to constrain political decision makers systematically to make the "right" decisions. Depending on the problem at hand, one might well conclude that reducing the role of politics while increasing the realm of private ownership and responsibility would be generally advisable.

Conclusion

Property rights have been shown to correlate strongly, all around the

world, with prosperity, material progress, and a clean and healthy environment for citizens. Even when we look at the economic and natural environments surrounding the poorest people in each country, this result holds. Property rights, when established and enforced, hold people accountable for their actions. Those who use a resource should pay full cost; those who provide for others should benefit according to value provided. Innovation at the expense and risk of innovators should be encouraged and, when successful, should be rewarded. And those who violate the rights of others should be stopped from doing so. While perfection is never possible in this world, property rights work well wherever they have been used.

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Endnotes

[1] Armen A. Alchian, "Property Rights," in John Eatwell et al., eds., *The New Palgrave: A Dictionary of Economics,* New York, NY: Stockton Press (1987), vol. 3, pp. 1031-1034, at 1031.

[2] Economist Seth Norton, writing in the *Cato Journal*, Fall 1998, pp. 233-234, summarizes the evidence this way:

> In recent years, empirical evidence consistent with the proposition that well-specified aggregate property rights enhance growth has

emerged. Studies by Gerald Scully (1988 and 1992), Robert Barro (1991), Barro and Xavier Sala-i-Martin (1995), Stephen Knack and Philip Keefer (1995), Knack (1996), and Keefer and Knack (1997) show that measures of well-defined property rights, the rule of law, and public policies that do not attenuate property rights at the nationstate level tend to generate economic growth and wealth accumulation.

[3] The source of the data used in this section is Seth W. Norton, "Property Rights, The Environment, and Economic Well-Being," in Peter J. Hill and Roger E. Meiners, eds., *Who Owns the Environment?* Lanham, MD: Rowman and Littlefield (1998).

[4] Pollution is typically thought of as associated with economic production, but all human activity – even respiration – generates pollutants.

[5] This is the "Coase Theorem." Ronald Coase developed this analysis to demonstrate the crucial importance of transaction costs (Coase 1960).

[6] Because we are considering the complete exhaustion of a resource, it does not matter whether it is renewable or non-renewable.

[7] I do not necessarily agree that a statement to the effect that the Amazon rain forest "provides oxygen to the world" is factual. During the daytime, growth of plants does just that, taking in carbon dioxide (CO2) and releasing oxygen, but the process is slowly reversed as plants decay, being consumed by termites, for example, or reverses rapidly when plants burn. At night, the reverse process proceeds while the growth process is much slower. On balance, in a steady state year to year, there is no net contribution of oxygen or the reverse. Sunlight and moisture are so prevalent that soil buildup is approximately nil; matter is neither created nor destroyed nor, in tropical rain forests, stored in the same manner that carbon is gradually stored in soils built up over time in temperate zone forests.

COMMENTARY

Lee Hoskins

Walker Todd: The next speaker, our official commenter on Richard Stroup's paper, is one of the Armen Alchian students from UCLA, Lee Hoskins. He used to be my boss, also, when he was the President of the Federal Reserve Bank of Cleveland, 1987-1991. Afterward, he was chairman and CEO of Huntington Bank of Ohio in Columbus. He's a current member of the Shadow Open Market Committee and a trustee of Carnegie Mellon University and its Gailliot Center for Public Policy, a director of the Western Economic Association, and he was a member of the Meltzer Commission.

Lee Hoskins: It's a pleasure to be here. Walker's been very kind. I now work for him, *(laughter)* which is an odd turn of events. It's a pleasure also to have a chance to comment on Richard Stroup's presentation this morning. Let me tell you that he has a center in Bozeman, Montana, that is the premier property rights and free-market environmental group in the country, perhaps the world. It's a great center, doing great work, and it is effective. People on the other side of property rights and environmental issues actually have to deal with them and listen to them because the center ends up getting into all kinds of issues, and court issues as well.

To me, property rights probably are the essence of economics, and as you heard this morning from both speakers, it's been under-studied by economists, to be polite about it. I went to UCLA as an undergraduate and started my Ph.D. there in 1966. Armen Alchian received tenure there probably about 1958. And Ronald Coase already had written his famous article on the Coase Theorem. In my book, the holy trinity of economics is really Coase, Harold Demsetz, who also was and still is at UCLA, and Alchian. If you want to understand economics, not just the issues about property rights, which are very popular in environmental studies—that's the way most economists understand it, but once you get away from the environment or pollution issues, property rights don't seem to enter their thought processes—get Alchian's book. Apparently there will be a new version now. He's working on it with his daughter. He's frail now. The old edition is called *University Economics*. If you work your way through it, it will bring you to an understanding of the importance of property rights.

As you know, graduate schools are insular, so you talk to other graduate students at your university. When I left UCLA, I thought everybody understood property rights. You know how it is—you go off to a research department and talk about property rights and two things happen. One is that nobody responds to you—they don't understand what you're talking about.

And the second thing is, every now and then, to them, you appear to have a great insight *(laughter)* because they'd never heard of the stuff before. Right? I mean, they had no insight.

I wasn't one of Alchian's best students. I dodged him regarding trying to take a dissertation under him principally because I thought of him as a god, and I didn't want to be around God on campus. The issues that Alchian tried to focus on and wrote about were property rights, as in his famous 1965 article. He basically says that economics has a bunch of fields, and property rights is not one of those recognized fields. And I'll bet you today it's still not one of those fields in a classification index.

So we haven't advanced much in raising the profile of property rights, but the real hey-day was the period around the 1960s through the early 1970s.

Exclusivity, legal protection, and *transferability*. Those are the three terms emphasized by Alchian. I agree with the primacy of all of those terms as the starting point for property rights analysis. However, I want to make a couple of side comments. *Exclusivity* does mean that you can you use your resources any way you please, as long you don't violate the property rights of somebody else. It doesn't mean that you cannot harm him. You can harm him. You can build a restaurant next to his restaurant. If Richard Stroup has a restaurant and I'm building one, I assume that I'm going to give better service. I'm going to do him economic harm by taking his business away from him. So exclusivity of property rights doesn't mean that you can't harm someone else economically. It just means you cannot violate his or her property rights.

The *legal protection* issue is an interesting one because I think most property rights probably were developed before there was a legal system. So I don't emphasize the legal protection when I talk about property rights because I think people have already generated property rights. There are customs and traditions that define and protect property rights. There are customary punishments, such as causing violators to leave the community, banishment, and not speaking to them. There are lots of similar ways that people have enforced property rights. Then the law comes along and codifies that customary system. And then, of course, the legal system begins to attenuate property rights. There was an old saying among graduate students at UCLA when Alchian was serving as God there, if you got caught in your oral exam—you had to take four of them then—if you didn't know the answer to the question, then you'd just say, "Well, that's because of attenuation of property rights." *(Laughter)* And 50 percent of the time or more Alchian would say, "Yes, that's right." *(Laughter)*

States attenuate property rights; individuals really don't. As Richard Stroup points out, there are courts and institutions to enforce property rights, but what I see is that any action by the state does something to property rights. And I have an article with Jerry O'Driscoll and Mary O'Grady on property rights within the Heritage *Index of Economic Freedom*. Heritage uses a narrow definition of property, I thought, so I just said, everything that you're measuring here is basically a property right, and it goes to the point that Richard was making as well. That study shows that, the stronger the property rights, the more effectively the price system works, the more effectively prices allocate goods and services and the costs of production. And the wealthier societies are. So the stronger the property rights, the greater the wealth the society has. That's an empirical result supported by theory.

I would say that legal protection of property rights is important. But I would still say that property rights probably arise prior to any legal system. I think Tom Bethell made that point as well.

On *transferability*: The focus should always be on voluntary exchange. Being able to exchange goods and services is a key function of economists in terms of how they make things work in their elegant models. Alchian's complaint about that was, although voluntary exchange is really important, we need to study the competitive aspects of what property rights really are. People and societies, as well as individuals, have conflicts of interest, and there are lots of ways to resolve them: You can kill the other guy; you can take his stuff; you can bribe him. But competition in the sense that we use it today is really a system of property rights. It is defining what is the legal way, the acceptable way, to resolve conflicts between individuals. And that largely is Alchian's point. It is the basic essence of economics. So transferability is important, but you have to look at the system that underlies transferability, the forms of competition that society allows. Property rights are a form of competition that we've chosen to use, as well as many other societies. Property rights work very well for the reasons I've already suggested. I'm not going to go over Alchian's other points about incentive systems, which I think most of us can see.

I shall give you an example. Walker asked me to bring up an example about the Federal Reserve. There's a whole industry that the Federal Reserve created, and it's called money market funds. How did the Fed do this? Well, the Fed used to violate your property rights with Regulation Q, which limited the amount of interest you could be paid on bank deposits. Most of you are too young, but some of you remember Regulation Q. You could only receive up to 5 percent on deposits under $10,000. Well, some smart guy, probably in Pittsburgh, figured out that if he bundled up ten of

these $10,000 deposits that were only receiving 5 percent, he'd then be at the $100,000 level, and deposits of that size were not subject to the Reg. Q ceilings. Interest on such deposits could be paid at the market rate. So some smart guy in the private sector figured out a way, while the Fed was violating your property rights, to hand them back to you. And that's another beauty of the system that we have. A key factor in this analysis was the opportunity costs. In this case, the Fed didn't care if Reg. Q was distorting the allocation of funds in the banking system. The Fed didn't really pay any price. But if a private bank made decisions like those of the Fed, then it would pay a price—incur an opportunity cost for its behavior.

My conclusion and my main message here are that the system of property rights is much broader than just thinking about land or whether you own a car or something like that. It's an underpinning of the way we live and the way we interact with each other.

Thank you.

THE IMPORTANCE OF PROPERTY RIGHTS IN THE COMMON LAW TRADITION

Richard A. Posner[1]

[After the telephone connection is established:]

Walker Todd: This is Judge Richard Posner from the 7th Circuit of the U.S. Court of Appeals in Chicago, the leading light of the law and economics movement. The man doesn't know it, but he taught me what I originally learned about property rights by my teaching his textbook over a number of years. Anyway, I asked him if he would be willing to phone in at this time, and Judge Posner, would you prefer to make remarks or do you want to deal with an interview?

Richard Posner: Whichever format you prefer.

Walker Todd: The main thrust of what I asked you to address originally was that we had a couple of talks earlier today about the original leading lights in the economics profession who emphasized the importance of property rights in the 1960s especially, and later in the 1970s. Would you please describe, on the legal side, what was happening to legal scholarship and the rediscovery of property rights about that same time?

Richard Posner: Well, sure. I'd be glad to. I'm not sure that it's entirely responsive to your question, but the economists' modern concern with property rights may be said to have begun with Armen Alchian, a very prominent economist at UCLA who advocated the importance of property rights in the early 1960s, maybe even earlier. His emphasis was on the importance of property rights protection for creating incentives to invest. That's incomplete, and what began in the later '60s and carries through to this day is a focus on very specific institutions of the property rights system, such as common law property rights and their extension into areas like intellectual property. The focus is on the actual texture of the legal system of limitations and rights enforcement, the reasons for those limitations, what improvements may be necessary, etc. That's the main emphasis in law, at any rate, so I'm talking mainly about lawyers influenced by the economic approach.

There are also lawyers like Randy Barnett who emphasize the importance of property rights, but from a somewhat different angle. Or Charles Freed, formerly solicitor general and now again a professor at the Harvard Law School, who has written about common law legal protection, but emphasizing more the moral dimension of property rights. That strain in the property-rights literature goes back to John Locke, who thought people had a moral right to property—land, for example—that they had improved

with their efforts. That's quite different from an economic analysis which thinks of property rights as instruments for promoting economic efficiency or economic welfare. That's been my own interest. And I could amplify that a little or be happy to answer any more specific question you might have.

Walker Todd: All right, we have one Alchian student and one prominent writer on the history of property rights who both raised their hands at this point.

Richard Posner: Yes. Sure.

Walker Todd: Do you want to hear from the Alchian student first? That would be Lee Hoskins, who used to be the President of the Federal Reserve Bank of Cleveland. He is a UCLA product of the early to mid 1960s himself. Lee, what was your question on this?

Lee Hoskins: I'd like Judge Posner to trace the takings issue through history if he can. *(Laughter)*

Walker Todd: We have *(laughter continues)*—right, right. You asked us. We have a panel tomorrow, Judge Posner, on eminent domain.

Richard Posner: Yes.

Walker Todd: Including reviewing some of the recent cases that are going into the Supreme Court. But do you have some preliminary remarks you'd like to share with us on eminent domain and where this whole mess is going? The emphasis on that tomorrow, of course, would be the taking of private property, not for public use necessarily, but for giving it over to another private owner who arguably will make better use of it. What do you think about these cases?

Richard Posner: Well, what the Fifth Amendment to the Constitution says is that property can't be taken for a public use without just compensation. So there's always been an interesting question, well, what if the property is not taken for public use, but for private use? And the general understanding has been that if the property is taken for a use that is not public, then it's simply a deprivation of property without due process of law, so that it violates another clause of the Fifth Amendment, and if it's done by a state or local government, then it violates the due process clause of the Fourteenth Amendment. The most difficult issues relating to taking are two. One is, what is a public use and (what is largely the same question) does a public use have to be a *governmental* activity? The historical answer was no because one of the actually least criticized uses of the eminent domain power is by certain types of private companies. The classic case is a railroad. Railroads have to buy rights-of-way for extensive distances.

Now, in principle a railroad could just negotiate with the owners along the intended right-of-way. But if it is known that the railroad is trying to assemble a series of strips of land for its tracks along a specific route, each owner of property along that route will have a kind of monopoly power. It would be like being able to charge a toll. That's the historical rationale for allowing railroads and other right-of-way companies, such as an oil or coal pipeline, to acquire rights-of-way by eminent domain and thus force the landowner to accept a fair market value as determined by a court. That's considered a public use. So that's one issue.

The other issue has to do with the fact that it's always been understood that property rights are not absolute. There are all sorts of limitations on them, including regulatory limitations. And so then the question is, at what point is a limitation imposed by law, by a regulatory agency, or by a legislature so extensive, so pervasive, so damaging that it ought to be treated as a taking? For example, if a regulation provided that a particular property could be owned by anyone but couldn't be *used* for anything, so that it would have to be left completely unimproved, untouched, well, that would, by rendering the property completely valueless, be judged a taking. But all sorts of lesser restrictions are treated as not involving a taking. Suppose a piece of property is at a dangerous intersection; can the state say, well, you can't build a fence or structure right at the corner of your property where it abuts the road because it will make for hazardous traffic conditions? There are all sorts of uses of private property that have been deemed nuisances, like brothels and other questionable uses, which can be outlawed without a duty to pay compensation. Ditto with most zoning restrictions. So the general legitimacy of these regulations is assumed, but at some point they become so intrusive and so destructive of property values that the courts intervene.

Unfortunately, there aren't any really crisp standards unless we go to the extreme of saying that no interference with property rights is permissible without compensation.

Walker Todd: Right. Tom Bethell, who wrote the book *The Noblest Triumph: Property and Prosperity Through the Ages* (1998), is here, and he wants to ask you a question.

Richard Posner: Sure.

Tom Bethell: Judge Posner, in some of your writings you have equated justice and efficiency.

Richard Posner: Yes.

Tom Bethell: And in particular you have made the argument that judges

have over the years often decided cases on a sort of efficiency maximizing basis.

Richard Posner: Yes.

Tom Bethell: And there's a famous case in particular that I wanted to mention, and it was associated with a famous article by Ronald Coase: the *Sturgis v. Richmond* case, in which there was a dispute between a doctor and a candy maker. The noise from the candy making machine was disturbing the doctor, so who would have the right to be free of or to make this noise? And Coase claimed that it was decided on some kind of an efficiency basis, and then the case was re-examined. And I know this because you yourself pointed this out to me in a letter you kindly wrote to me. But this was re-examined by a Professor Simpson from—

Richard Posner: Yes.

Tom Bethell: I believe Michigan, and he wrote an article in the *Journal of Legal Studies*. He actually went in 1996 to London. He looked up the records of the case and did all kinds of research on it that Coase himself had not done, and he concluded that it had not been decided on an efficiency basis at all. I also just would like to make one comment, and it seems to me that the concept of efficiency and economic analysis may be somewhat empty because benefits – if you make a cost-benefit analysis, there is always the subjective element of satisfaction that is included in the benefit. So if you say that, well the benefits actually exceeded the cost, the subjective element of satisfaction is always included in that, so it's sort of a tautology. It's essentially meaningless. Whatever happens or whatever event—whatever decision is made by the owner, it's always efficiency maximizing in that way. Anyway, do you have any comment on the Simpson rebuttal of Coase? Do you remember that?

Richard Posner: Brian Simpson is a very able and distinguished English legal history scholar, and on the basis of the research that he did on *Sturgis v. Richmond* I'm sure he's right about the facts. But in regard to your point about subjective utility, there is no doubt that utility in the economic sense includes very large subjective components. So if someone offers you the market value of your house, you may refuse because it's worth more to you than the market value. That's perfectly appropriate; even apart from relocation costs, it may be worth more to you. The problem in cases like *Sturgis v. Richmond* is that you have competing property interests: the candy maker wants to run his machine, and the doctor wants to have a quiet examining room. And it seems to me that some kind of cost-benefit analysis is the only way to resolve conflicts of that sort. We have first to make a judgment on whether there is any way to silence the ma-

chine; if not, then one of these land uses will have to be changed. Maybe the doctor will have to move to a quieter area, or the candy maker to a noisier area. That's the general problem that Coase discussed, most illuminatingly, in the context (though he did mention the *Sturgis* case) of damage to crops from locomotive sparks. The locomotives of nineteenth-century trains emitted sparks that would occasionally cause fires along the right-of-way. If there were crops planted there, particularly crops that are especially fire-sensitive, there would be harm to the farmer. But if court says that the railroad is going to be liable for any damage caused by the sparks, this will increase railroad costs. But maybe they can install spark arresters. One would then have to compare the expense to the railroad of the spark arresters against the expense to the farmers of moving their crops back or planting different crops (or no crops). I can't myself see what rational basis there would be for deciding such issues of conflicting property use other than some kind of cost-benefit analysis, probably quite informal. The alternative would be to take the issue out of the courts, letting the legislature make basically zoning judgments. But it is not clear that the legislative judgments would be any better than the judicial. What would you do?

Tom Bethell: I think Professor Simpson had something—he referred to the Doctrine of Last Grant, I believe? Essentially I think it means that if you have some kind of property, and somebody comes along and makes a noise, and you don't do anything about it for a few years, and then you decide that it's annoying to you, you've lost your right to complain about it. I think Simpson said that it was in fact decided along those lines, using some such rule, a purely legal rule, not an efficiency rule at all.

Richard Posner: Yes, but actually that is efficient. It's an aspect of a general legal rule called prescription. Suppose you have a neighbor, and you happen to build a structure that encroaches on his land. You think it's your land, but it's actually his. He sees the structure, he knows you consider it to be your land, and then he doesn't do anything for, say, seven years. After a certain point, he can no longer sue; the statute of limitations has run. But all this doesn't get to the basic question, which is: suppose in *Sturgis* that the doctor complains promptly, and the candy maker says I have a factory, and my property right includes the right to manufacture candy using a noisy machine because there aren't any quiet candy-making machines. The doctor says no, my property right includes quietude. So now what do you do with that conflict? There's no satisfactory pure legal doctrinal rule that resolves that issue. They both have property rights. The problem is that their property rights are in conflict because of their proximity.

Walker Todd: All right. Anyone else with a question from the floor? I

have one. Mine was—there are two things I would like you to comment on that have already come up in this conference so far. We just finished a panel on development finance where one of the turning points of the discussion was, what's the role of property rights in development? Well, you don't have to answer that one unless you want to. But in the Anglo-American common law tradition, what do you think the role of property rights is? Is it nine-tenths of law, with torts, contracts, and other things all following afterward? Are these other legal subject matters just the residue of what's left over in property rights and property rights enforcement? Or how do you see that mix? I know that you—I think you believe as I do, that property rights are the fundamental component of the law, and the other things follow after. But in what mix or in what proportion? Do you have a view on that?

Richard Posner: Property rights certainly are fundament in the sense that if you were talking about a contract, say, the contract would presuppose preexisting property rights. Say you sign a contract with someone to build a house on your property. That presupposes that you own the property and also that the builder is going to purchase building materials from the people who own them, and then he will own them, and then when he builds the house on your property the ownership of the house will be yours, not his. In that sense property rights are fundamental, and similarly in most tort cases, including trespass and, what we were just talking about, what is called nuisance. Is the candy maker causing a nuisance that can be abated at the suit of the doctor? Again, resolving such cases presupposes the existence of property rights. The major qualification has to do with personal injury because we don't really think, at least from a legal standpoint, that people actually own their bodies. If someone drives onto your land without your permission, then, with very, very rare exceptions, that is a trespass. That person could be arrested, enjoined, and so forth. But if you're a pedestrian and someone runs you down, that person does not bear any civil or criminal liability unless he was negligent. Which means you don't have property rights in your body. You do have legal protection. You're protected by a liability rule which says that if you're a victim of negligence, you can obtain damages, and maybe there will be a criminal prosecution. But those are weaker forms of protection.

Walker Todd: Are there any recent developments in intellectual property law that you want to flag in particular as worth following, or raising some new lines of development that we have not really taken into account if all we focus on is traditional lines of property inquiry, especially real estate?

Richard Posner: Yes, I would like to comment because I think intellec-

tual property brings out more sharply than physical property some of the paradoxes, purposes, and complexities of the concept of property and its administration by the legal system. Physical property has the important characteristic of not only being visible, definite, and identifiable, but more important than those is the fact that, generally, physical property can be used by only one person at one time. Obviously there can be sharing, but in general, if you're lying in my hammock, I can't lie in my hammock. And if you're squatting on my lawn, maybe there's room for me to sit there, but you're clearly invading my space and reducing the value to me of my use of the property. And that violates an essential characteristic of property, which is that it should be possessed exclusively, because if you have squatters and other interlopers occupying your property, that reduces its value. That is a very strong foundation for exclusive property rights. Intellectual property is different because a general characteristic of such property is that it can be used by an indefinite number of people. You can make a million copies of a book and as a result have a million people reading the same book, and they're not, by doing that, interfering with any other persons' uses of it.

Because intellectual property is sharable in this sense, and also because it's invisible, making it difficult to ascertain boundaries, there is a lot more difficulty in implementing a system of exclusive property rights than we have with physical property. And so there are dangers in trying to transport wholesale our system of physical property rights into intellectual property.

An example is the doctrine of fair use. If you're reviewing a book by me, you can quote from my book and put the quotations in your book review and you don't have to get my permission. So you are in fact appropriating my property; you're using my property, my copyrighted book, without my permission. But you have a legal privilege to do that. Now we would never tolerate that with physical property. A person can't come up to you and say, "I'd like to take your car—I'm taking your car for a joy ride. But it's only going to be a short joy ride. *(Laughter)* I'll return it in a half hour, so you have nothing to worry about." Our property laws don't allow that. You have to get permission. But in the case of intellectual property, we permit a good deal of copying without the permission of the owner, and we call that fair use. It's a controversial doctrine; its boundaries are vague. But it's a very important doctrine, and the reason for this comes back to Ronald Coase. It's the core of his article that contains the discussion of the *Sturgis* case. Transaction costs tend to be high in the case of intellectual property. Sometimes they're absolutely high because you're trying to get permission to reproduce something that was copyrighted 75 years ago and you can't find out who the copyright owners are because we don't have the same kind of registry system that we have for physical

property. Or sometimes, as in the case of quotations, it's just too costly to have to negotiate with someone from whom you want to quote one sentence – not that the cost would be that high, but the benefit, after all, of only one sentence is small relative to the transaction costs.

So potentially there is a lot of lawful depropertization in intellectual property. And we know, of course, with all the file sharing litigation that's going on, that even if we say, we conclude that it's not fair use to download someone's song, you're just doing it so you don't have to pay, you're not doing it because you're incorporating it into some other work or into the musical counterpart of a book review. Nevertheless, because of technology—because it's so much easier to download someone's song than it is to pick up and walk away with his physical property—it is extremely difficult to police property rights in certain forms of intellectual property. Eventually what we may come to in the case of downloading is just jettisoning property rights as unworkable and saying, well, we're going to have some compulsory licensing scheme or tax so that every time someone downloads a song, there will be some mechanism by which a 25 cents license fee is credited to the copyright holder.

From an economic standpoint, property rights are instruments for achieving or maximizing economic welfare. So if in particular cases property rights are too costly relative to the benefits you get from them, then you may substitute some other instrument that results in depropertizing some area of intellectual property. But as long as it's a sensible measure to promote economic welfare, the economist will tend to approve it.

Walker Todd: We've now reached about 3:30 p.m. I don't know how much time you have. We'd agreed that maybe you could go for about half an hour, but if you have more time, we'd be glad to keep you on.

Richard Posner: Well, I do actually have to leave pretty soon, but another question or two would be all right.

Walker Todd: Any last shots? I see one in the back. Yes, go ahead.

Questioner: I just wondered if I could follow up on a question with *[indistinct]*. One of the arguments that file sharers and other people are making against *[copyright protection?]* right now is that the copyright protection system is not keeping in accordance with the Framers' original idea that copyright protection should confer a short, reasonable monopoly for a valued idea—

Walker Todd: Right.

Questioner: And so you should ask, What does the judge think about that?

Walker Todd: Yes. Right. I'll repeat that for Judge Posner. The question follows up on the intellectual property issue regarding matters like copyrights and patents. If you recall, the original Framers' idea on that was, for a limited time, inventions and the like would be reserved exclusively to their inventors and then fall into the common use, but recent trends, which I believe are almost exclusively legislative, not judicial, right?

Richard Posner: That's correct.

Walker Todd: Recent trends have extended these times to arguably unreasonable lengths, so that we're flying in the face of the original intentions. Do you have any thoughts on that?

Richard Posner: I agree with that. It used to be that, although there have been a lot of changes, until 1976 in the United States the original copyright term, going back to the eighteenth century, was fourteen years. You were allowed one renewal term of fourteen years, but I think by the 1970s it was 28 years and then a 28-year renewal. (I may be off some.) But then in 1976, because we wanted to join the Berne Convention, we had to agree to conform to the European model of intellectual property rights, which was not a fixed term from the creation—the publication of the copyrighted work—but instead from the death of the author. Initially it was the death of the author plus 50 years. And then in the Sonny Bono Copyright Term Extension Act, which the U.S. Supreme Court upheld in *Eldred v. Ashcroft* (2003), Congress substituted 70 for 50 years. Life plus 70 years is a very long term, much longer than can be justified in terms of creating incentives to create intellectual property, because with discounting to present value, if you extend the term from the end of your life plus 50 years to end of life plus 70 years, that extra 20 years of potential royalties, when discounted to present value at any reasonable discount rate, is utterly negligible. There's also depreciation, not just discounting.

There may be other justifications, as explained in a recent book by Bill Landes, an economist at the University of Chicago, and me called *The Economic Structure of Intellectual Property Law* (2003), but they're not related to the basic incentive to create, which is the principal rationale for copyright. The biggest concern that I have with very long copyright terms arises from the fact that, as the question reflects, most intellectual property is actually made out of other intellectual property. It builds on preexisting expression. In principle, you can incorporate any previous expression in your work by obtaining a license from the copyright owner. But if the copyrights are very old, if you want to use material owned by a lot of different copyright holders, or if it's unclear about whether a particular kind of borrowing you're going to do will or will not actually infringe, the transaction costs of obtaining the permission to incorporate this work may

be utterly prohibitive. That's the economic argument for having a large public domain of intellectual property from which anyone can draw on without being able to prevent other people from also using what he has taken. Historically, that intellectual public domain, that area of depropertized materials for use by later authors, has been extraordinarily important. The longer the copyright term, the smaller the public domain. We have tried to transport physical property rights, which have no fixed time limitation, into the intellectual sphere. But doing so leads to and underscores the fact that depropertization, as well as property rights, can be a tool for bringing about efficient results.

Walker Todd: All right. I want to thank you for being with us.

Richard Posner: Oh, you're very welcome—I'm very sorry I couldn't be there in person.

Walker Todd: We've enjoyed it thoroughly so far, and I'm sure you would have enjoyed it, too. We do know how much you like coming here. *(Applause)*

Endnotes

[1] Hon. Richard A. Posner, Judge, U.S. Court of Appeals for the Seventh Circuit (Chicago), was unable to be present because his court was in session this date. There follows a telephone discussion with Judge Posner during the conference. The questioner is Walker F. Todd, AIER, the conference organizer.—Editor.

COMMENTARY

Howard Segermark

Walker Todd: I'm going to introduce Howard Segermark while we make our way to our seats. I originally asked Mr. Segermark if he would take on this dual role as I characterized it to him – I'd like him to respond to anything that Judge Posner said that appealed to him and also, given his background, which I shall explain in a moment, to talk a little about what it's like to defend property rights on Capitol Hill. *(Laughter)* And you can well imagine that's one of the most thankless tasks in the universe: the old saying about no man's life or property being safe when the legislature is in session, and so on.

Male voice: As with judicial decisions.

Walker Todd: Right. Howard Segermark is a veteran of eighteen years experience as a congressional aide on Capitol Hill, culminating as an economic affairs counsel to, among others, former Senator Jesse Helms (R-NC). In that role, he was able to develop monetary and tax legislation and legislative strategies that were implemented when the Reagan administration arrived in January 1981. He is a Washington lobbyist representing various trade associations, and he is a senior trustee for the American Motorcyclists Political Action Committee. *(Laughter)* And he is a member of the Philadelphia Society, the Committee for Monetary Research and Education, and the Board of the National Civic Art Society. He's author of the paper, "The Citizen Lobbyist."

Howard Segermark: I appreciate that. I did not ride my bike up here this weekend. Unfortunately, I just didn't have the time, though it would have been a perfect weekend to do so. The following is an interesting anecdote which I think illustrates some of the political issues facing property rights in Washington. Jeanne Kirkpatrick was nominated by President Reagan to be U.S. Ambassador to the United Nations, and in 1981 the Senate Foreign Relations Committee held hearings on her confirmation. My boss at the time, Senator Helms, was a member of that committee, and just because he was going to vote for her didn't mean that we couldn't throw some logs in front of the train that was going down the track. I drafted a question for him which simply said this: **"**Ambassador Kirkpatrick, are property rights human rights?**"** As you know, Jimmy Carter was talking about human rights in every other speech he made, and this was still a politically high-priority issue. And she fumbled it. She started talking about the importance of human rights and didn't address property rights at all. About six years later, there she and I both attended a dinner in Georgetown. I asked her if she remembered that question and said that I had drafted it for Senator

Helms. She said, "You did that!" She added, "Howard, I have learned a lot. And property rights are absolutely human rights." I think that was an interesting educational experience and it illustrates something that we have to teach other policymakers.

Tom [Bethell]'s comments are an important insight into the idea that the origins of human rights lie essentially in the nature of man. Indeed, property rights are integral to man's ability to prosper and, as he pointed out with the Plymouth Colony example, to man's ability to survive. This concept of the nature of man and the integration of property rights within that nature raises an important question that reverts to Tom's theme, and also to important intellectual history.

In the late Enlightenment, the positivist philosophies of Voltaire and subsequently Jean-Jacques Rousseau and Auguste Comte basically theorized that the nature of man was malleable. And in fact, Rousseau had said regarding social situations like the future Paris Commune (1792) that he believed that by the end of the 19th century, children born or raised under such circumstance certainly would be born speaking at least three languages. *(Laughter)* In other words, the nature of man would be changed by the institutions of society. One of the interesting things, and I do not know enough to tell you why, but one of the sources of the concepts that those philosophers were dealing with is what Eric Voegelin talked about: the Immanentization of the eschaton, the bringing into the real world of the final end: bringing about heaven on earth.[1] And they were going to do so by changing the nature of institutions.

The source of evil, interestingly in some of the positivists' views, was private property. Utopian socialists are perhaps the most benign embodiment of this philosophy; i.e., you eliminate private property and place all the means of production in the hands of the state, and people will go about their lives in an idealistic situation. Perhaps Edward Bellamy's book, *Looking Backward* (1888), is one of the best examples of that utopian socialist concept. Karl Marx, however, recognized the fact that human nature does not change as easily as simply eliminating private property. Marx pointed out that the dictatorship of the proletariat was going to be necessary until the Marxist man was created. And of course, millions of people died in the process. I think that the positivist philosophy is still extant, certainly in Washington. My favorite example of this idea that we're going to change the nature of man by changing our institutions was Sargent Shriver's testimony when he was made head of the Office of Economic Opportunity under Lyndon Johnson in 1964, commencing the War on Poverty: "We are going to eliminate poverty in this decade," he said. I mean, that is a classic positivist statement.

Not more than four or five years, ago the concept of the Takings Clause of the Fifth Amendment was brought before Senator Joseph Biden (D-DE) in the Judiciary Committee. Biden basically was appalled that someone would say that people were eligible for compensation when government imposed on property rights and took uses or portions of those property rights. Biden said, "My God, if we have to do that, then we can't do anything around here." *(Laughter)* And of course, he's right. I think that the concept that needs advancement here is that a regime of property rights rigorously enforced is actually a radical critique of the positivist world view that government is basically omniscient and can do anything.

There were a few things in Judge Posner's comments in which I was very interested, but they were addressed in the audience's questions to him. I'm not going into that. But I would like to talk for another minute or two on the concept of political solutions. That is because, as some of our speakers are describing contemporary takings, Washington is where both the problems and hopefully some of the solutions lie.

I think that the only positive news is that there may be hope for incremental improvements in property rights legislation, and certainly things will improve if the President is successful in putting the necessary effort into good judicial appointments in his coming term.

The education effort in any fight affecting public policy is crucial. This effort by AIER (hosting this conference) is excellent and is an early round in the intellectual fight. Earlier today**,** I was speaking to someone here about a political problem**—**one that needs to be solved in Washington. He asked how I would go about effecting a solution, and I said, "Having justice and truth and the facts on your side is often helpful in getting someone to support you in Washington, but it doesn't necessarily mean you'll be successful." That means that there also must be a political fight, and politics is a marketplace. The question has to be asked: Are those who are most directly affected by the property rights issue, and those who support them, willing to work in the political battlefield and against those people who are obviously on the other side?

My second and final point, which also has become clear in this conference by now, is that there is also a very important and politically effective argument in favor of the defense of property rights, and that is the humanitarian argument. Contrary to the evils that the early positivist philosophers thought were brought about by or embodied in private property, it's clear today that humanitarian arguments are on the side of private property, and that private property rights promote wealth creation and a more humane society. That's basically my observation at this point, and thank you very much.

Endnote

[1] The reference is to Eric Voegelin, *Science, Politics and Gnosticism*, Chicago, IL: Henry Regnery and Co. (1968), and Voegelin's *New Science of Politics*, Chicago, IL: University of Chicago Press (1952, rev. ed. 1987).—Editor.

PROPERTY RIGHTS IN DEVELOPMENT FINANCE

Gerald P. O'Driscoll, Jr., and Lee Hoskins*

Introduction

THE importance of having well defined and strongly protected property rights is now widely recognized among economists and policy makers. A private property system gives individuals the exclusive right to use their resources as they see fit. That dominion over what is theirs leads property users to take full account of all the benefits and costs of employing those resources in a particular manner. The process of weighing costs and benefits produces what economists call efficient outcomes. That translates into higher standards of living for all.

Unfortunately, much bad development policy resulted from a neglect of the importance of property rights by many professional economists before the late 1990s. Even if policymakers in developed countries and international institutions now recognize the critical role played by a system of private property in economic development, they are limited in what they can do to help developing countries evolve such a system. Policymakers can, however, avoid recommending policies that undermine private property.

Why Property Rights?

The excuses for development failure are legion: lack of natural resources; insufficient funding of education, culture, religion, and history; and, recently, geographical location. As Friedrich Hayek, Nobel laureate in economics, taught us in another context, we cannot explain success by examining failure: "Before we can explain why people commit mistakes, we must first explain why they should ever be right."[1]

The question that we need to ask is why should nations prosper? We argue that the difference between prosperity and poverty is property. Nations prosper when private property rights are well defined and enforced.

The Wealth of Nations

UCLA researchers Richard Roll and John Talbott provocatively titled a paper, "Why Many Developing Countries Just Aren't."[2] Economic development has been exceptional rather than typical. As Peruvian economist Hernando de Soto points out, capitalism has been successful mainly in the West.[3] The result is incredible disparities in living standards around the world.

Depending on the measure, real income varies across countries by a

factor of more than 100. In 2000, real per-capita GDP was $50,061 in Luxembourg and $490 in Sierra Leone. Those figures are measured in purchasing power parity (PPP). Using 1995 constant dollars produces even more extreme variations across countries.[4] Differences between neighboring countries can be huge. Depending on the income measure used, real per-capita GDP in the United States is about four to eight times that of Mexico. The socioeconomic consequences of that difference are huge and well-known. Conservatively measured, South Koreans have 17 times the income of North Koreans. That difference surely has something to do with the current tensions on the Korean peninsula.

In the 1930s, the Finns and Estonians enjoyed a similar standard of living. The two countries are virtually neighbors. Their languages share a common linguistic root, and they are culturally similar and share many values. (Despite being a Baltic country geographically, Estonians consider themselves to be a Nordic people.) Depending on the measure employed, in 2000 the average Finn earned two and a half times to more than seven times what the average Estonian earned. Fifty years of Communist rule surely had something to do with the gap in incomes that opened between the two countries.

In the past, substantial differences existed between the standard of living in East and West Germany—two countries with essentially the same resources, education, culture, language, religion, history, and geography.[5] Why the tremendous income differences?

Hong Kong and Singapore are city states, almost completely lacking in natural resources. They border much larger and poorer neighbors. Hong Kong in particular experienced long periods of immigration from its poorer neighbor, mainland China. Yet both island nations sustained periods of annual growth of real per-capita GDP at 5 percent for a long period. Singapore's real per-capita GDP doubled from 1962 to 1971.[6] The real per-capita GDP of Hong Kong, a former colony of Great Britain, now exceeds that of the mother country ($25,153 vs. $23,509 at PPP in 2000). The paradoxes abound. Despite its own recent economic miracle, China's real per-capita GDP in 2000 was still just under $4,000. Taiwan's is over $17,000, more than four times China's (both measured in PPP). Prof. Allan Meltzer has recently commented on these near-laboratory experiments in development:

> In each of these comparisons, culture, language, and traditions are the same. Outcomes are markedly different. The countries with capitalist institutions and the market system grew richer; the others faltered or went backwards. A South Korean now lives on an average income about equal to average incomes in the United States in 1945. His North Korean cousin, if he manages to survive, exists by eating roots and

> grass. My colleague Nick Eberstadt points out how much diet and living standards matter: seven-year-old South Korean boys are 8 inches taller than North Korean boys.[7]

Actual, historical economic development of countries cannot be explained by the presence or absence of natural resources. Resources are neither necessary nor sufficient for development. Development has occurred in inhospitable circumstances, and *lack of* development has occurred in countries rich in natural resources. Oil's "curse" is well known.[8] Real per-capita income in Saudi Arabia is a fraction of what it once was. Nigeria, an oil producer, is categorized as a highly indebted poor country. And, Argentina, rich in natural resources including oil, has recently experienced a long recession due to its bad policies and defective institutions.[9]

In their empirical studies, economists correlate output with investment capital, human capital, and productivity.[10] Empirical relevance aside, there is a fatal conceptual flaw in this approach. Both sides of the equation are measuring the same thing:

> The left side measures a flow from wealth, while the physical and human capital variables on the right side measure the stock of wealth. Obviously, if one regresses wealth on wealth plus some "true" determinant of wealth, the latter doesn't have much opportunity to be detected as significant.[11]

It is no wonder then that institutional determinants of growth have been neglected. Even when included in empirical studies, they compete against wealth in explaining economic growth. The modeling of the growth process has obscured it.

Our paper is not intended to be a review of the empirical development literature. Roll and Talbott do a nice job of that.[12] Our focus is on what does matter for growth: private property. We do take note of the empirical results in Roll and Talbott, however.

Roll and Talbott find that nine institutional variables explain over 80 percent of the international variation in per-capita gross national income, with property rights (+) and black market activity (-) having the highest levels of significance. The other variables are regulation (-), inflation (-), civil liberties (+), political rights (+), press freedom (+), government expenditures (+), and trade barriers (-). We commend their paper to the reader who wants more details on the empirical findings.

Economics, Property Rights, and Development

Armen Alchian, Ronald Coase, and Harold Demsetz founded the modern property rights school of economics.[13] They sought not only to delineate the importance of a system of private property rights to the effective

functioning of an economy but to identify the circumstances that lead to the assignment and formation of property rights. Alchian stated:

> By a system of property rights I mean a method of assigning to particular individuals the "authority" to select, for specific goods, any use from a nonprohibited class of uses. As suggested in the preceding remarks the concepts of "authority" and of "nonprohibited" rely on some concept of enforcement or inducement to respect the assignment and scope of prohibited choice. A property right for me means some protection against other people's choosing against my will one of the uses of resources said to be "mine."[14]

Coase shows that the way rights are initially assigned or partitioned does not affect the way resources are used when there are no transaction costs associated with voluntary exchanges of property and no policing costs.[15] Because there are policing costs and transactions costs associated with defining and protecting property rights, such rights will be defined and protected only when the benefits of doing so are greater than the costs.

It is a mistake to assume that the task of assigning, defining, and protecting property rights is the exclusive job of the state. Property rights developed from custom and tradition long before we had nations. In *Property and Freedom,* Richard Pipes provides an overview of the evolution of the institutions of property from primitive times to the emergence of the state. He noted that "in most countries property took the form of possession, claims to which rested not on documented legal title but on prolonged tenure, which custom acknowledged as proof of ownership."[16] Only later did property become regularized with the emergence of the state.[17]

Today, property rights are often worked out among individuals or firms first and then recognized by law. However, governments at all levels continue to weaken or attenuate property rights on a daily basis with a barrage of regulations affecting the use of private property.

The two essential elements of property rights are (1) the exclusive right of individuals to use their resources as they see fit as long as they do not violate someone else's rights and (2) the ability of individuals to transfer or exchange those rights on a voluntary basis. The extent to which those elements are honored and enforced will determine how effectively prices in an economy will allocate goods and services. Both experience and theory indicate that economies with effective price systems are better at producing wealth. In short, the stronger the private property rights system, the better the economy is at efficiently allocating resources and expanding wealth-creating opportunities.[18]

Individuals in all societies have conflicts of interest. One way conflicts are resolved is through competition. The property rights system in a soci-

ety defines the permissible forms of competition. A private property system gives the exclusive right to individuals to use their resources as they see fit and to transfer them voluntarily.[19] Such a system prohibits force and encourages cooperation. Indeed, economic competition is a system of social cooperation.[20] The broader and stronger the protection of private property rights, the more effective prices are at allocating resources, and the more effectively resources are allocated, the greater the wealth creation.

The relationship between protection of property—defined in terms of the transparency, independence, and efficiency of the judicial system—and wealth, measured in GDP per capita for 150 countries around the world, makes the point. On average, GDP per capita, measured in terms of purchasing power parity, is twice as high in nations with the strongest protection of property ($23,769) than in those providing only fairly good protection ($13,027). Once the protection of property shows clear signs of deterioration (moderate protection), even without a totally corrupt judicial environment, GDP per capita drops to a fifth of that in countries with the strongest protection ($4,963). Countries with a very corrupt judicial system are also very poor on average ($2,651).[21]

Some economists raise the problem of external costs as an objection to a strong property rights system. The existence of external costs is used to justify government action to attenuate private property rights. While the existence of an externality or "market failure" is a necessary condition for government intervention, it is not a sufficient condition. Government actions have their own costs and these should be weighed against the potential benefits of such actions.[22] Yet many countries impose regulations that weaken property rights on the mere whiff of an external cost. Regulation affects economic activity because it interferes with private property rights. It does so by attempting to modify, supplant, or replace market outcomes with outcomes mandated by government. Deregulation, as a result, responds to the realization that strengthening of property rights ensures the best use of resources.[23]

Even though preserving property rights clearly enhances countries' growth and development perspectives, assigning and enforcing property rights in some areas can be challenging. This is particularly true with respect to knowledge-based goods and economic use of some natural resources. In both cases, it is very difficult to achieve a consensus across nations either on how to define property rights or on what sort of international mechanism should be created to enforce them. In this sense, the environment and knowledge-based products will continue to be at the heart of the biggest potential conflicts on property rights. Nevertheless, the fact remains that effective protection of property is the only effective

means for societies to make use of what they own, in the most efficient way, to promote both economic growth and prosperity.[24]

Building strong property rights systems in poor countries is no easy task. Establishing a democratic form of government is no guarantee of a strong private property rights system. There are plenty of poor, illiberal democracies that violate or attenuate private property rights with abandon, Argentina being the most recent and flagrant example.[25] Nor is it clear that democracy is a necessary condition for the protection of property rights since property rights have been strongly protected under dictatorships (Chile) and by outside authority (Hong Kong). Yet the strongest systems seem to be in wealthy, established democracies. The source of their success stems not from strong governments but from governments focused on protection of property and individuals' use of that property in commerce. In Hayek's words:

> It was not under the more powerful governments, but in the towns of the Italian Renaissance, of South Germany and of The Low Countries, and finally in lightly governed England, i.e., under the rule of the bourgeoisie rather than warriors, that modern industrialism grew. Protection of several property, not the direction of its use by government, laid the foundations for the growth of the dense network of exchange of services that shaped the extended order.[26]

What would most benefit less-developed countries would be a focus on establishing and protecting property rights. Yet most aid from the United Nations, International Monetary Fund, and World Bank is directed toward other goals and often undermines property rights. Protecting property, letting individuals pursue their own self-interest, and opening up trade offer the best chance for economic growth.

Corruption

Pro-growth development officials increasingly focus on corruption as an impediment to development. Traditionally economists have held two distinct opinions about corruption. Robert Barro has suggested that, under some circumstances, corruption can have beneficial effects.

> In some circumstances, corruption may be preferable to honest enforcement of bad rules. For example, outcomes may be worse if a regulation that prohibits some useful economic activity is thoroughly enforced rather than circumvented through bribes. However, the economy will be hampered when few legitimate activities can be undertaken without bribes. Thus, the overall impact of more official corruption may be ambiguous.[27]

Many economists would agree with the cost/benefit approach to corruption, if not the moral ambiguity seemingly underlying the position. Under

that approach, there is an optimal amount of law-abiding behavior. Economists would tend to agree even more strongly with Barro's position on black market activity, which he sees as an adaptation to poorly defined property rights, high tax rates, and oppressive regulation. By operating in the informal sector, individuals are able to engage in economic activity that would otherwise be lost to weak institutions and bad policies. Still, there are recognized costs in terms of inefficiency, inability to enforce contracts, and lost tax revenue.[28]

Hernando de Soto graphically outlined the costs to the entrepreneurs operating in the black market:

> Contrary to popular wisdom, operating in the underground economy is hardly cost-free. Extralegal businesses are taxed by the lack of good property law and continually having to hide their operations from the authorities. Because they are not incorporated, extralegal entrepreneurs cannot lure investors by selling shares; they cannot secure low-interest formal credit because they do not even have legal addresses. They cannot reduce risks by declaring limited liability or obtaining insurance coverage. The only "insurance" available to them is that provided by their neighbors and the protection that local bullies or mafias are willing to sell them. Moreover, because extralegal entrepreneurs live in constant fear of government detection and extortion from corrupt officials, they are forced to split and compartmentalize their production facilities between many locations, thereby rarely achieving important economies of scale. In Peru, 15 percent of gross income from manufacturing in the extralegal sector is paid out in bribes, ranging from "free samples" and special "gifts" of merchandise to outright cash. With one eye always on the outlook for police, underground entrepreneurs cannot openly advertise to build up their clientele or make less costly bulk deliveries to customers.[29]

De Soto's research led him to conclude that, when it is possible for entrepreneurs to obtain title to their property and operate legally, it is worth paying taxes to avoid the costs associated with operating underground. The poor do not choose to operate illegally out of predisposition to lawless behavior. Speaking of the urban migration process in developing countries, De Soto wrote that "in every country we investigated, we found that it is very nearly as difficult to *stay* legal as it is to *become* legal. Inevitably, migrants do not so much break the law as the law breaks them—and they opt out of the system."[30]

An increasing number of observers of developing countries decry the effects of pervasive corruption. Alejandro Chafuen and Eugenio Guzmán wrote:

> Nevertheless, the same corrupt activity that might enable one person to avoid the burden of an unjust law might also allow someone else to avoid complying with just

> laws. The bureaucrat who accepts a bribe to help one person with a contract might also accept a bribe to leave someone else out of business. Officials who accept bribes to accelerate a regular business errand might also accept a bribe to leave someone defenseless against blackmail. Executives of U.S.-based corporations find themselves frequent victims of such bureaucratic behavior.[31]

There is ample evidence that Chafuen and Guzmán were on the mark. In Roll and Talbott's 2001 study, corruption (the "black market" factor of the *Heritage Index of Economic Freedom*) has a large and statistically significant negative effect on per-capita real gross national income. That variable is second only to property rights in its influence on the standard of living in a country. Once corruption takes root, it is difficult to stamp out. The illicit payments received by government officials become part of their expected compensation. Customs agencies can become little more than schemes for collecting bribes.

One way out of this problem has been for governments to employ private firms, such as the Swiss firm Société Générale de Surveillance, to enforce the rules or even collect customs imposts. In Peru the Fujimori government licensed several inspection companies to conduct pre-shipment inspection of import commodities, which would be used as a valid reference for settlement of duties and clearance charges. This private competitive scheme enhanced customs revenue collection and reduced clearance delays.[32] The government establishes the tariff schedules and rules, but the profit-seeking firm enforces them. Its "reputational capital" at stake, the firm will employ resources to combat corruption.

Alternatively, a country can diminish the incentives for bribe payments by altering policies. Complex tariff schedules containing large variations in rates create incentives for importers to seek favorable treatment by customs officials on the category into which a good falls. Chile introduced a flat tariff schedule for most goods, which greatly diminished rent seeking. That still left a high tariff rate of 10 percent. In 1999, the government announced a policy of reducing the flat rate by one percentage point per year until the flat rate hit 6 percent in 2003.[33]

Although not impossible, weeding out corruption that has taken root challenges the political system. That consideration surely led Thomas Jefferson to argue that prevention is the best cure:

> Human nature is the same on every side of the Atlantic, and will be alike influenced by the same causes. The time to guard against corruption and tyranny, is before they shall have gotten hold of us. It is better to keep the wolf out of the fold, than to trust to drawing his teeth and talons after he shall have entered.[34]

Countries that have held the wolf at bay have generally prospered. The

Scandinavian countries are famous for their low level of political corruption. Despite onerous taxes, their citizens enjoy comparatively high real incomes. Finland and Denmark are often cited as favorable places in which to conduct business. With the exception of Norway (the oil curse again), they enjoy high levels of economic freedom.[35]

As Chafuen and Guzmán analyze it, corruption attenuates property rights by making them insecure. In a politically corrupt society, the ability to open a business and continue to operate it is governed not by rules, but by bureaucratic whim. The rule of men is substituted for the rule of law. The greater the degree of corruption, the less secure are property rights. One would certainly expect a negative correlation between the security of private property and the level of corruption.[36]

The informal sector is an outlet for entrepreneurial activity in repressed economies. That sector is a safety valve for the poor and economically disenfranchised. Nonetheless, it can itself attenuate private property rights. When "knockoffs"—goods violating copyright and trademarks—are sold on the black market, producers of the originals suffer. This is not an argument for harassing entrepreneurs in the informal sector, but for reforming the policies that channel entrepreneurs onto the black market.

Such reforms will enhance the security of private property. That in turn will bring participants in the informal sector into the formal sector. De Soto has written eloquently about how the poor benefit when means are provided for formalizing informal activity. Once an extralegal entrepreneur becomes legal and can title his assets, the whole world of credit opens up to him. His assets "can be used as collateral for credit. The single most important source of funds for new businesses in the United States is a mortgage on the entrepreneur's house."[37]

De Soto and his colleagues estimated the amount of "dead capital" in untitled assets held by the world's poor as "*at least $9.3 trillion*."[38] He estimated the value of savings of world's poor to be "forty times all the foreign aid received throughout the world since 1945."[39] Haiti, the poorest Latin American country, exemplifies the process:

> In Haiti . . . the total assets of the poor are more than one hundred fifty times greater than all the foreign investment received since Haiti's independence from France in 1804. If the United States were to hike its foreign aid budget to the level recommended by the United Nations—0.7 percent of national income—it would take the richest country on earth more than 150 years to transfer to the world's poor resources equal to those they already possess.[40]

In sum, the absence of secure property rights is the cause of corruption, and the creation of private property rights would be the cure for corruption.

If they could operate in an environment of secure property rights, the world's poor would have the solution to their own plight. Indeed with their already accumulated property secured, the world's poor would be much less so.

U.S. Policy: First, Do No Harm

All too often U.S. aid policy, bilateral and multilateral, has been counterproductive, resulting in the people of the recipient countries being harmed rather than helped. Direct U.S. economic assistance, through the Agency for International Development (USAID) and other agencies, and indirect assistance funneled through such institutions as the World Bank, have failed to spark economic development and have too often sustained corrupt institutions.[41]

What Melvyn Krauss has labeled the "consensus of expert opinion" on development in the 1950s, 1960s, and 1970s has largely been proven wrong.[42] Development nostrums have led not to prosperity but to penury in all too many developing countries. Private property was omitted from the development consensus.[43]

The official assistance policy of the United States, and that of many multilateral institutions, is now directed at helping developing countries develop the rule of law and an institutional structure for private property. The problem is that those efforts largely ignore the history of private property in the United States and other countries in which private rights are strongly protected. In *The Mystery of Capital,* Hernando de Soto looked for lessons from U.S. history that could be applied to developing countries. The lesson he gleaned was that each country must evolve its own property rights system according to its own history.[44]

Richard Pipes focused on the history of property in two countries: England and Russia. He also presented evidence for a number of other countries, such as France, Spain, Portugal, Sweden, and the Netherlands.[45] One theme emerges from all the histories. Property and freedom emerged from a struggle over finances between a representative body and a king or ruler. When the ruler was compelled to rely on parliament or its equivalent for a permanent source of revenue, property was protected and liberty flourished. When the ruler was not so compelled, the converse resulted.

In Russia, sovereignty and property merged. Consequently, the Russian despotic ruler had no need of a representative assembly for revenue. The story was mixed in other countries. The English king became increasingly dependent on Parliament for revenue, and Parliament thereby gained supremacy. The struggle was always couched in terms of protecting property and liberty from encroachment by the king:

> The originality of the English parliament, therefore, lies not in its antiquity and function but in its longevity, for it went from strength to strength, whereas its continental counterparts, with few exceptions (notably Poland, Sweden, and the Netherlands) did not survive the era of royal absolutism.[46]

Exporting a country's system of private property rights ultimately entails exporting its history and political culture. That has not been done successfully, other than through colonialism, and then only effectively, for property rights, in the case of the British Empire. History does not repeat itself, and the American political culture finds colonialism alien. So the scope for effective official assistance in this process is limited.

Following de Soto, we see the need for each developing country to work out the problem of evolving a system of private property in terms of its own history. The transition economies of Central and Eastern Europe had the advantage, to different degrees, of a pre-Soviet history of free economic and political institutions on which to build. In some cases, such as the Baltic countries (especially Estonia), and Poland, the transition has been truly rapid.

For countries without such a history of freedom, the process will necessarily be longer. It is unlikely to be a process attractive to outsiders. Russia is a prime example. U.S. policy is constrained in its ability to aid directly the evolution of the rule of law and private property in such countries.

Getting from Magna Carta to parliamentary supremacy in England took roughly half a millennium. Is it reasonable to assume that a country such as Russia could attain the same degree of protection of private property under a rule of law in less than a century?

What any U.S. administration can and should do is to vigorously pursue trade liberalization with developing countries. Tariff and nontariff barriers hit the exports of developing countries particularly heavily, notably on agricultural, and textile and apparel exports. Many of the benefits claimed by advocates of aid, which are seldom realized through aid, actually accrue to international trade. Moreover, developing countries that open their markets to trade set in motion a process of institutional change that can lead to the establishment of the rule of law. The current United States Trade Representative has proposed a number of trade initiatives to help developing countries, and the current and future administrations should pursue these.[47]

Conclusion

Historical economic development can only be explained by private property, the rule of law, and other key institutions. Classical economists un-

derstood this but did not emphasize what they took to be obvious. As economics matured as a discipline in the 19th century, ideas critical of property rights began to take hold. In the 20th century, economists became enamored of macroeconomics and technique over microeconomics and institutions.

The rise of the omnipotent nation state in the 20th century, accompanied by the decline of classical liberal ideas, caused economists to lose sight of the fundamentals of development. Economists came to accept absurdities as fact. "'Measured Soviet real GNP has grown more rapidly over the long run than have most of the major market economies,' Paul Samuelson wrote in the 13th (1989) edition of his famous textbook, even as the Berlin Wall was coming down."[48]

The lessons learned from the economics of property rights have yet to be effectively incorporated into policy by bilateral and multilateral aid agencies. Shifting aid resources away from fashionable development programs toward institutional arrangements that protect property, improve market price systems, and reduce trade barriers may give the poor a shot at a better economic future. More likely, the countries themselves will need to evolve the needed institutions. Promoting free trade is one practical way to advance the rule of law and protection of private property.

Endnotes

* An earlier version of this paper was published by the Cato Institute as "Property Rights: The Key to Economic Development," *Policy Analysis*, No. 482, August 7, 2003, from which this article is adapted with permission of the Cato Institute.

[1] Friedrich A. Hayek, "Economics and Knowledge," in *Individualism and Economic Order*, Chicago, IL: Univ. of Chicago Press (1948), p. 34.

[2] Richard Roll and John Talbott, "Why Many Developing Countries Just Aren't," Los Angeles, CA: Univ. of California at Los Angeles, November 2001 (unpublished manuscript). This paper is available in the Social Science Research Network (SSRN) electronic library.

[3] Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, New York, NY: Basic Books (2000).

[4] See Gerald P. O'Driscoll Jr., Edwin J. Feulner, and Mary Anastasia O'Grady, 2003 *Index of Economic Freedom*, Washington, DC: Heritage Foundation and Dow Jones (2003), esp. table "Per Capita Income throughout the World," pp. 432–35. This table is used for the subsequent comparisons in this section of the paper.

[5] Official U.S. statistics missed these differences. In 1989, the year the Berlin Wall fell, per-capita income was reported to be higher in East Germany ($10,330) than in West Germany ($10,320).U.S. Department of Commerce, *Statistical Abstract of the United States*, Washington, DC: Government Printing Office (1989), p. 822. Cited in Tom Bethell, *The Noblest Triumph: Property and Prosperity Through the Ages*, New York, NY: St. Martin's Press (1998), p. 12.

[6] World Bank, *World Development Indicators Online,* www.worldbank.org/data. See also Gerald P. O'Driscoll, Jr., and Sara J. Fitzgerald, "Trade Promotes Prosperity and Security," *Heritage Foundation Backgrounder*, No. 1617 (December 19, 2002), tables 1 and 2 and pp. 6–7.

[7] Allan H. Meltzer, "Leadership and Progress," The Irving Kristol Lecture of the American Enterprise Institute, Washington, DC, February 26, 2003, p. 5. Meltzer's comparisons were the two Germanys, the two Koreas, and between China and "the Chinese diaspora in Taiwan, Hong Kong, and Singapore." Richard Pipes, the distinguished historian of Russia, makes a similar comparison in *Property and Freedom*, New York, NY: Alfred A. Knopf (1999), pp. 286–87.

[8] Sachs and Warner found a negative correlation between natural resource exports and economic growth. Natural resource abundance tends to lead to higher protectionism. See Jeffrey Sachs and Andrew Warner, "Natural Resource Abundance and Economic Growth," National Bureau of Economic Research *Working Paper*, No. 5398 (1995).

[9] The Argentine economy contracted 10.9 percent in 2002 and has been in recession since July 1998. The consumer price level (CPI) rose 42 percent from 2001 to 2003 as the value of its currency declined 70 percent against the U.S. dollar. The government also defaulted on the public debt. "Argentina's GDP Contraction Breaks Record," *Wall Street Journal,* March 20, 2003, p. A16.

[10] This discussion follows that in Roll and Talbott, note 2, pp. 5-6.

[11] Roll and Talbott, p. 6.

[12] For a discussion of the technical issues involved in their study, see Roll and Talbott, pp. 8 and 13–15.

[13] The classic articles are as follows: Armen A. Alchian, "Some Economics of Property Rights," reprinted in his *Economic Forces at Work*, Indianapolis, IN: Liberty Press (1977), pp. 127-149, reprinted from *Il Politico* (1965); Harold Demsetz, "The Exchange and Enforcement of Property Rights," *Journal of Law and Economics*, vol. 7 (October 1964), pp. 11-26; and Ronald Coase, "The Problem of Social Cost," *Journal of Law and*

Economics, vol. 3 (1960), pp. 1 *ff*, reprinted in Avery Wiener Katz, ed., *Foundations of the Economic Approach to Law*, New York, NY: Oxford Univ. Press (1998), pp. 69-79.—Editor

[14] Alchian, note 13, p. 130.

[15] Coase, note 13, pp. 69-73.

[16] Richard Pipes, *Property and Freedom*, New York, NY: Alfred A. Knopf (1999), p. 65.

[17] Pipes, note 16, pp. 97-98. Possession, inheritance, and customary law precede the state. This view is consistent with Hayek's. See, for instance, F.A. Hayek, *Law, Legislation and Liberty: Volume I: Rules and Order*, Chicago, IL: Univ. of Chicago Press (1973). De Soto, note 3, focuses on the absence of legal title to property in developing countries, despite the presence of well developed states. He concludes that "the only way to find the extralegal social contract on property in a particular area is by contacting those who live and work by it." That is, look to who possesses it and is accepted as customary owner. De Soto, p. 182.

[18] See James Gwartney and Robert Lawson, *Economic Freedom of the World: 2002 Annual Report*, Vancouver, BC: Fraser Institute (2002), pp. 6–7.

[19] Alchian, note 13, pp. 127–29.

[20] Ludwig von Mises, *Human Action: A Treatise on Economics,* 3rd rev. ed., Chicago, IL: Henry Regnery Co. (1966), pp. 143–45.

[21] See Lee Hoskins and Ana I. Eiras, "Property Rights: The Key to Economic Growth," in Gerald P. O'Driscoll, Jr., Kim R. Holmes, and Mary Anastasia O'Grady, *2002 Index of Economic Freedom*, Washington, DC: Heritage Foundation and Dow Jones (2002), p. 40.

[22] This is the essential lesson of Public Choice Theory. James Buchanan and Gordan Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy*, Ann Arbor, MI: Univ. of Michigan Press (1962). See also www.econlibrary/Buchanan/buchCv3c1.html. Public Choice Theory spawned a vast literature on "market failure" and "political failure." In 1986, Buchanan won the Nobel Prize in economics partly for that contribution.

[23] Hoskins and Eiras, note 21, p. 40.

[24] Hoskins and Eiras, p. 46.

[25] Fareed Zakaria, "The Rise of Illiberal Democracy," *Foreign Affairs* (November/December 1967), pp. 22–43. See also, Fareed Zakaria, *The*

Future of Freedom, New York, NY: W.W. Norton (2003).

[26] Friedrich A. Hayek, *The Fatal Conceit*, Chicago, IL: Univ. of Chicago Press (1988), p. 33.

[27] Robert J. Barro, "Rule of Law, Democracy, and Economic Performance," in Gerald P. O'Driscoll, Jr., Kim R. Holmes, and Melanie Kirkpatrick, *2000 Index of Economic Freedom*, Washington, DC: Heritage Foundation and Dow Jones (2000), p. 36. Compare with David Osterfield, *Prosperity versus Planning: How Government Stifles Economic Growth*, New York, NY: Oxford Univ. Press (1992), pp. 204–218.

[28] Barro, note 27, p. 32. Compare with Enrique Ghersi, *Teoría de la Corrupción*, Lima, Peru: Cecosami Editores (2003); and Enrique Ghersi, "Economía de la Corrupción," Centro de Divulgación del Conocimiento Económico, *Monografía* No. 73, no date, Caracas, Venezuela, www.cedice.org.ve/archivos/ghersi3.doc.

[29] De Soto, note 3, p. 155.

[30] De Soto, p. 21.

[31] Alejandro Chafuen and Eugenio Guzmán, in O'Driscoll, Holmes, and Kirkpatrick, note 27, p. 61. Compare with John Mukum Mbaku, "Bureaucratic Corruption in Africa: The Futility of Cleanups," *Cato Journal*, vol. 16, no. 1 (Spring/Summer 1996).

[32] Roberto Abusada Salah, Javier Illescas Mucha, Sara Taboada Peña, *Integrando el Peræ al Mundo*, 1st ed., Lima, Peru: Centro de Investigación de la Universidad del Pacífico e Instituto Peruano de Economía, (2001), p. 93; Richard Webb, quoted in "Mar de Fondo," *Caretas*, May 25, 1995, Lima, Peru; "Congreso Eliminó Régimen de Supervisión de Importaciones," in *Diario Gestión*, May 21, 2003, Lima, Peru. We thank Alejandro Caballero Aste for his research help on this point. Also, the Peruvian Congress decided in 2003 to renationalize import supervision.

[33] José Piñera and Aaron Lukas, "Chile Takes a Bold Step Toward Freer Trade," Wall Street Journal, January 15, 1999.

[34] Thomas Jefferson, *Autobiography, Notes on the State of Virginia, Public and Private Papers, Addresses, Letters*, New York, NY: Literary Classics of the United States (1984), p. 671. Quoted in Chafuen and Guzmán, note 31, p. 61.

[35] Sara J. Fitzgerald, "Scandinavia's Changing Political and Economic Landscape," in O'Driscoll, Feulner, and O'Grady, note 4, pp. 39–47. Compare with Gwartney and Lawson, note 18.

[36] Chafuen and Guzmán, note 31, pp. 55–61, found a strong negative correlation between economic freedom and corruption.

[37] De Soto, note 3, p. 6.

[38] De Soto, p. 35.

[39] De Soto, p. 5.

[40] De Soto, p. 5.

[41] See the relevant discussions in the *Report of the International Financial Institution Advisory Commission,* Allan H. Meltzer, chairman, submitted to the U.S. Congress and the U.S. Department of the Treasury, March 8, 2000. See also, David Dollar and Lant Pritchett, "Assessing Aid: What Works, What Doesn't and Why," World Bank Policy Research Report, 1998; and William Easterly, *The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics*, Cambridge, MA: MIT Press (2001).

[42] Melvyn Krauss, *How Nations Grow Rich: The Case for Free Trade*, New York, NY: Oxford Univ. Press (1997), p. 86.

[43] Krauss, note 42, p. 94.

[44] De Soto, note 3, pp. 105–151.

[45] See Pipes, note 16, pp. 151–158.

[46] Pipes, p. 151.

[47] Gerald P. O'Driscoll, Jr., and Sara Fitzgerald Cooper, "Trade, Aid and Economic Growth," forthcoming.

[48] Bethell, note 5, p. 28.

A SURVEY AND COMMENTARY ON THE PROPERTY RIGHTS ENVIRONMENT IN LATIN AMERICA

Mary Anastasia O'Grady

Insufficient Institutional Support for Property Rights

THE need for an improved property rights regime in Latin America, like the ubiquitous call for the rule of law, is by now a cliché. A wide body of evidence makes it quite clear that development requires a strong property rights system, and much of Latin America's struggle to advance is related to weak property rights. Yet when so-called experts inside the Beltway gather round to discuss the region's stubborn poverty these days, the language is invariably directed toward carping about inequality, education, and tax evasion. The property rights issue rarely gets the attention it ought to in policy debates or in action.

I believe there are two main reasons for this. First, establishing and protecting property rights in nearly all of Latin America today would require going against entrenched and powerful interests in these largely closed economies. Any politician who wants to lead a serious property rights reform in the judicial and regulatory bodies would expect to spend enormous amounts of political capital and would take on enormous risk. In short, the costs would be high. Of course, the benefits would also be great but that return wouldn't come about immediately and it would be dispersed.

Asking the political class to go against these realities is naíve. For the average politician, it is much easier to run on promises to alleviate poverty through education spending, taxing the rich, and redistributing wealth. Such rhetoric has broad appeal to large, disenfranchised populations, squeezed middle classes, and large bureaucracies dependent on big government.

This problem is compounded by intervention from wealthy countries, and especially from Washington. The abundance of poverty provokes a cry for distributive justice from international do-gooders, and their solutions nearly always involve wealth redistribution. Many so-called international experts fail to grasp the importance of property rights and instead exert their influence in favor of models that support soft-socialism and weak property rights.

Another reason that the developed world cannot be relied on to encourage stronger property rights is that in the foreign aid world (at international financial institutions [IFIs] and aid organizations like the U.S. Agency for International Development [AID]) the incentives are perverse. Lenders

advance in their careers when they lend; the more loans, the better, regardless of outcome. Moreover, the staffs of these large bureaucracies have no control over domestic political reforms in the countries they work in. Undoubtedly they prefer not to be judged by what they cannot control. Indeed, they do not even want to be evaluated by the outcomes of their projects. Proof of this is the fact that James Wolfenson, the president of the World Bank, staunchly resists all efforts to establish an independent auditing program for World Bank lending.

Governments as Principal Violators of Property Rights

In assessing the property rights problem in Latin America, one has to start with the most egregious culprit: government. From Nicaragua to Peru to Argentina, in Mexico and in Brazil, government is the prime violator of property rights. A few examples demonstrate the point.

In Nicaragua, the defeat of the Sandinistas at the polls more than a decade ago did not clear the way for a more classically liberal government to advance a firm property rights agenda. The Sandinistas never really gave up control of the military and forced the opposition party into a political agreement that amounted to a sharing of the spoils of war. The Sandinistas who had confiscated large homes and land holdings during the 1979 revolution maintained their "Piñata" grab. Today, Sandinistas hold important positions as judges ruling on property rights issues.

Peru has such a dismal track record on property rights that when the Camisea gas project sought commitments from international investors it had to sweeten the deal with a loan from the InterAmerican Development Bank (IDB). A source close to the project told me that it was not the money that the investors required but rather the IDB involvement, which, they reckoned, would reduce the chance of an expropriation in the future.

That may be true, but it misses the point. If IDB involvement is to protect investors from government confiscation, how are small and medium size businesses, which cannot secure IDB loans, supposed to give confidence to their investors? What is particularly troubling is that this kind of case-by-case lending in mega-deals allows the Peruvian government, which quite obviously wanted the Camisea project to go forward, to avoid reforming its property rights structure.

If there was no IDB guarantee, Peru would have to do something to demonstrate its commitment to property rights. This would help all investors, small, medium, and large, to achieve greater security. Instead, less influential businesses that are trying to attract capital remain vulnerable to the discretionary whims of the Peruvian government, while the big fish like Camisea get safe passage.

This raises one of the key drivers of the perpetual poison of populism in Peru. "Equality under the law," such that small investors can be protected in the same way that large investors are protected, is non-existent. No wonder a resentful population is attracted to the ideas of snake-oil salesmen like former president Alan Garcia. Mr. Garcia's presidency devastated the country, but he is now making a political comeback, largely as a reinvented populist.

The Argentine case is classic. Not only did the government devalue the Argentine peso in 2002, which of course is a major violation of property rights, but it also confiscated bank accounts and converted dollar deposits into newly devalued pesos. It also forced banks to alter their loan portfolios asymmetrically, and it tore up contracts it had signed with investors in a variety of public sector utility suppliers. It was this government-sanctioned violation of property rights that has destroyed the Argentine economy and still threatens its future.

Mexico, though inching, in my estimation, toward a rule of law, still has many problems. And most of them are an outgrowth of a culture that fails to restrain government. A recent case in Mexico featured a Supreme Court decision which ruled that Mexico City owed compensation to a property owner whose property was confiscated some years ago. The mayor of Mexico City, Andres Lopez Obrador, announced that he would not pay it since he felt that the money could be better used to fund social programs. The good news here is that the federal government has come down hard on Mr. Lopez Obrador, suggesting that it understands how this flagrant contempt of the courts threatens Mexico's democracy. The bad news is that Mr. Lopez Obrador remains a very popular politician and a serious candidate for the 2006 presidential election.

Importance of the Regulatory Framework

Takings are not the only vehicles that government uses to damage property rights. Another important impediment to development is a failure to provide an efficient regulatory framework.

This involves much more than the failure to title land efficiently. However, to understand the nexus between property rights and regulation, the example of land titling is a good place to start.

Bringing informal home owners into the formal sector is a serious challenge that most Latin American governments traditionally have ignored. Former Peruvian President Alberto Fujimori originally was celebrated internationally because he embraced, in his first term, the efforts of Peru's private Liberal Democratic Institute, founded by Hernando de Soto, which was working hard to increase land-titling for the "young towns" around

Lima. Unfortunately, that project was eventually turned over to the government and bogged down in bureaucracy.

Yet even if the titling process had been fully successful, it has become clear that it would have serious limitations if not accompanied by other reforms. Mr. de Soto now writes about how a land title without the legal framework that allows property owners to make use of their assets, beyond a place to live, is suboptimal.[1]

A World Bank study released recently, called *Doing Business in 2005: Removing Obstacles to Growth*,[2] defines the problem as follows: "Facing high transaction costs to get formal property titles, many would-be entrepreneurs own informal assets that cannot be used as collateral to obtain loans."

But the study goes on to say that many titling programs, while they sound good, have not been especially successful. "While it is critical to encourage registration of assets, it is as important—and harder—to stop them from slipping back into the informal sector and to use their formal status to gain access to credit."

That is because other aspects of regulation have to be included in the reform effort. As the World Bank report says, "Registering property—a new topic in this year's report—explains that when formalizing property rights is accompanied by improvements in the land registry, collateral registry, the courts, and employment regulation, the benefits are much greater. If the formal cost of selling the property is high, titles will lapse by being traded informally." This, of course, is a tall order for governments in poor countries, particularly because challenging corrupt regulatory structures requires some real political heavy lifting. Bureaucracies live off the fat of regulatory graft. Cutting out the middle man is sure to starve more than a few civil servants.

As the Bank notes, "Simple procedures to register property are also associated with more perceived security of property rights and less corruption. This benefits all entrepreneurs, especially small ones. The rich have few problems protecting their property rights. They can afford the costs of investing in security systems and other measures to defend their property. But small entrepreneurs cannot."

The report also notes that "Reform can change this. Across countries, firms of all sizes report that their property rights are better protected in countries with more efficient property registration. But the relationship is much stronger for small firms."

Another topic the Bank studies in its report is "Protecting Investors:

Corporate Governance." Again, the report importantly highlights the costs to small and medium size businesses of poor governance. "Good corporate governance is just as relevant for entrepreneurs in poor countries that seek equity from business partners. Potential investors everywhere worry about expropriation by controlling owners or managers. Whether in rich or poor countries, the same principles of good corporate governance apply."

The report notes that "Preventing expropriation, and exposing it when it occurs, requires legal protection of shareholders, enforcement capabilities, and—the focus of *Doing Business in 2005*—disclosure of ownership and financial information. Whether small investors decide to go to the court, file a complaint with the regulator or feed the information to the media and embarrass the insider, better information disclosure helps."

A third element that heavily impacts business and is treated by the World Bank report is "Enforcing Contracts: Court Efficiency." Contract enforcement is critical for businesses to engage with new borrowers or customers. The institution that enforces contracts between debtors and creditors, suppliers and customers, is the courts. In many countries around the world, courts are slow, inefficient, and even corrupt. The evidence here tracks the differences in the efficiency of contract enforcement, looking at simple transactions of relevance to the average firm in everyday business activity.

Finally, the report measures "Closing a Business: Bankruptcy." Report authors note that socializing failures, which appears to be the politically correct way for governments to handle bankruptcy, has been extremely costly for entrepreneurial development. As the report notes, "In countries where bankruptcy is inefficient, unviable businesses linger around for years, not allowing assets and human capital to be reallocated to more productive uses. Most often, the bottlenecks in bankruptcy are associated with an inefficient judicial process, and hence the unwillingness of banks and other lenders to push for a formal bankruptcy resolution."

This has been a major deterrent to recovery in Mexico since the "tequila effect" crisis of 1995. Banks have not been able to enforce contracts and, as a result, have not returned to lending.

How Latin America Compares

Latin America scores extremely poorly on most of the measurements in the World Bank study just discussed. The sum of its record has acted to suck the oxygen out of the air for entrepreneurs and has badly damaged economic mobility. With so little chance to better themselves legally, it is no wonder that the poor gravitate toward political mechanisms that seek relief through populism. Add to the regulatory nightmares most striving businesses encounter the decades of inflation in much of the region, and

the property rights picture grows even dimmer.

Thus one of the consequences of bad government policy is bad private-sector behavior. Land invasions are one, though not the only, manifestation of this phenomenon. Squatters taking over property are a massive problem in much of rural Latin America, but ubiquitous land grabs cannot be viewed in a vacuum. I think they must be seen as a natural result of government policy that blocks every other possible path to upward economic mobility.

Property Rights Allocation and Enforcement: Problems in Costa Rica and Brazil

Costa Rica and Brazil are two good examples of the land seizure phenomenon. The Costa Rican example shows what happens when government refuses to apply the rule of law to the threat of violence. Brazil demonstrates how a frustrated mass of humanity, shut out of the legal economy by the kinds of government failure reported by the World Bank, naturally becomes a politically powerful movement.

Back in 1995 I wrote a column about land invasions in Brazil. The column prompted a phone call from an American man whose father had bought land in Costa Rica and was under siege by squatters. I traveled to Costa Rica to research the case. Max Dalton was a retired farmer from Idaho who had bought land on the southwestern coast of the country, with the altruistic vision of teaching the locals more sophisticated agricultural techniques. But an organized group of criminals, who had once been union leaders of the United Fruit operation in Golfito, had other ideas for the land Mr. Dalton bought. They organized to take his land because they had an expectation that developers would buy the property to build a resort.

Thus began Mr. Dalton's struggle. The courts continually affirmed his legitimate deed to the property, but due to the country's "homesteading" law, the squatters had incentives to keep invading the property. Under Costa Rican law squatters who manage to squat for a year gain a partial claim. After ten years, they become rightful owners. The onus is on the property owner to remove trespassers, and thus Mr. Dalton was sentenced to a continual series of hostile confrontations in order to protect his property. One day, despite his secure legal claim, his adversaries surrounded him, chopped off his arm and watched him bleed to death on the ground.

The squatters who wanted Mr. Dalton's land masqueraded as the "marginal" poor. Yet my interviews in the area revealed that they were a well-organized group of extortionists, without any worry that the law would stop them. Locals repeatedly told me that these "squatters" had managed to acquire land all over the area and that they practiced a kind of blackmail,

demanding money from homeowners to protect them from assaults on their property.

According to the 2004 *Index of Economic Freedom*, published by the Heritage Foundation and the Wall Street Journal, the U.S. State Department reported in 2003 that land owners in Costa Rica "face an error-prone land titling system and sluggish judicial system vis-â-vis civil cases." That report noted that in recent years legal frameworks have been improved and property owners have been compensated for government expropriations of land, but that "land invasions by squatters remain unresolved." In my own estimation, Costa Rica is aware of the problem but has only moved to deal with it selectively, in places where it has decided that foreign investment matters. In places like Golfito, the law of jungle survives and thrives. The victims are not only Mr. Dalton but also the people he employed and the businesses that would have benefited if his ranch were operating today.

The squatters I encountered in Costa Rica were real thugs. In Brazil, squatter movements may be led by similarly opportunistic operators, but the rank and file seems to have a more honest motivation: to acquire some small piece of property on which to farm.

Looking at Brazil is useful because it provides a clear illustration of how pernicious government policy fuels lawlessness and poverty. Bad policy unfairly rewards a few while making it almost impossible for the majority to survive without going outside the law. As this case shows, the massive organized squatter movement in Brazil is directly related to the grim economic future that most Brazilians face.

My 1995 column on squatters in Brazil was prompted by a massive slaughter of peasant squatters on the edge of Brazil's Amazon Basin—some killed execution style—in a showdown with a large landowner. Onlookers didn't know "quite what to make of the horrifying tales of violence unleashed on these desperately poor people. The squatters' aggression prior to the incident seems mild compared with the brutal torture and murder that ensued," I observed.

But beyond the implied cruelty implied there was a lesson about government policy. "In a study commissioned by the National Science Foundation and the World Bank, researchers Lee Alston, Gary Libecap, and Bernardo Mueller found that violent clashes over land in the northern state of Para are symptomatic of a dangerous mix of government policy: slow bureaucratic land titling combined with a rapid increase in property values due to government development programs. Ironically, land has been settled peacefully and traded informally where government subsidy programs have not distorted values. By contrast, when land lacks clear title and suddenly

increases in value due to government subsidy and incentive programs, conflict and violence result." It is worth pointing out that an additional incentive for property investments in the Amazon was Brazil's persistently high inflation numbers.

The conflict I described happened almost a decade ago. But the matter has not been solved. In October 2004, the World Markets Research Centre *Daily Analysis* reported that "Brazil's radical landless movement, the MST, has threatened to stage 12 'red' months in 2005 if the government does not meet its [land redistribution] targets for this year, according to a report in Folha de Sao Paulo. The warning is in reference to the 'Red April' earlier this year, when the MST staged a record number of land invasions in a bid to put pressure on the government to prioritise agrarian reform. Although the government has made progress, it is not clear as to whether it will meet its targets for this year. Brazilian Minister of Agrarian Development Miguel Rossetto said earlier this month that the government's National Agrarian Reform Plan had settled 56,000 families on a total of more than one million hectares [2.471 million acres] of expropriated land up to the end of September 2004—short of the goal of the Plan, which is to settle 115,000 families by the end of this year."

Of course, Brazil is a huge and complex country, and it would be a mistake to try to explain Brazilian poverty too simplistically. But government regulators ought to ask why, in an age of increasing urbanity and modern agricultural industry, so many Brazilian families view a small plot of land as nirvana. The reason, in my view, is that the development of the Brazilian economy in services, technology, and industry at the micro level is so stifled because of the lack of property rights protection that economic mobility is immensely difficult. For most of the poor, their only hope is in scratching out a living on the soil. Some examples from the World Bank report, *Doing Business in 2005*, illustrate how Brazil's "animal spirits" are damped daily.

It takes 152 days to start a business in Brazil. The only place where it takes longer in the Western Hemisphere is Haiti. In Australia it takes 2 days. Brazil also ranks worst in the region in "bankruptcy" law. It takes ten years to go through insolvency—longer than in Haiti—and creditors get back the least, an average of 2 cents on the dollar. Lastly, Brazil has enormously inflexible employment regulation. It costs roughly 16.5 weeks of pay to fire a Brazilian worker, the second most costly level in the region, and in terms of labor rigidity, Brazil ties with Mexico for the most rigid in the region.

Conclusion: Property Rights Still Are Insufficiently Enforced in Brazil

These policies speak dramatically to the government's view of property

rights, either directly or indirectly. Glacially slow bankruptcy settlements directly contravene property rights. Rigid labor laws discourage the risk-taking of hiring and result in the disenfranchisement of so many. The massive movement of the poor then turns to pressure politicians to confiscate a share of the pie for them.

All this creates a remarkably backward looking economic landscape, defined by an overly intrusive government and controlled by narrow special interests. No one likes the MST, which is widely viewed as a radical leftist organization, but it would be foolish to ignore what is driving its popularity. Rather than redistribute land through expropriations, Brazil would be far better off reforming its property rights regime. It is a lesson from which the entire region could benefit.

Endnotes

[1] Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, New York, NY: Basic Books, 2000.

[2] This study was released in Washington, DC, September 8, 2004, by the World Bank, the International Finance Corporation, and Oxford University Press.

COMMENTARY

Robert Skidelsky

Introduction

THE main point of the O'Driscoll and Hoskins paper is that economic development depends on private property rights. The stron ger and better protected those rights are, the faster countries will grow. The strong version of property rights consists of (a) the exclusive right of individuals to use their resources as they see fit, provided they do not violate others' rights, and (b) the ability of individuals to transfer or exchange those rights on a voluntary basis. Property rights, once assigned, need to be protected not just against other private agents, but against a predatory state. This is generally taken to require, at the very least, a politically independent and uncorrupted judiciary and police force (the Rule of Law). Markets depend jointly on property rights and their enforcement: one cannot sell what one does not own,[1] and one needs to be assured that one gets what one pays for.[2] The more completely specified property rights are, the more complete the market will be, and the faster, therefore, the accumulation of wealth. Creating secure property rights can thus be seen as an optimum growth strategy.

By contrast, "market failure" lies at the heart of Godfrey's paper, though it is confined to a single area: certain types of public lands, such as forests, rangelands, and wildlife sanctuaries. "Essentially all the reasons why lands in the West[ern United States] did not transfer to private ownership are related to an inability to establish enforceable property rights," he writes. His focus, therefore, is on "market failure" as setting a limit to the market economy in the American West, a developing area, which is a topic dealt with cursorily by O'Driscoll and Hoskins. Retention policy in the West was driven by the difficulty of creating a private ownership structure with incentives to use certain types of land efficiently—to preserve it while exploiting it. The tension between preservation and economic exploitation was not, however, resolved by retention—and is reproduced today in the conflict between those who want to keep the land as "wilderness" and those who want to use it for recreation and other economic activity. Godfrey's paper also brings out the point that, in the era of United States expansion westward, property rights were created by the state, as contrasted with Europe where customary possession was more important.

Discussion

Property Rights and Economic Development

The O'Driscoll and Hoskins paper is a good example of contemporary

orthodoxy concerning the relationship between property rights and development. North and Thomas (1973) pointed out that secure property rights were crucial to the "rise of the West" by enabling the equalisation of social and private rates of return. Alchian and Demsetz (1972) argued that only private ownership could solve the monitoring problem in team production. More recently Hernando de Soto (2000) has argued that lack of legal title to property prevents the poor of the Latin American *favelas* from collateralising or equitising their "squatters" holdings. The property rights perspective—coupled with the failure of state enterprises—drove the privatisation movement in Britain and Latin America in the 1980s and 1990s, as well as the "transition" to capitalism of the former Communist countries. As Poland's first post-communist Finance Minister Leszek Balcerowicz argued in 1992, private ownership generates the "quickest improvement of the level of life of citizens. This is so because economizing costs, good organization of work, high quality of production, effective search for new markets, as well as technical progress and development, are in the interest of the proprietors who direct the work of enterprise" (Balcerowicz, 1992).

The problem is that nearly all countries have achieved self-sustaining growth to high levels of per capita income without having the clearly specified property rights postulated by O'Driscoll and Hoskins. Specifically, factor markets—in land, labor, and capital—have everywhere and at all times been more heavily restricted than trade in commodities, with the feudal concept of multiple ownership of the factors never entirely extinguished (Polanyi, 1944). (Its contemporary revival is known as "stakeholder capitalism.") In the political economy of the West, allocation has typically been left to the market, while distribution has been settled through the political process. O'Driscoll and Hoskins acknowledge that, "Despite onerous taxes the . . . citizens [of Scandinavian countries] enjoy comparatively high real incomes." Latterly, East Asian countries have combined extraordinarily high rates of growth with high levels of corruption and strong symbiosis of government and property. The glamour of East Asian "crony capitalism" has faded since the currency crisis of 1997-1998, but China remains a major challenge to the O'Driscoll and Hoskins thesis.

Since the 1978 reforms, Chinese GDP per capita has grown by an average of 9 per cent per year, but its property rights have remained famously "fuzzy." The Chinese experience may be contrasted with the collapses of output which accompanied the mass privatisations in Russia and Eastern Europe following the end of communism.

Chinese economic growth has been driven by the non-state sector, which now accounts for over 50 per cent of industrial output. However, this is not

a private sector in the Western sense. At its core is the "township village enterprise" (TVE), a "vaguely defined co-operative." Legally, TVEs are owned by the local community, not by individual owners. Reward structures are vague and informal. Managers make the operating decisions, while long-term investment, recruitment and profit allocation decisions are jointly determined by community government and managers. "The Chinese model emphasizes competition over privatization. [It] essentially allows or encourages TVEs to compete with and outgrow the state sector, while not attempting to privatize the latter" (Weitzman, 1993).

As Weitzman notes, standard property rights theory would predict disaster for the Chinese model. This prediction has not been fulfilled so far, and it may miss out a crucial strength of the system—its ability to solve conflicts informally. In the standard Prisoner's Dilemma one-shot game, the only result is an inferior Nash equilibrium. However, repeated games can yield Pareto-efficient solutions. "If every member of the group expects that every other member of the group will play co-operatively and that there will be a relatively severe payment for not playing co-operatively, then the cooperative solution may be a self-sustaining equilibrium" (Weitzman, 1993). The crucial variable is the degree of trust. Property rights literature is implicitly culture-free. Ownership gives residual right to control an asset in the case of missing contractual provision, thereby resolving conflicts and preventing shirking. But the orthodox theory is only appropriate to a low cultural function. In the absence of trust, it is critically important to specify legal rules. But East Asia is a "high trust" culture.

O'Driscoll and Hoskins are frustrated by the obstacles which the U.S. government and aid agencies encounter in exporting the "rule of law and private property" to countries whose cultures are inhospitable to them. "Getting from Magna Carta to parliamentary supremacy in England took roughly half a millennium. Is it reasonable to assume that a country such as Russia could attain the same degree of protection of private property under a rule of law in less than a century?" they write. The question is reasonable, but they should not assume that restricted, legally insecure private property rights will abort the economic development of non-Western societies. There are many institutional forms between centrally-planned, publicly-owned economies and market, free enterprise ones which may be able to deliver sustainable rates of economic growth—and, what is more important, sustainable social systems.

Nor should it be assumed that a private property system automatically generates high growth rates. British property rights led to a capitalist agriculture which encouraged the flow of workers from land to towns and agriculture to industry; in France a peasant agriculture, equally based on

private ownership, had the reverse effect and, by most accounts, slowed down the French rate of growth over most of the modern period.

The key difference in outcome lies in the specification of property rights: the British relied on primogeniture, but the Code Napoleon entrenched partible inheritance—that is, the whole family inherited a farm, not just the eldest son. This characteristic of inheritance rights is probably the main explanation of the low birth rate which set in after the French Revolution. If there were too many children, the family farm risked *morcellement*, being divided up into small, unviable plots. Thus "over roughly the same period in which British landowners secured a dramatic and permanent hike in real rents per acre, the Revolutionary land settlement . . . worked to consolidate the economic position of those who farmed the land in France" (O'Brien, 1996, p.229).

From the modern property rights standpoint, partible inheritance is an example of poorly specified property rights. But the economic historian Patrick O'Brien finds virtue in the system:

There is no problem [he writes] in understanding why peasants maintained and extended their proprietorship over the cultivated area of France. They wished to minimise risks over the life cycle inseparable from proletarian status either in the countryside or the town. . . . For millions of French families the peasant farm provided an adequate standard of living, status, security, and opportunities for advancement through fertility restraint and the purchase of land. . . . At present it is . . . no longer clear that Britain's earlier industrial revolution could be represented by even the most panglossian of its historians as the best of all possible paths to the twentieth century (O'Brien, 1996).

I cannot tackle the question of why some countries grow rich and others stay poor in a brief discussion note. But at least three factors seem more important than the precise specification of property rights. The first is the degree of openness to other countries. This boils down to having a trade policy which preserves the link between domestic and world relative prices. East Asian countries—and China today—have gone in for export-led growth, in contrast to the Soviet, Chinese, Indian and Latin American import-substituting growth strategies of the 1950s through the 1970s. It is allowing growth to proceed along the lines of comparative advantage that squeezes the most out of a given set of resources. Second is the raising of social capability through primary education and health care.

Third, Deepak Lal, reporting on a multi-country comparative study of developing countries undertaken for the World Bank in the early 1990s, has emphasised the importance of the monetary and fiscal constitution.

Stability of property rights was more important than their *efficiency* in leading to successful growth performance. "This does not mean that a clean (once and for all, well-defined) redistribution of property rights is ruled out. What is harmful is uncertainty about such distribution."[3] Because a property right is in effect a claim on an income stream from the use of that property, property rights can be altered not just by asset redistribution, but also by changes in the set of taxes and subsidies on goods and factors of production which change the net income stream attached to property. These include changes produced by inflation. Thus, stability of property rights includes a stable fiscal and monetary constitution.

To sum up, while well-specified and protected private property rights may be the "essential ingredient of personal liberty," they are not the essential ingredient of economic growth. Government policy remains the key to the "wealth of nations," as it always has been.

Property Rights and Land

My last comment relates to the discussion of public land and property rights, in the small area of overlap between the two papers. According to Godfrey, it was the absence of property rights which preserved forests in the western United States, whereas O'Driscoll and Hoskins endorse von Mises's view that forests and woodlands were preserved in central and western Europe because the early establishment of private property rights caused the owners to conserve the land in "their own selfish interest." The question arises: Is "Nature" best preserved under public or private ownership?

Mises is right up to a point: the enclosure of common land was started in the 17th century by the European nobility for economic, as well as recreational, ornamental, and status reasons, and this led to preservation and planting of forests.[4] However, this analysis ignores the fact that nobles' property rights were at the expense of peasant rights. As feudal privilege was curtailed, it was the state which intervened, as in the United States, to protect Nature from property rights claimed by land-hungry peasants. Deforestation was greatest in Britain where property rights were most secure and widespread: Britain stopped to figure in the modern story of European deforestation because it had hardly any forests left to chop down.[5] In 19th century France "the destruction of woodland was in evidence everywhere," accompanied by social erosion, driven by land-hungry peasants.[6] The 19th century United States, which had no nobility or feudal privileges, witnessed "one of the greatest episodes of global deforestation ever . . . enacted," with 200 million acres of land, almost half of its original wood cover, cleared between 1850 and 1909.[7] In Imperial Russia, as in the United States, ferocious deforestation was synonymous with the creation

of private property rights beyond the domain of existing settlement, a process vividly captured in Chekhov's *Uncle Vanya* (1899).

Led by Germany, an active policy of state-led "scientific" forest preservation got under way in all Western countries and their colonies and offshoots in the 19th century. The policy of preservation was only possible because of globalisation. The affluent populations in the rich core of the world economy consumed an increasing quantity of agricultural products and timber from the periphery: they were able to preserve small forest areas for themselves by deforesting the rest of the world, a process which continues to this day.

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Endnotes

[1] Burglars are an exception: that is why, if caught and convicted of theft,

they are put in prison.

[2] "Trust" is more important than law and preceded it, particularly in the development of international trade. Without trust, the enforcement system would be overburdened, and the area of exchange would shrink.

[3] Lal (1993), pp. 356-357.

[4] Williams (2004), pp. 206, 272.

[5] Williams (2004), p. 291.

[6] Williams (2004), pp. 281, 283.

[7] Williams (2004), pp. 301-303.

COMMENTARY

Ian Vasquez[1]

Walker Todd: Continuing our discussants on the development papers, I'll now ask Ian Vasquez to come forward from Cato Institute. Ian is an old friend who has written numerous articles on the international financial institutions (IFIs), development finance, and U.S. foreign relations. My favorite book of his that is relevant to this conference is *Perpetuating Poverty: The World Bank, The IMF and the Developing World* (1994), with his co-author Doug Bandow. Ian?

Ian Vasquez: Thank you, Walker. This panel is on development finance, and Jerry O'Driscoll mentioned something that Douglass North, Raghuram Rajan, and others have written extensively about, and that is the close tie in the history of England between the development of public finance and property rights. When the landowners through their wealth and also through their political power in Parliament imposed limitations on the power of the Crown, property rights were respected. Now one key to making that happen was that the landowners were wealthy enough to raise an army against the monarchy. So they could credibly enforce their demands. Another key was that the Crown soon realized that it could raise more money by imposing taxes on productive private property than it could from relying on periodic expropriations. And so the protection of private property really became strong, and public finance in the way that we understand it in the modern era was born. Great Britain was able to issue a lot of public debt following that change.

None of this happened in Latin America, and as Mary O'Grady pointed out, private property rights have never been respected in the region. The conditions that existed in Great Britain did not exist in Latin America. But Latin America governments have come up with many ways of raising a lot of money, getting themselves into debt, and even into over-indebtedness periodically. One of the ways that Latin America has done so has been to rely on resource wealth that governments controlled or owned in one way or another. This was certainly true in Peru in the 1800s, when the tremendous wealth from exploiting guano made the country feel rich: but it was a false type of wealth because the boom soon turned into a bust, with over-indebtedness. This is a process that we've seen in Latin America many times. And that's one of the keys to understanding property rights in Latin America: It has been the state that has so often, through regulations and through direct ownership, appropriated the wealth of each country. In Peru, scholars even talk about the "guano state leviathan" during that era.

In Mexico, in the late 1800s, especially after 1876, the regime of Presi-

dent Porfirio Diaz decided to raise money in a different way. Mexico already had gone through a few debt defaults, so it couldn't easily raise money by issuing public debt in the usual way, and instead it did something which is also very common in Latin America. What it did was to create a special privilege for a certain group of people in Mexico. In this case, one of the favored groups was Banamex, the country's biggest bank, which turned out to be the government's most important financier. And the rules that Porfirio Diaz came up with basically excluded competition in the banking sector. This near monopoly, the World Bank notes, set back the development of financial intermediation in Mexico throughout the 20th century.

This example gives you a picture of the way that, although some people may have had property rights and property rights may have existed in Latin America from day one, governments there have violated everybody else's property rights when they set up this type of mercantilist system. In that sense, I very much disagree with Lord Skidelsky's depiction of Latin American property rights. In fact, what has happened in Latin America has been a continuous violation of property rights by the state. After you've gone through centuries of mercantilism, like Latin America, a generalized condition of presumptive illegitimacy sets in.

I think that the popular sentiment in so much of Latin America against private property that has existed, especially beginning in the 20th century, is the result of continuous violations of private property rights under the mercantilist systems that have prevailed there. In the 20th century, Latin American governments have come up with various other ways of violating people's property rights, through inflation, through direct confiscation, and so on, oftentimes with the direct help of the World Bank and the International Monetary Fund (IMF).

Jerry O'Driscoll mentioned how long it has taken for the idea of the importance of private property to be discussed and recognized by economists. Or rediscovered is probably a better word.

In the developing world, that rediscovery, I think it's fair to say, began in the late 1980s and early 1990s with the publication of Hernando De Soto's book, *The Other Path* (1990), where he popularized the idea of the importance of titling, the importance of the informal economy, and what that means. But in fact, scholars have been writing about the informal economy since the 1960s, so it took a long time for this idea to achieve prominence. And it's interesting to note that, in 1979, Hernando De Soto and his institute held a big conference in Lima where they invited a lot of notable economists, including Friedrich Hayek, to talk about the market economy and market democracies and so on. This was right at the time

when the military dictatorship in Peru was ending and there was about to be a transition to democracy. They produced a big volume of very impressive papers and talks on the market economy and all the implications that were in store for Peru. But there were only about two pages in this very thick volume discussing the informal economy. Hayek himself, in a dinner at Hernando De Soto's house with a few Peruvian colleagues, discussed and impressed upon our Peruvian friends the importance of the informal economy and what it really means for Latin America.

So it took a long time for us to get to what some have called the "orthodoxy" of considering private property rights important. But in practical terms in the developing world, we're very, very far away from actually converting property into title. If you look at Peru, for example, virtually nothing has been done in agriculture; in the rural areas hardly any land has been titled. A lot of land has been titled in the urban areas, and there have been some improvements in urban property rights. Elsewhere in what used to be called the Third World, virtually nothing has been done, and so in practical terms, hardly any improvement has been made in private property rights.

Hernando De Soto has, thus, from the very beginning, been talking about the importance of titling property and what that means in practical terms, with the value of assets going up maybe by 100 or 150 percent, with tax revenues going up, and so on.

We now have several years of experience in Peru with urban titling to see what exactly have been the results, and the agency that is in charge of titling has a web page, and is starting to post some of those results. COFOPRI is the name of the agency. Unfortunately, the results are less encouraging than expected. Mary O'Grady mentioned this during her talk, and I couldn't agree with her more. The problem is exactly as Mary described it: it turns out that titling property is not enough. In Latin America, the entire institutional policy framework is still such that property rights are violated in a number of other ways, especially through regulation and taxation, in ways that don't exist in rich countries, at least not to the extreme levels that exist in Latin America and most of the developing world. Industrial economies typically do not suffer from such transgressions against property rights now, and they did not when today's rich countries were becoming rich. And that is a significant insight that I think people at the World Bank and some other economists are beginning to discover and are starting to catalog. So it is as Peruvian writer Alvaro Vargas Llosa says in his forthcoming book that will be published early next year in the United States: titling property in Latin America today without changing many other policies, institutions, and regulations is "like placing a cello between the knees of a

handcuffed musician." And so the results of titling are not as great as we would like them to be.

This is a point that Hernando De Soto himself recognizes. He goes around the world emphasizing property and titling and so on. But if you ask him, What about regulation, what about these other factors? he'll readily concede that these things have to be reformed at the same time. After all, the same state that can give you title can persecute you once it knows where you are, what belongs to you, and so on. So you do have to create the right incentives for people actually to want titles to begin with.

Finally I want to mention one point about institutions and transplanting institutions from one country to another. If you go to a country like Peru or almost anywhere else in Latin America where people don't actually have titles or property that's recognized or protected by the state, people in different communities will know exactly where one family's or one person's property begins and where the other person's property ends. And at the same time, when there are conflicts, as when a tree falls on somebody else's property, or if somebody has a business problem, there are also informal ways for resolving those problems. A sort of informal law has been developed in Latin America, and it is very much a common law system. That is, it operates entirely outside the formal legal framework of each country. In my view, it's every bit as big a challenge to formalize the informal economy as to formalize the informal legal system that exists throughout Latin America. And that means somehow figuring out a way to set aside that common law system that has developed in different parts of each country, each subsection of each country, and then to incorporate it into the larger civil law tradition of Latin America. And that's certainly not something that can easily be transplanted. It may take a long time, but the challenge is to actually go and see how people live in Latin America, not draft a constitution or copious regulations in Washington and hope they work in Latin America. Thanks very much.

Endnote

[1] Mr. Vasquez edited an earlier version of the O'Driscoll and Hoskins paper for publication by the Cato Institute, Washington, DC, in August 2003.—Editor

COMMENTARY

Lee Hoskins and Gerald P. O'Driscoll, Jr.

Walker Todd: Last in our lineup of scheduled discussants for today, I bring back to the podium Lee Hoskins, former president of the Federal Reserve Bank of Cleveland.

Lee Hoskins: Thank you, Walker. Don't I get to comment on Mary O'Grady's paper?

Walker Todd: Yes.

Lee Hoskins: (Laughter) I thought it was good paper. Mary brings a lot of practical insights to the property rights issue that people who read books about property rights don't often have. I think that was very valuable in the paper.

I don't really know where to start with some of the criticisms. I guess I'll start with using counter-examples, perhaps a treacherous path to follow. China is growing very fast, no doubt about it. But if you think back a few years, decades rather, you'll remember a Soviet Premier named Khrushchev (deposed in 1964). They had five-year plans in Russia at that time, and they were growing at a phenomenal rate. Much faster than the U.S. And Khrushchev's famous comment was, We'll bury you. Well, look who's buried now. Khrushchev, of course, but so is the Soviet Union. Right? So there are explanations about China's rapid growth, but even without those, you can see systems that can grow fast for substantial periods of time often simply crumble. Particularly if their national policy is one of government ownership as opposed to private property ownership.

Now I want to move a little bit away from property. What I was trying to do in my comments earlier today was really to talk more about why property rights are so important in the functioning of an economic system, and maybe I was too terse about it, but basically most countries around the world now use a price system. I mean, the markets of a price system, in some sense. That price system works more effectively when you have stronger private property rights rather than weaker property rights. That means that the signals to consumers and to investors and to producers are clearer, so fewer mistakes are made in the system with the strong private property rights, and it's that sense of a private property rights system that I think is important and essential to understanding economics. At least, it is so from my perspective. I think national policies would be about the last thing I would choose as a dominant factor for creating wealth, unless you're prepared to say, I'm going to get out of the way and let the private sector run everything and not have a government sector. In other words, if

our national policy were to have a private property system.

I think Tom Bethell might have said it earlier today—the degree of inequality that exists today didn't come about in poor countries because they're poor. It's a consequence of the kind of system that they have, or have had. Their inequality comes about because you have bad economic systems in place. And so in that sense bad policy makes for inequality of income. And those are some things that the World Bank and the IMF are maybe beginning to understand, but let us not worry about that much today. Those institutions still treat income and wealth inequalities as significant variables to be changed in developing economies; that is, to create more equal opportunity, even more equal outcomes. They believe that reducing inequality increases the wealth of an economy, and I don't think there's much evidence to support that.

And I'll stop there and let Jerry O'Driscoll have a shot at these issues. *(Applause)*

Gerald O'Driscoll: Actually I think that we can narrow the disagreements among this panel's speakers. First of all, while it wasn't emphasized in our (O'Driscoll and Hoskins) paper, it is certainly the essence of the property rights literature to view property rights as a bundle of rights, with a spectrum from perfectly well-defined property rights to highly attenuated property rights. It's not a 0-1 choice, but it's a spectrum, and Alchian especially always emphasized that. And he always talked about bundles of rights. What we call property rights are really bundles of rights.

I think a lot of the literature on property rights, such as what Rick Stroup has done, as well as the people at PERC,[1] is getting down to the nitty-gritty and seeing what happens when you do not have 100 percent well-defined property rights or you have different kinds of property rights systems coexisting in the same space. And I think that inheritance is a fascinating topic that economists haven't studied as much as other issues. I have a suspicion that the reason American economists haven't studied it much is that our inheritance system is much more flexible than what—if you let me borrow a phrase—existed of yore. That is, you can as a practical matter practice primogeniture and allow all or nearly all of your estate in most states to descend to one child. Or equally to all children, or you can disinherit the whole lot of them. These matters were big issues in Europe, but in the new world flexible inheritance worked. Still, it's a fascinating issue. So I consider all these remarks—namely that property rights and their many different systems, those bundles of rights, may be partially attenuated, inheritance laws can be different, that different property systems lead to different results—all of those things fit very well, I think, in the property rights literature, and I consider these remarks friendly criticisms rather

than things that need great responses.

I think the issue that Lord Skidelsky raised at the end of his remarks, on the role of institutions versus good public policy, is the essential debate now among serious people in the development literature. I've never been called part of any orthodoxy before. I wish that this were orthodoxy because frankly, my next paper would be on wine appreciation, because I would feel that I had won. *(Laughter)* But the idea that good public policy is what's most important is, I believe, what we consider the Washington policy consensus. If we get the macro-economic fundamentals right and a few other things, then the particular country that we are targeting will prosper. And as Lee Hoskins points out, frequently when the IMF and World Bank—the international agencies—go into a country, they can create growth spurts with this kind of program (i.e., pursuing "good public policy" while ignoring other aspects of institutional structure). Lots of countries, including a number of the ones that I talked about, and some that I didn't—like Ghana, like Argentina—have had periods of growth spurts that proved unsustainable after following good public policy recommendations but ignoring institutional structures like property rights.

What we need is systematic analysis of the factors that contribute to systematic development. Now I think it was very much on point for Lord Skidelsky to challenge us as to whether what were we saying was a necessary or sufficient condition or both. Well, the Roll and Talbott paper I referred to is the first paper that I know of, empirical paper, that only looked at institutional factors to explain economic development.[2] There are no policy factors in their paper. And they found that nine institutional factors explain over 80 percent of the international variation of per capita income that I talked about in the beginning of my presentation on our paper.

Now it's almost unheard of to explain 80 percent of the variation of anything in economics unless you surreptitiously created an identity. And the amazing thing is that, in their paper, Roll and Talbott mention almost casually that the property rights variable by itself explains about 70 percent of income variation. Of course, one might argue that important countries could be missing from the data set. Now I'm familiar with their data set, and I'm very familiar with their measure of property rights because it is the measure of property rights that we used at the Heritage Foundation.

Now I think both in terms of the theory and the facts, certainly property rights with the caveats that I gave at the beginning, property rights are necessary, and almost sufficient. And the only reason I say almost is that there are other things, very important things, that they have found and that other studies have found, too. Lee Hoskins mentioned this in his comments

earlier, which is that really these things are all variations of property rights, but it does appear that when you partition data, things like corruption and regulation, regulatory burden, etc., do appear to enter separately and significantly, so I wouldn't press the conceptual point. So I guess I would say that property rights are necessary and almost sufficient for development. *(Applause)*

Howard Segermark: Mary O'Grady's paper and Ian Vasquez's and Jerry O'Driscoll's comments as well reminded me of an anecdote that Robert Graham reported in his analysis of development efforts.[3] He said that after the United States imposed land reform in Iran under the Shah (deposed in 1978), he was there investigating it, and he talked to a farmer he just happened to meet on the road. He asked the farmer through a translator what he thought of the Shah's land reform program. And the man—Graham was assuming that he would get a favorable answer, because it was the farmer's class supposedly that were the beneficiaries—said he didn't like it. He said he felt that way because, when the Shah could take land away from the richest and most powerful people in the country, think how easily they (the state) could take all of his rights away.

Endnotes

[1] PERC is the Property and Environment Research Center, Bozeman, MT.—Editor

[2] Richard Roll and John Talbott, "Why Many Developing Countries Just Aren't," Los Angeles, CA, UCLA, November 2001 (unpublished manuscript).

[3] Robert Graham, *The Illusion of Power*, New York, NY: St. Martin's Press (1979).—Editor

LESSONS OF PRIVATIZATION: PROPERTY RIGHTS IN AGRICULTURAL LAND IN UKRAINE

Leonid Krasnozhon

Abstract: *The purpose of this paper is to examine and analyze the process of introduction and establishment of the "new and old" institution of property rights in land in Ukraine. This paper consists of a historical overview of property rights in agricultural land. The review starts when Ukraine was a part of the Russian Empire and continues through the period of the former Soviet Union into the present, when Ukraine is an independent nation. The focus of the paper is the transformation of property rights in land in Ukraine through the process of privatization.*

Introduction

THE most well-known and distinguishing characteristic of Ukraine, first as a part of the Russian Empire and then as a republic of the former Soviet Union, is that it was a center of agricultural production for millennia. Currently, Ukraine is undergoing the process of command-market transition. Consequently, changes in property rights in agricultural land are the central issues in contemporary Ukraine that should be addressed in order to secure the developing institution of private ownership, stimulate economic growth in farming, and contribute to the democratic and market economy transformations of the country.

Much has been said in Ukrainian mass media and scientific publications recently to the effect that the Ukrainian government cannot adopt international practices of land reform because of various socio-economic reasons and the excessively naive, new-born, market-economy mentality of Ukrainians (see, e.g., Chebotaryov 2003). In this paper I argue that Ukrainians are capable of withstanding the privatization and command-market transformation despite fictional claims about "our mental readiness." Instead, the transformation of property rights in Ukraine is challenged by economic, political, and legal issues that are raised and considered in this paper.

I. Historical Record of Property Rights in Ukraine

It is most effective to begin with the historical background of property rights in land in Ukraine, because the background sheds light on institutional specifics of the current privatization process. Looking back to the period of the Russian Empire (Romanov dynasty, 18th-19th centuries, to 1917), we can see that land was owned by the tsar, nobles, and church. Landlords (*pomestchik*) gained absolute power over their serfs,[1] who had no right to move from one pomestchik to another. That socio-economic

and political phenomenon was called *"serfdom"* and was fully sanctioned by the state.

In 1861, the Russian Emperor Alexander II, famous for his abolition of serfdom, issued an edict granting personal freedom to serfs. However, the abolition gave nothing to peasants except their "freedom" and poverty. In fact, the peasants were still bound to the land until they repaid their redemption to their previous landlords (the redemption period was over 49 years). In addition, the agricultural land was given to peasant communes instead of becoming a subject for each individual peasant's property. In other words, the idea of shared communal land was behind all those actions. Later on this idea was revived in the form of the collective state farms (*Kolkhoz*) by the communist regime (1929).[2] The property rights in agricultural land mostly remained under the control of the *pomestchiks*, who represented the institution of private property in the Russian Empire of those times. As a result, these land issues sparked several revolts against the Russian monarchy. In order to stabilize the situation, the Russian prime minister Stolypin passed a new decree in 1905 that abolished redemption payments and allowed peasants to leave the communes. Additionally, they were given private property rights in land. Stolypin also created the Peasant Land Bank and other financial institutions aimed at providing mortgage loans to peasants for their real property. The government of Stolypin achieved several positive results. First, land reform gave a peasant private property in land. Second, the government dissolved the agricultural communes that turned out to be inefficient. And finally, the output of the Russian agricultural sector and the share of private farming increased significantly in the period of Stolypin's reforms. In fact, the share of private agricultural business in total agricultural output reached almost 50 percent during that period.[3]

In 1917, the Bolsheviks usurped power, proclaimed a communist regime, and then declared the Union of Soviet Socialist Republics (USSR) on the territory of the former Russian Empire. During the Soviet Union period, the land became common property and was used by collective agricultural organizations named *"Kolkhoz"* (*"kol"*- collective, *"khoz"*— household). Actually, the state possessed all property rights in agricultural land entirely. Land banks and mortgage institutions were abolished by the Soviet government. The communist land reforms embodied a step back from the private property reforms that Stolypin applied to communal (in fact, state) property.

We can see that the allocation of property rights in land in Tsarist and then Soviet Ukraine made a round trip from state and communal property to state and private property and then back to state (communal) property.

Consequently, peasants did not own the cultivated land for several centuries, except for a period during Stolypin's reforms. However, short periods of private farming were sufficient to cause notice of its high efficiency and productivity. World practice indicates several centuries' efficient existence of private ownership of land in countries outside Ukraine. Despite all these facts, the institution of the private property rights in land is still unreasonably doubted and criticized ideologically in Ukraine.

II. Stages and Results of Ukrainian Privatization

A significant literature about privatization states that the Coasian theoretical framework was applied to most post-Soviet privatization reforms. But did the reformers really achieve the expected results? A well-known assumption of zero transaction costs and a perfect stock exchange market underlies the Coase theorem (1960), which assumes and tends to prove an efficient reallocation of property rights, whatever is their initial distribution. This theory is very attractive for first-time reformers. But the reformers tended not to take seriously the fact that the assumptions of the Coase theorem would be relaxed in the institutional context of a transitional economy. That relaxation, in turn, caused the outcome of the Ukrainian reforms to be less certain and less efficient than Coase assumed. The assumptions required by the Coase theorem were not satisfied in transitional reality (Andreff 2003). The neglected pre-privatization transaction costs have grown into numerous issues such as *nomenklatura's* privatization, land embezzlement, corruption, "shadow" privatization, social inequality, etc., that are described more fully below.

Indeed, it is not an easy task to analyze a new and until recently unknown process applying the frameworks and models that were built and used in a completely different institutional environment. At the same time, these unique specifics of all transitional economies make this task more interesting and informative. So we shall start from an overview of the development and transformation of property rights in land, while considering all stages, types, and agents of Ukrainian privatization.

According to Andreff (2003), participants in any privatization process can be divided into two main categories: insiders and outsiders. In the context of the Ukrainian economy, the regional rural administrations, directors of former Kolkhozes or collective agricultural enterprises (henceforth CAEs), and people employed at the same former Kolkhozes or CAEs represent the class of insiders. Outsiders are banks, resident land shareholders, foreign investors, and private persons who expect some institutional changes in different periods of reforms.

Now we shall proceed to the phases and related types of the land owner-

ship transformation. Roughly, the whole privatization process can be divided into the following periods:

- *Nomenklatura*'s privatization," 1987-1991 (up to the declaration of independence of Ukraine);[4]
- Mass privatization," 1991-1995;
- Certificate privatization," 1996-1999; and
- "Period of abolished CAEs, new Land Code, and moratorium," 1999 – present.

The first reallocation of property rights began in 1987. That period, lasting until 1991, was called the *Nomenklatura'*s privatization because the only people who benefited from it were national and regional ex-communist leaders – *nomenklatura.* The reallocation of ownership rights was based on criteria of the position occupied or administrative power. As a result, the directors of former Soviet enterprises or farms received control of all former state property. For example, according to the old Land Code, the former chairman of a Kolkhoz obtained not only property rights in the privatized buildings and facilities but also in the related land plots. The new Land Code stopped that process of automatic transmission of the property rights in land. Another aspect of that period is that the bureaucrats (especially, the directors of the state-owned enterprises and farms) exploited institutional weaknesses of Ukraine, using various scams, and received licenses for the use of natural resource lands. *Nomenklatura*'s privatization played a crucial role in the creation of several of the most influential political and economic groups, later known as FIGs—financial and industrial groups.

The next phase of the Ukrainian privatization process started when Ukraine declared its independence at year-end 1991 and ended in 1995. Originally, this privatization was targeted to fight the excessive control of the former *nomenklatura* and to create institutional preconditions for market incentives. The Ukrainian government decided to go through a mass privatization instead of classical and direct sale of land.

That period also was characterized by a legislative boom in Ukraine. The law "On types of land ownership" (1992) soon was followed by the law "On collective agricultural enterprise" (henceforth CAE, 1992), and a decree "On privatization of land parcels" (1992). An edition of the old Land Code of Ukraine (1991)[5] introduced state, collective, and private land ownership in Ukraine. In addition, both the laws "On privatization of state-owned enterprises and organizations" and "The conception of the denationalization and privatization of enterprises, land, and residential real

property" allowed certification of property rights (for landowners) and conversion of property into private ownership (for anyone). But at the same time, a six-year moratorium on land sales was enacted in 1992. Thus, on the one hand, the pre-existing exclusivity of state ownership finally was abolished, but on the other hand, previously state-owned agricultural lands were transferred into ownership by the CAEs, which replaced the traditional Kolkhozes. Formally, land passed from state to collective ownership.

Despite the introduction of private property in land, most rural residents preferred to invest their land and asset shares in the local CAEs rather than risk private farming. It was a *"Kolkhoz inertia"*: i.e., peasants were still accustomed to collective work and did not adapt to private agricultural business yet. This situation suggested that land reform in Ukraine was in danger of stagnation. The solution was obvious: To abolish collective ownership in land and give people more incentives to start their own farms. But government focused its attention on that issue only several years later because mass privatization then was on its agenda.

A money-certificate type of privatization was the primary method used during that period. A land certificate (*pai*) was given for free, granting property rights on certain land shares that, in turn, could be subject to rental, inheritance, gift, mortgage, and sale-purchase. The land of a former Kolkhoz was shared equally among its members and retired former employees. One of the goals of the land reform was to give land to efficient owners. It is very doubtful that a retired person could be considered an efficient proprietor. On average, a certificate gave its owner 4.1 hectares (10.13 acres) of land. The highest land share was 8.69 hectares (21.47 acres) in the Lugansk *oblast* in eastern Ukraine, and the lowest was 1.1 hectares (2.72 acres) in Ivano-Frankovsk *oblast* in western Ukraine.[6] The discrepancy in the size of land shares was caused by different numbers of CAEs located in particular areas of Ukraine and the amounts of land that were in their ownership.

But what did non-members of collective farms get? At that time, most of the urban population was engaged in another type of mass privatization: voucher privatization of state-owned factories, enterprises, residential real property, etc. Therefore, only the rural population except non-members of Kolkhozes received land shares. Was the land privatization a "mass process" (that is, a failure to take individual cases into account)? Was it a violation of the social justice that was declared as one of the principal objectives of the privatization process? Unfortunately, it looks as though it was. The mass privatization separated the Ukrainian people into two categories, possibly forever: people with land, and people without it. But it is

also very important to realize that the mass privatization also sounded good to the shadow owners of the *nomenklatura's* capital, i.e. the "old new owners." It gave them a chance to protect themselves and their "privatized" assets during the *nomenklatura's* period of dominance against the existing uncertainty and instability in the judicial, economic, and political systems. Those "old new owners" benefited tremendously from the ambiguity and chaos of the mass privatization.

In addition, another type of Ukrainian privatization dominated the certificate type, contrary to the government's expectations. The rental of state or municipal property with a right of future purchase was used widely. It arose from the very low purchasing power of a majority of the population (per capita GDP, only $223 in 1994, was $966 in 1997 and $1,018 in 2003) and other institutional obstacles (e.g., absence of auctions and other aspects of perfect competition, limited public access to objects of privatization, pervasive corruption, etc.). In order to resolve the problems surrounding the certificate privatization process, the Ukrainian parliament (*Verhovna Rada*) approved the presidential decrees "On measures to secure citizens' rights to use the privatization property certificate" and "On measures to accelerate the process of the privatization in Ukraine" in 1994. Both acts implied that:

- mainly the certificate form of privatization would occur in Ukraine;
- privatization certificates would acquire the characteristics of shares of stock; and
- no rental agreement with the option to purchase for small-scale privatization could be made after the effective dates of these acts.

These events initiated a new stage of privatization that lasted until 1999. Afterward, the Ukrainian government planned to make the stock exchange market one of the essential driving forces in the process of privatization. Were those expectations reasonable? The great plan of the certificate exchange in the context of the underdeveloped stock exchange and other supplementary institutions was doomed to fail. But at the same time many economists and politicians claimed that the certificate phase of privatization significantly activated the development process for the stock and commodities exchange markets and complementary infrastructure. They also claimed that the certificates introduced and involved the mass of the population in various financial and stock exchange operations. I do not argue that the stock exchange was really revived by the mass privatization. However, it is a well-known fact that real certificate privatization did not leave the borders of rural areas.

The government failed to educate the rural population about its basic

property rights and related laws. The number of accidental certificate sales is astonishing. Many shareholders "rented" their land to the former Kolkhoz's directors or other entrepreneurs, expecting monthly rent payments. Actually, the land shares tendered usually turned out to have been sold because of the total illiteracy about the law in rural areas. A huge share of land certificates became a source of short-term household income but also of a total loss of property rights in land.

There was another widespread type of transactions between sellers (holders of land shares) and buyers (either directors of former CAEs or representatives of FIGs) in Ukraine during that privatization period. Typically, peasants signed long-term rental agreements on their land plots, and they received monthly or mostly annual payments. The problem was that peasants received outrageously inadequate rental payments for their land shares. They could receive either a bushel of wheat at best or a funeral service at worst.[7] The whole mechanism of market price determination and social justice as determined in a competitive market were savagely corrupted.

Another drawback of the certificate privatization plan was the absence of legal guarantees of property rights in agricultural land. The local authorities forced some farmers who cultivated their purchased land plots to return their certificates. In accordance with Article 14 of the Constitution of Ukraine, the right to own land is held and exercised by individuals, legal entities, and the state exclusively in compliance with the law. The principal (but not the only) law regulating property rights in land is the Land Code of Ukraine. Thus, on the one hand, it is common sense that an intervention by the authorities, like the forced return of certificates, violates the Land Code of Ukraine. On the other hand, these forced returns were a consequence of the imperfect judicial system of Ukraine. In fact, it is very hard to find any actual limitation of administrative interference in the area of individual property rights in current land legislation. This unbridled interference is a very serious constraint for successful farming activity. Therefore, there is a need to improve land legislation concerning the protection and enforcement of private property rights in land in Ukraine.

The next stage of Ukrainian privatization was launched in 1999. The highlights of that period were: First, significant changes in the land legislation of Ukraine that had been expected for a long time, and, second, the issue of returning expatriates' (repatriates') property rights in land. In 1999, the president of Ukraine approved the decree "On immediate measures to accelerate the reform of the agrarian sector of the economy." Thus, the liquidation process of the CAEs (that is, liquidation of collective ownership of land) finally began. New agricultural enterprises and farms based on private ownership were created from CAEs. People could acquire agri-

cultural land plots or land share certificates but could not assert their property rights in such land plots until they received state certificates of ownership. That additional type of certificate was created by the government to let people affirm their property rights. However, in practice, it only hindered the assertion of property rights.

The second highlight of the most recent phase of Ukrainian privatization was a new Land Code enacted in January 2002. Originally, it was treated as a progressive law that introduced two basic changes in the forms of ownership: liquidation of the collective ownership and establishment of communal ownership of land. The abolition of collective ownership of land turned Ukraine from the old way of doing agricultural business, without any prospect of reversal. In turn, this change should stimulate the private agricultural sector to overcome its stagnation.

The third highlight of this period is a significant improvement in property appraisals. The law "On estimation of property, property rights and professional estimation activity in Ukraine" was enacted in September 2001. It is intended to provide lawful procedures of appraisal and should facilitate reasonably approximate estimates of the real market price of agricultural land. In general, one hectare (2.471 acres) of agricultural land would be valued in the range of $300 – $3,000, depending on location and arable conditions. Two methods of land appraisal were discussed in parliament: either state control of prices or free-market price determination. I believe that the market would do this job better despite the underdevelopment of market infrastructure.

This most recent period also demonstrates the hastiness and shortsightedness of land reforms that in turn created another social issue: the property rights of repatriates, particularly of Crimean Tatars who came back to Ukraine after their deportation in Soviet times.[8] The Tatars also asked to be granted property rights in land, just as members of CAEs were when the president issued the land allotment decree in 1999. Ironically, although this problem was foreseen clearly at the beginning of the land share distribution in 1999, it was ignored. Currently, the Crimean Republican Committee for Nationalities (CRCN) predicts that more than 230,000 deported citizens are expected to return to Crimea by 2010. In theory, under the conditions specified for allotted land, the Crimean government will have to use its reserves of still untouched farmlands and distribute them among repatriates. However, in reality, Crimean Tatars just occupied several land plots in Crimea because local authorities could not solve the problem of land reallocation.[9] Accordingly, this issue is still unresolved.

Finally, as a part of land reform, a moratorium on agricultural land sales until 2005 was approved by the president and parliament. Recently, the

moratorium was extended by parliament until the beginning of 2008.[10] What does the extended moratorium mean for 6.6 million land share holders? A farmer cannot use his main asset to finance his farming business. So we are back to a situation very similar to what occurred in the Russian Empire: Peasants are bound to their land again. They cannot borrow money secured by land, and they cannot sell land, but they may lease it. A drastic shortage of financial resources does not allow most farmers properly to cultivate agricultural land and proceed to harvest. Therefore, most small farms hardly survive nowadays. Could they make it to 2008 and avoid bankruptcy? It seems that nobody will take risks to answer this question with certainty.

The moratorium on land sales stays permanently on the agenda of parliamentary discussions. On the one hand, some politicians and economists believe that it should not be cancelled but even should be prolonged after 2008. On the other hand, other scientists and government officials state that the moratorium affects the whole process of command-market transition negatively and request its cancellation. The supporters of a ban on sales of agricultural land argue that the legal, political, and economic systems are not ready to ensure transparent and fair additional privatizations and transactions in the land market. They are afraid that Ukrainians would not be capable of purchasing land if the moratorium were lifted now (at about $1,000 per capita GDP, most Ukrainians have very low purchasing power). Furthermore, there is an underdeveloped system of land cadastres (registries), and there is no properly established system of institutions to serve the land market. For example, the parliament has not yet passed draft laws on the land market and land mortgage bank. On the contrary, the current government opposes the prolongation of the moratorium and promises to prepare the necessary legislative base for transparent and civilized functioning of the land market very soon. At this writing, the fall 2004 presidential elections in Ukraine are still incomplete, and the outcome is undecided.

Objectively, both points of view, for and against the land sale moratorium, are based on substantial reasons. In contrast to the supporters of prolonging the moratorium, I argue that two more years will not increase the purchasing power of Ukrainians significantly. Also, two more years probably will not be long enough to allow for institutional changes that would guarantee transparency of the land sale process. Any observer of the contemporary Ukrainian political arena can see easily that all decisions are backed up by the interests of several FIGs managed by oligarchs. These groups represent the network of politicians, banks, industrial firms, private security forces, and mass media, which are by far the most influential lobbies in Ukraine. Thus, it is almost taken for granted that the sequence of

property divisions described above were caused every time by changes in the government. The reason for this assumption stems from the fact that each administration represents different FIGs that have their own views on the process of property rights transformation.

I would prefer to call Ukrainian privatization "private privatization" because the whole process was subordinated to the private interests and needs of several political-financial groups. Most lands are controlled by FIGs that obstruct competition in the land market and hinder the sale of land that is unofficially in their free possession. In scientific articles, that process is called "shadow privatization."[11] "Shadow privatization" might be behind the support for the land sale moratorium. The moratorium prevents commercial banks from issuing mortgages to agricultural producers because farm land cannot be taken as reliable security. That in turn hinders national and foreign investment into agricultural business, thus sustaining the stagnation and underdevelopment of the whole private farming sector in Ukraine. But it also is needless to say that if the legal system cannot provide lawful due process for land sales and reallocation of property, this is as much an obstacle to development as an economic system that still lacks free-market economy institutions to support the legal system. As a matter of fact, the decline in the number of foreign investors interested in Ukrainian privatization is caused by limited access to land. The current Land Code prohibits foreigners from purchasing agricultural land, which is said to be an issue of national security. This situation has led to numerous violations of private property rights and has increased the negative effects of imperfections in the legal and economic systems.

III. Summary of the Transformation of Property Rights in Ukraine

Ukraine has achieved significant results in the transformation of property rights in land. The process of structural changes in the area of property rights in land started in the early 1990s, when the Ukrainian agricultural sector, like all of Ukraine, was undergoing a drastic decline amid high inflation (the real effective exchange rate fell 56 percent from 1992 to 1993). The decline of agriculture was caused by institutional alterations and the collapse of the pre-existing network of links within the former Soviet economic framework. Later, the recovery of the farming sector was spotty in the period 2000 – 2002.[12] It could be said that reforms positively affected the agricultural sector. On the other hand, the share of private farming in total agricultural output is no more than 3 percent in Ukraine now, while it reached almost 50 percent during the period of Stolypin's reforms.[13] Therefore, the recent reforms were not very efficient. In addition, the absence of a developed market economy (particularly capital market institutions, a modern legal system, and the drastic shortage of

domestic savings) was the main obstacle to a quick and successful transformation of property rights. This process, in turn, like any significant structural change, had not only advantages but also disadvantages.

Objectively, Ukraine successfully overthrew the system of exclusive state ownership and introduced the institution of property rights in land. These changes partially provide the institutional, legal, and economic conditions for the development of private sector agriculture.

But there are still so many legal, economic, political, and social issues that should be solved to complete the successful privatization and reallocation of agricultural land property. Although the Ukrainian government attempted to define property rights in land more clearly through creation of an effective legislative system, the original specification of property rights turned out to be incomplete and left a lot of space for controversial issues to emerge. No guarantees have been established yet to protect the transparent and efficient reallocation of the property rights from harassment by the authorities and other powerful economic agents. The analysis of the mass Ukrainian privatization in the early 1990s shows that insiders, foremost among them the former chairmen of *Kolkhozes* and disguised financial-political groups, benefited from the early stages of property rights reforms. Even though later phases of privatization have reallocated a part of privatized assets, those insiders still are the major winners.

The issues of "shadow privatization," instability, and vulnerability of property rights in land are not solved yet, either. The best examples are the issue of repatriates' property rights that is still not worked out, which causes social conflicts, the decrease of foreign investment in the land market, and the ongoing moratorium on agricultural land sales.

Typically, a private farming business activity is heavily encumbered by the following problems, which are endemic in transition countries: First, starting a new business is complicated by administrative (artificially extended registration process, compulsory bribery, etc.) and legislative (imperfect legal system) puzzles that make it highly time-consuming and discouraging to complete the process. Second, the crucial issue of mortgage financing remains unresolved as long as the moratorium on land sales stays effective. These factors, in turn, make the lawful and market-economy mechanisms of financial support temporarily unavailable. Consequently, "shadow privatization," incomplete land registries, imperfect mechanisms of property appraisal (particularly for land), underdevelopment of other institutions such as land or title insurance, direct sales, auctions, stock exchange markets, etc., significantly hinder the development of a mortgage market in Ukraine.

Ukrainians are mostly unaware of their property rights. Accordingly, a special network of legal institutions should be developed to guarantee the allocation and enforcement of property rights and update information about changes in relevant legislation. At present, land shareholders cannot properly exercise their property rights because they cannot sell their land allocations or use them as subjects for mortgages. The introduction of a state act of ownership that finally validated property rights in land only complicated and prolonged the process of ownership allocation. Thus, the certificate privatization started in 1992 resulted in 50 percent of certificate holders not having affirmed their property rights yet.

Many Ukrainian economists suggest divergent methods of improving the agricultural land situation, such as implementing a moratorium on sales, reprivatizing, or even renationalizing the economy. I doubt that the people and government would agree to doing everything over. A new allocation of property rights would only worsen the existing situation. It might be a huge step backward through almost a decade of the reformation process. I believe that the moratorium should be revised to let the land market work and attract financial resources to the farming sector, inspiring its advancement.

In conclusion, I contend that property rights in my country are still undergoing a process of transformation. The privatization of land is not over yet. The disposition of agricultural land, in turn, was, is, and will be a crucial issue in the Ukrainian transition period. Therefore, it should be a primary task for the Ukrainian government to address properly all the issues raised in this paper and to provide all necessary legal, economic, and institutional support to the positive changes that are taking place in Ukraine.

Post-Conference Editor's Note

At the time of the Property Rights conference in early November 2004, it was unclear who would prevail in the Ukraine presidential election. Eventually, in January 2005, it became clear that the nominal "reform" candidate, Viktor Yushchenko, would become the new president of Ukraine. Theoretically, the prevailing faction favors more market-oriented reforms, including privatization of agricultural land claims, than the defeated faction.

Appendix

Table: **Rankings of the Methods of Privatization in Several Transition Economies.**[14]

Country	*Share of Private Sector in GDP, 2001 (%)*	*Direct Sale*	*Mass (voucher) Privatization*	*Management-employee buy-out*
Czech Republic	80	*Secondary*	**Primary**	Third
Estonia	80	**Primary**	*Secondary*	Not applied
Latvia	70	*Secondary*	**Primary**	Not applied
Poland	75	**Primary**	Third	*Secondary*
Russia	65	*Secondary*	Third	**Primary**
Ukraine	65	Third	*Secondary*	**Primary**

Endnotes

[1] A serf was a peasant who was owned by the landlord (pomestchik) until the abolition of serfdom in 1861.

[2] See generally, Robert Conquest, *The Harvest of Sorrow: Soviet Collectivization and the Terror-Famine*, New York, NY: Oxford Univ. Press (1987).

[3] P. Gaidutskyi, "Agrarian reform: myths and reality," *Economy of AIC (Agricultural Industrial Complex),* vol. 9 (2003), p. 5.

[4] E. Gaidar, *State and Evolution: Russia's Search for a Free Market*, 2nd ed., St. Petersburg, Russia: Norma Press (1997).

[5] A new Land Code of Ukraine was enacted in January 2002 and made the previous one invalid.

[6] Ukraine is divided into administrative and territorial units named oblast, equivalent to provinces or states in the USA. Data source: http://www.cia.gov/cia/publications/factbook/geos/up.html#Govt.

[7] N. Alexandrova, "Land reform: the story is to be continued," *Vecherniy Kharkov*, no. 91 (August 2004).

[8] Approximately 75 percent the Tatars lived in the countryside and were employed by Kolkhozes until their deportation from Crimea in 1944 (Semena 2001). At present, Crimea is an autonomous republic of Ukraine.

[9] Source: Center for Land Reform Policy in Ukraine, http://www.myland.org.ua/eng/17/2983/.

[10] Source: Center for Land Reform Policy in Ukraine, http://www.myland.org.ua/ukr/17/3698/.

[11] K. Kritshenko, "Property denationalization in the context of Ukraine,"

Finances of Ukraine, vol. 3 (2003), p.16.

[12] In 2002, the index of total Ukrainian agricultural output was 101.2, with 2001 value = 100. Source: http://www.ukrstat.gov.ua. Nominal GDP increased 8.2 percent in local currency terms over the same period. IMF, *International Financial Statistics Yearbook* (2004), p. 648.

[13] P. Gaidutskyi, "Agrarian reform: myths and reality," *Economy of AIC (Agricultural Industrial Complex),* vol. 9 (2003), p. 5.

[14] Source: M. and P. Vagliasindi, "Privatization Methods and Enterprise Governance in Transition Economies," in V. Andreff and Y. Kalyuzhnova, eds., *Privatization and Structural Changes in Transition Economies*, London, UK: Palgrave (2003).

PROPERTY RIGHTS AND PUBLIC LAND MANAGEMENT: WHAT HAVE WE LEARNED IN THE 200 YEARS SINCE LEWIS AND CLARK?

E. Bruce Godfrey*

Introduction

ON May 14, 1804, at four o'clock, Lewis and Clark officially started their journey to the west when they left Camp Dubois by sailing across the Mississippi and starting up the Missouri River into territory few white men had seen. The epic journey of this group of men has been referred to by historians as the Corps of Discovery. This journey led to the discovery of most of western America and is one of the most important events in the history of the United States. As a result, many communities along the path they followed have celebrated or will celebrate the 200th anniversary of the Lewis and Clark expedition this year. This anniversary provides a convenient point in time to consider and evaluate the events that have occurred since their departure.

This paper has three major sections. The first is a brief historical overview of why federal (public) lands[1] primarily exist in the western United States. This section is followed by a brief overview of the uses of these lands during the last few decades. These two sections provide the background for the final section that outlines how similar the issues of disposing of public lands in the past are to the issues associated with allocating use on public lands today.

A Brief Historical Overview

On July 4, 1803, two events occurred that changed the history of America.[2] The first was the departure of Meriwether Lewis from Washington, DC, on what Stephen Ambrose called a voyage of undaunted courage. Coincidentally, President Thomas Jefferson received word the same day that the Louisiana Purchase had been approved by France. When Lewis and Clark returned to St. Louis on September 26, 1806, the "settlement of the West" that had started before they left was given a major shot in the arm by the reports they provided that touted the bounties of the land they had discovered.

From the beginning, Thomas Jefferson envisioned that all of the land acquired by the United States would be settled and privately owned. This purpose was outlined by Jefferson as early as 1774 when he indicated that the colonies and not England had the right to grant land ownership to citizens residing in America:

> From the nature and purpose of civil institutions, all the lands within the limits which any particular society has circumscribed around itself, are assumed by that society, and subject to their allotment only. This may be done by themselves assembled collectively, or by their legislature to whom they have delegated sovereign authority: and, if they allotted in neither of these ways, each individual of the society may appropriate to himself such lands as he finds vacant, and occupancy will give him title. (Jefferson, quoted in Gates, p. 3.)

It is clear that federal officials at that time unanimously favored the proposition that lands acquired by the United States were to be conveyed to private individuals, but it is not clear how these lands were to be transferred. Several methods were tried, but all were failures for various reasons. Many of the reasons why these methods failed have been outlined by others. The one thing that is clear is that these failures occurred primarily in the 11 western states where most public lands are currently located.[3]

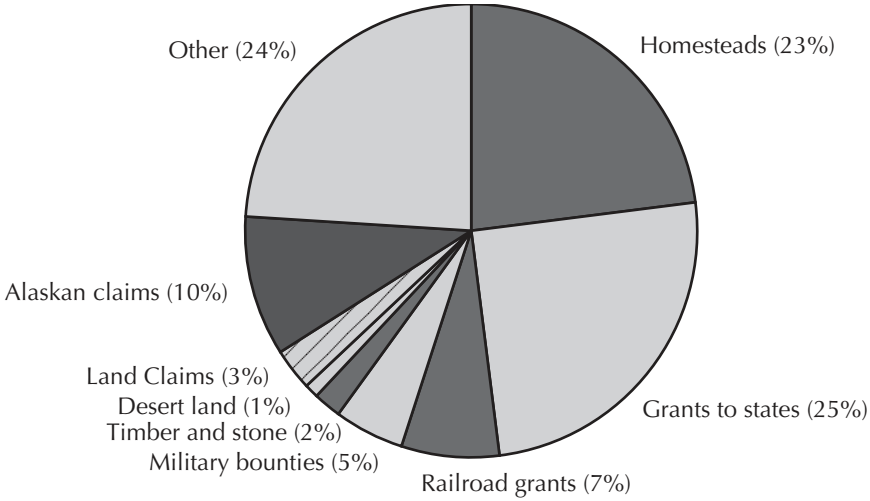
Methods Used to Dispose of Public Land

Public lands were disposed of in various ways. The most common disposal methods used are shown in Figure 1. The reasons for their failure in the West are outlined briefly below.

Land Claims

People had already settled Western lands and had been given title to lands acquired by countries such as France and Spain. When the United

Figure 1. **Percentage of public land disposed of by method.**



Source: *Public Land Statistics*.

States acquired these lands, existing land claims needed to be reconciled with new patterns of ownership. This presented many problems for Congress and the General Land Office. But nearly all of the problems associated with original, pre-Independence land claims existed in the East or where Spanish land claims existed because, apart from Spanish claims, the white man had not settled lands in western America.[4]

Land Grants

Grants to soldiers (5 percent) as payment for service in the armed services, to railroads for the construction of railroad lines (7 percent), and to other groups or local units of government (35 percent) for internal improvements were the primary disposal methods used, with the largest number of acres given to the states for various public purposes and as a condition of statehood. The remaining lands were disposed of via sales or one of the homestead acts (homestead, timber and stone, desert land, etc.).

Sales

Alexander Hamilton was an early and probably the most influential advocate for the sale of public lands. He viewed the sale of public lands as a major source for financing the government and supporting the national currency. As a result, cash sales were commonly used to convey ownership to private individuals until about 1862. Sales resulted in the disposal of about a quarter of the public land. But these were of very limited success for two basic reasons. First, the amount of land available was large and, as a result, prices were not high. Second, those who wanted to buy the land were commonly poor and unable to pay large sums. The second reason gave rise to the other disposal systems proposed by Jefferson and others. Furthermore, essentially all of the land sales occurred in the East.

Homestead Acts

Jefferson viewed public lands primarily as a place of settlement for people who lacked capital, a place for the poor. It is also clear that the original intent was to have the public lands transferred to private ownership with the view that they would be farmed, because "Jefferson was convinced that the only society that could be truly democratic—truly self-governing—was one in which small farms and independent farmers predominated" (Kemmis, p. 25). The two concepts that were important to this vision were *farms* and *small*. These two concepts were at the heart of essentially all of the homestead-type disposal laws. The literature also clearly indicates that the homestead acts were commonly violated. But there is a much smaller body of literature concerning why these acts failed to transfer lands to private ownership, particularly in the areas near the Rocky Mountains. These will be referred to as western lands throughout

the remainder of this paper—although lands in the plains states are commonly included in references to the West.

Reasons Why Lands in the West Were Not Transferred to Private Ownership

Essentially all of the reasons why lands in the West were not transferred to private ownership are related to an area of "market failure,"[5] or the inability to establish enforceable property rights. These failures are generally different for the major agencies that currently manage public lands in the West—U.S. Park Service, U.S. Forest Service, U.S. Fish and Wildlife Service, and the Bureau of Land Management.

Park Service

Lands that were to become America's first national park (Yellowstone) were withdrawn from entry and settlement in 1872. This was a significant departure from what had occurred in the past. "Reserving so large an expanse—larger than the two eastern states Rhode Island and Delaware combined—with all its potential wealth of water power, timber and grazing lands barred from private use was so dramatic a departure for the public land policy of Congress that in retrospect it seems to smack of miraculous" (Everhart, pp. 8-9). This and the ceding of the Yosemite Valley and Mariposa Big Grove to the state of California in 1864 were the beginnings of what was to become the Park Service. These designations clearly identified preservation as a reason for retention of public lands. These lands were to be maintained "to conserve the scenery and the natural and historic objects and the wildlife therein and to provide for the enjoyment of the same in such a manner and by means as will leave them unimpaired for the enjoyment of future generations" (Dana and Fairfax, p. 109).

Three market-related failures led to the reservation of most (if not all) parks as well as lands that were later set aside and managed by the Fish and Wildlife Service. The first source of market failure is associated with consumption—many of the attributes of reserved lands are not rival in consumption (e.g., viewing "Old Faithful"). The second potential failure involved the ability to exclude some who might want to enjoy these sights—the possibility of hyper-exclusion. One senator stated at the time lands in Yellowstone were set aside that if these lands were not protected, someone would "plant himself right across the only path that leads to these wonders, and charge every man that passes along between the gorges of these mountains a fee of a dollar or five dollars" (Everhart, p. 9). While the possibility of hyper-exclusion existed for some areas, the lack of ability to exclude was most common and represents the third area of market failure. For example, poaching of wildlife, vandalism, and taking of materials were

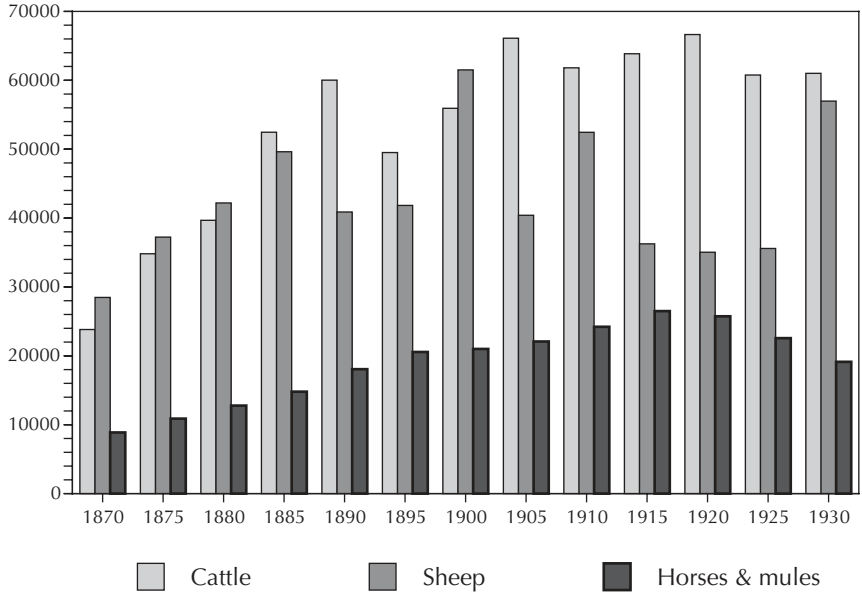
common after Yellowstone was set aside as a park. Congress and land administrators soon learned that reservation of these lands was not sufficient: property rights had to be enforced. As a result, on August 17, 1886, the U.S. cavalry entered Yellowstone Park to enforce these rights (a "common property" issue). Issues associated with exclusion, a necessary requirement for the existence of a property right, was a major reason why parks were established. These lands were not allowed to be transferred to private ownership because the associated costs were high.

U.S. Forest Service/Reserves

Lands that the Park Service currently manages were set aside or reserved because they had unique features. The same cannot be said for lands that were set aside and eventually administered by the Forest Service. Two of the major reasons for these reservations were overgrazing by livestock and a change in the philosophy of management.

Completion of the transcontinental railroad in 1868 significantly reduced the cost of moving people as well as goods and services to and from the populous East and the unpopulated West. One of the consequences of this reduction in cost was a rapid expansion of the livestock industry in the West. For example, the number of sheep and cattle in the United States

Figure 2. **Number of cattle, sheep, and horses and mules in the United States, 1870-1930.** (Thousands)



Source: *Agricultural Statistics*, 1940.

essentially doubled between 1870 and 1900 (Figure 2).[6] Most of this increase apparently occurred in the West. For example, Wentworth estimated that sheep numbers in Utah increased from about three thousand head in 1850 to three million in 1900, with similar increases in other states (see also *The Western Range*). Libecap shows that the percentage of the nation's cattle in the 11 western states increased from 9 percent in 1870 to 18 percent in 1920, while the percentage increase for sheep was even larger, from 20 percent in 1870 to 60 percent in 1920.

Increased numbers of sheep in the West were particularly important and occurred as a result of several comparative advantages that sheep had relative to cattle in the West. First, one herder could manage a band (generally 1,000 sheep) with the assistance of dogs, while several cowboys would be needed to handle a comparable herd of cattle (200 head). Secondly, sheep herders commonly lived with the flock, and a large portion of these flocks were not tied to a "home base." As a result, they could move to new lands as forage became available more rapidly than cattle. Third, the desert lands of the intermountain area could be used by sheep during the winter, while cattle usually required the feeding of hay. Fourth, sheep are able to use high and steep mountain ranges that commonly cannot be used by cattle. As a result, nomadic sheep herds had a comparative advantage in capturing forages that could not be used by cattle. Wool and cotton were the primary fabrics used for clothing at that time. As a result, wool was relatively valuable, which made the grazing of lands by wethers (castrated male sheep) relatively important compared to the raising of lambs today. Flocks of wethers were especially mobile and able to use lands faster than could a flock of ewes or a herd of cattle. All of these factors provided a strong incentive to expand sheep production in the western states.

Grazing by sheep has received much of the blame for the overgrazing of the western ranges. They were also blamed by foresters because "next to fires sheep were responsible for the greatest damage to new growth" (Gates, p. 582). It is doubtful that they were the only culprits[7] in the "relentless contest for range [that resulted in the] complete utilization of forage . . . [because] the only way to prevent another outfit from obtaining a given range was to strip it utterly naked" (*The Western Range*, p. 126). This is the classic example used in the literature of "common property use" with its associated market failure and the need for government intervention. The alleged overgrazing by sheep provided one of the major incentives for passage of legislation that established the forest reserves in 1891.

Formation of the forest reserves also marked a change in philosophy concerning the management of public lands that was made effective when the forest reserves were transferred to the Department of Agriculture in

1905. This transfer occurred largely through the efforts of two of the most colorful and controversial personalities in land use history—Gifford Pinchot (chief of the Forest Service, 1898-1910) and Theodore Roosevelt (President, 1901-1909).

The decision to withdraw lands from disposal and retain them as publicly administered lands is commonly referred to as the "shift to retention thesis" (Raymond and Fairfax). This thesis is essentially the contention that overt decisions were made that public lands should be retained and not transferred to private ownership.

> The old practice of disposing of nonagricultural lands to private owners, Pinchot and others argued, must give way to public ownership and management. To the general public, the goal of public ownership and the controversy over public or private resource management was the crucial conservation issue. But, to the officials of the Roosevelt administration, public ownership was merely a means to an end; it alone would permit rational development. The significance of the new public lands program, therefore, lay, not in the method of ownership, but in the objective of efficient, maximum development. (Hays, p. 69.)

Raymond and Fairfax have recently questioned this thesis. Nevertheless, Roosevelt and Pinchot set in motion the framework for managing public lands. Pinchot's vision and the perception of the Forest Service was that "every member of the Service realized that it was engaged in a great and necessary undertaking in which the whole future of the country was at stake. The Service had a clear understanding of where it was going, it was determined to get there, and it was not afraid to fight for what was right" (Dana, pp. 143-144). These individuals held a strong distrust for private firms whose only goal was short-term profit. As a result, they believed that the "only way to achieve rational, comprehensive scientific decision making was on government owned land" (Raymond and Fairfax, p. 659). This represents a philosophical belief that private ownership and market allocations were not what some might refer to as in the public interest, and one that is quite different from the principles espoused by Jefferson. Pinchot sought and Roosevelt readily added acreage to the forest reserves between 1900 and 1909, reasoning that "public ownership and management was superior to private ownership and no management" (Gates, p. 580). Congress, especially western senators, questioned this change in policy because they realized that a large portion of the most desirable lands in their states would no longer be open to homesteading when the forest reserves were set aside. As a result, authority to make additional reservations in Oregon, Washington, Idaho, Montana, Colorado, and Wyoming was withdrawn on March 4, 1907. While some lands were added later to the Forest Service, the 1907

act essentially ended the reservation of land as part of the forest reserves.

Bureau of Land Management

The General Land Office, which administered most of the remaining public lands from 1812 until the Bureau of Land Management was formed, worked under the philosophy that "the great objective of the Government is to dispose of the public lands to actual settlers only—to bona fide tillers of the soil . . ." (Gates, p. 462). As a result, several land disposal acts were passed, starting in 1862.[8] However, these acts were essentially a failure in the western states. As a result, lands that are managed by the Bureau of Land Management today are the residual lands that some have referred to as "lands nobody wanted" because they were not transferred to private ownership or retained for federal ownership (Park Service, Forest Service, Fish and Wildlife Service). One may question why these lands were not transferred to private ownership. Most authors emphasize transfer restrictions (acreage limitations and requirements that the land had to be farmed). For example, Hibbard (p. 409) noted that "The great weakness of the Homestead Act [1862] was, and is, its utter inadaptability to parts of the country for which it was not designed. The idea of the farm small in acres within the semi-arid regions was tenacious but untenable." This did not mean that the homestead act was not successful. "With all its shortcomings the Homestead Act clearly has more to its credit than any other one land act passed by the federal government" because "east of the hundredth meridian the Homestead Act was a success" (Hibbard, p. 409).

The homestead acts that emphasized farming were failures in transferring land to private ownership in the arid West because most of these lands were primarily useful only for grazing and could not be farmed. As a result, the Stock-Raising Homestead Act (1916) was passed. This act provided for the establishment of a homestead with the following conditions (among others):

1. 640 acres was the maximum acreage;

2. the lands had to be designated by the Secretary of Interior as stock-raising land;

3. the surface area had to be suitable only for grazing or forage, could have no merchantable timber, and could not be conveniently irrigated; and

4. the land had to be of sufficient quality for 640 acres to support a family.

It is generally recognized that 640 acres were not sufficient to support a family in the arid parts of the West, where the carrying capacity of 640 acres would support fewer than 10 animals year-round.[9] However, most

historians acknowledge that acreage limitations outlined in the homestead acts were commonly violated and were not a strict barrier to the transfer of land to private ownership. As a result, one must look for other reasons for the failure of the 1916 act, even if the acreage limitation had been increased. It is my belief that grazing by sheep was the other factor that led to the failure of the stock-raising homestead act in the intermountain area.

Anderson and Hill (1975) have shown how the introduction of branding, formation of stockmen's associations, barbed wire, and cooperatively held roundups allowed property rights to be established for grazing lands used by cattle in the plains. These innovations were not generally applicable in much of the West in the case of sheep for several basic reasons. First, branding was not feasible.[10] As a result, it was difficult (economically impossible) to identify ownership of a band of sheep. This resulted in high transaction costs of identifying herds that used lands traditionally used by someone else. The second factor that prevented the enforcement of property rights in the West was the cost of fencing because net rather than barbed wire fencing must be used to fence sheep—barbed wire fencing was/is commonly used to fence cattle. As a result, fencing any land, except for relatively small areas, such as lands that were farmed, was not feasible,[11] and "since cattle fences did not keep out sheep, sometimes even hay fields were invaded" (*The Western Range*, p. 125). The cost of fencing is also one of the primary reasons why a "fence out" rule of law was adopted in rangelands in the West instead of a "fence in" law [ed. note—"fencing in" animals is the general rule of law in the East]. Cooperative roundups that were used in cattle country were never used by itinerant sheep operators because once herds were intermingled, they became essentially impossible to separate (identification and herding tendencies). As a result, itinerant/independent bands of sheep used forages that cattle or sheep operations that were home-based could have claimed had fencing been feasible or if cooperative arrangements that were common to cattle operations had been feasible.

The use of rangelands was rival in consumption but exclusion was not feasible. As a result, property rights similar to those for farmable lands could not be established, and one of the basic things needed to establish a market or some type of collective control of the open access resource was absent.

It is generally conceded that the disposal of public lands ended with passage of the Taylor Grazing Act in 1934. Passage of this act was not without controversy. For example, Congressman Englebright of California bitterly and openly opposed passage of the bill because it would end homesteading and perpetuate federal ownership of lands in the 11 western states. This bill passed Congress by a vote of 265 to 92, but the representatives in

the western states who would be most heavily affected voted against passage. Land could still be obtained under one of the land disposal acts after the Taylor Grazing Act was passed, but the number of acres subsequently transferred was small. One therefore has to conclude that the inability to establish property rights (legal restrictions and the inability to enforce exclusion) are the primary reasons why public lands administered by the Bureau of Land Management exist today.

Property Rights to Use Public Lands

The discussion above explains some of the major reasons why lands acquired by the United States were retained in federal ownership, but this does not mean that property rights were not established for the use of these lands. Each of the major uses (timber, mining, livestock grazing, water, wildlife, and recreation) involved the establishment of property rights (use, exclusion and/or ability to transfer) in an economic if not a legal sense. The establishment of these rights was different by type of use because the costs of establishing these rights were very different.

The most common method used to allocate timber on public lands is essentially equal to the procedures that would be used by a private land owner. A specified quantity at a specific location is sold to the highest bidder. Numerous authors have questioned the competitive nature and the economic viability of these sales, but it is clear that the sales involve property rights that allow the successful bidder to gain the benefits of the right to cut the timber or to sell this privilege.

The right to remove hard rock and/or fossil fuels from public lands has a long and colorful history. Nevertheless, mining claims do provide the owners with the ability to extract materials in an "acceptable" manner by paying royalties to the agency that administers these claims. The claims can be and are sold in the market and have most of the characteristics of privately owned goods.

Rights to water and game animals were retained and managed by agencies of state government. As a result, there is some variation in the manner of use or transfer of these resources and the associated rights of use or transfer from state to state. Water rights generally involve prior appropriation and were some of the earliest rights established in areas that later became states. Rights to harvest game animals are more limited than are water rights because they primarily involve the right to harvest and not to transfer permits. Nevertheless, these economic rights are real and may involve transfers and the capture of rents.

Permits to graze public lands were established on Forest Service lands early in the 1900s and were basically established on Bureau of Land Man-

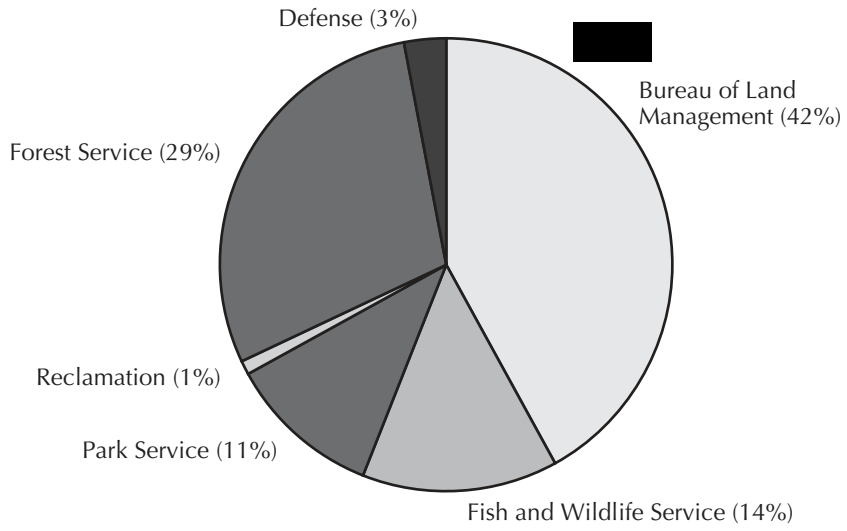
agement lands with passage of the Taylor Grazing Act in 1934. These permits were designed to exclude itinerant sheep operations because the permit holders were required to have "prior use" as well as "base property" that was used to support livestock when they were not on federal lands. Grazing permits present some interesting issues because they provide the owner the "right" to harvest forage from public lands, but they also involve significant impediments that do not allow efficient use of grazing lands (articles cited by Gardner). The courts consistently have indicated that grazing permits on federal lands are not "rights" but "privileges" (issues involving "takings" when levels of use are adjusted tend to dominate these decisions), but these "privileges" are commonly bought and sold, are used as collateral for federally sponsored as well as commercial loans, and are the real reason why the "grazing fee controversy" is so difficult to resolve.

Use of most federal lands for recreation was essentially a non-issue until shortly after World War II. As a result, the allocation of this use and the possible development of recreational property rights is evolving and is the focus of the latter portion of this paper. The pattern of use in the last few decades is very different than it is for other uses, as the following section shows.

Public Land Management Today: Status and Trends

Four major agencies—Forest Service, Bureau of Land Management, Park Service, and Fish and Wildlife Service—managed more than 95 per-

Figure 3. **Percentage of public land managed by agency, 1993.**

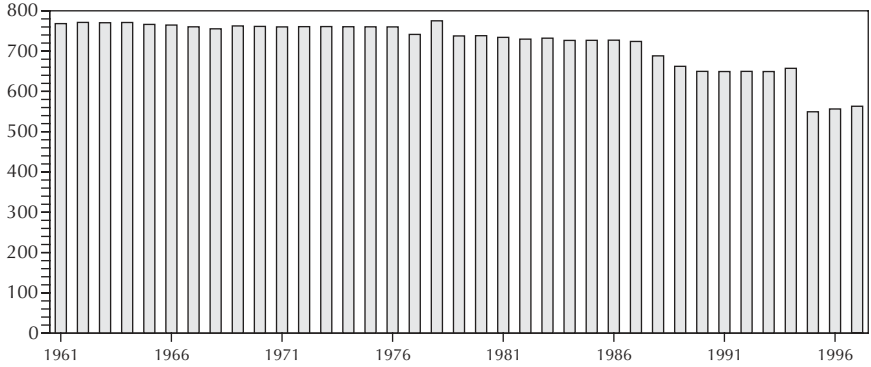


Source: Unpublished data from the General Services Administration.

cent of the public lands in 1993 (Figure 3). It should be noted that the total number of acres of public land generally has declined but recently has increased (Figure 4). Essentially, all the decline in the number of public land acres in the last 15 years occurred as a result of land selections in Alaska. It should be noted that the percentage of the land managed by each agency has not remained static (Figure 5). For example, the number of acres managed by the Bureau of Land Management generally has declined, while the number of acres managed by the other three agencies has increased.

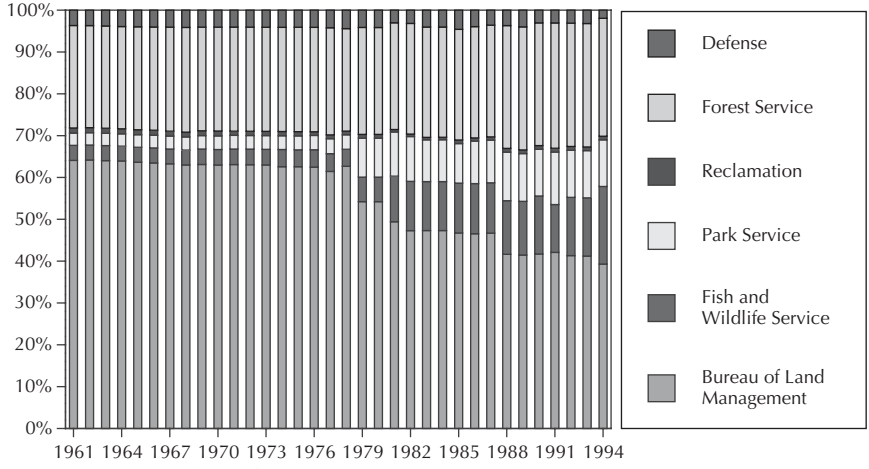
The number of acres managed by the four major agencies has varied

Figure 4. **Acres of public land in the United States, 1961-1997.**
(Millions of Acres)



Source: Unpublished data from the General Services Administration.

Figure 5. **Percentage of public land administered by agency, 1961-1994.**



Source: Unpublished data from the General Services Administration.

Figure 6. **Animal Unit Months of Grazing on Public Lands.**

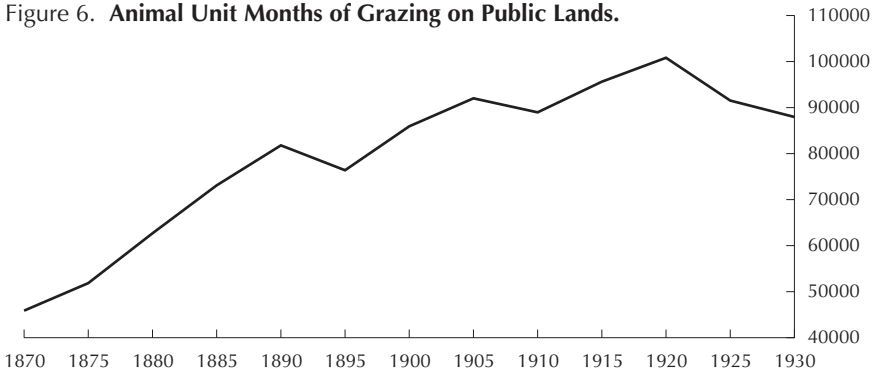
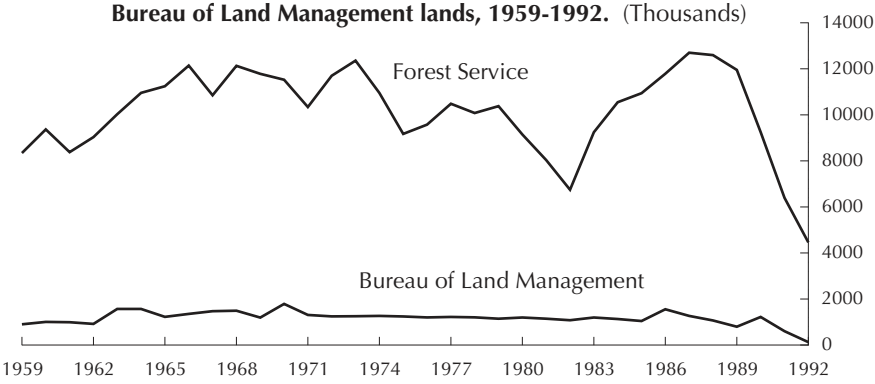
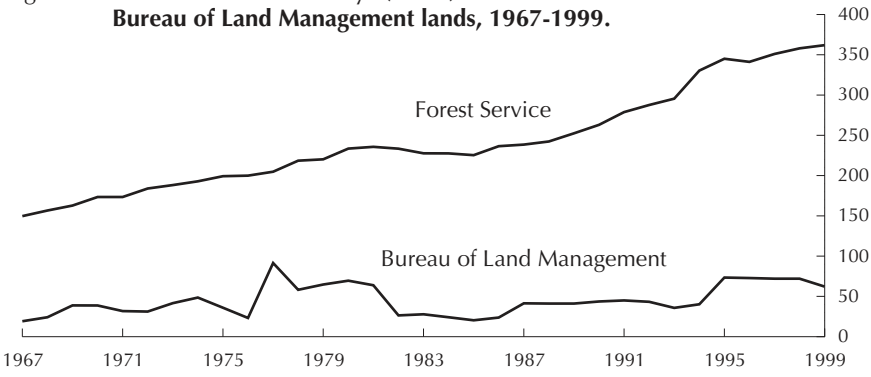


Figure 7. **Million board feet (MBF) of timber cut from Forest Service and Bureau of Land Management lands, 1959-1992.** (Thousands)



Source: *Public Land Statistics* and Forest Service *Annual Reports*, various years.

Figure 8. **Recreational Visitor Days (RVDs) on Forest Service and Bureau of Land Management lands, 1967-1999.**



Source: *Public Land Statistics* and Forest Service *Annual Reports*, various years.

Figure 9. **Receipts from grazing Forest Service and Bureau of Land Management lands, 1985-2002.** (Millions of dollars)

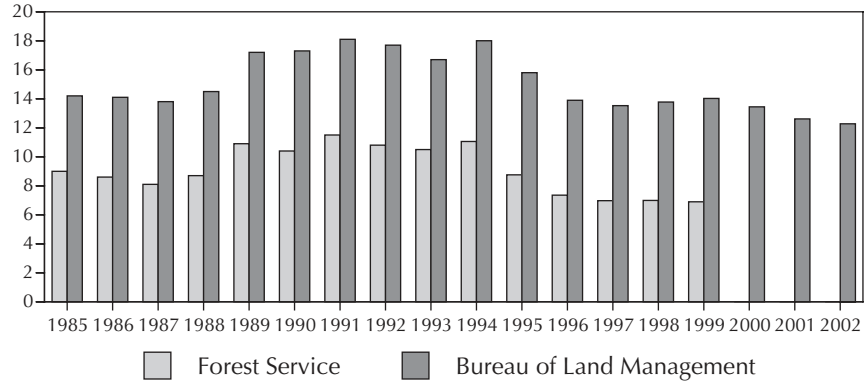


Figure 10. **Timber receipts from Forest Service and Bureau of Land Management lands, 1985-2002.** (Millions of dollars)

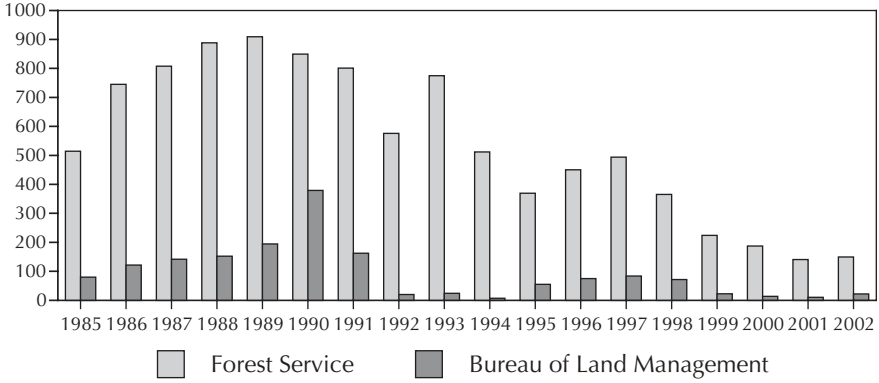
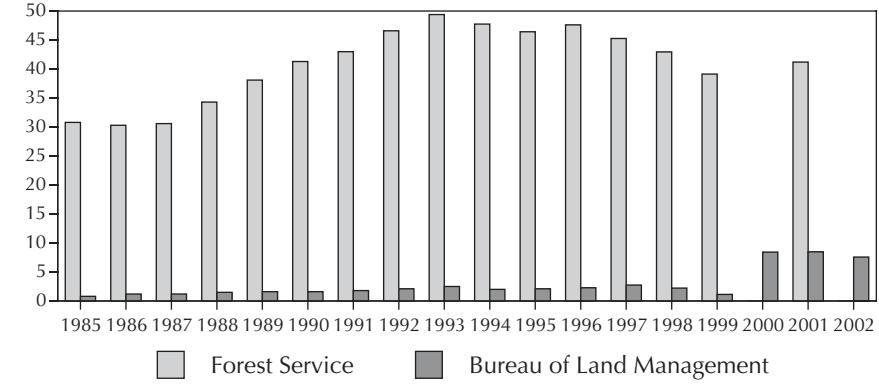


Figure 11. **Recreation receipts from Forest Service and Bureau of Land Management lands, 1985-2002.** (Millions of dollars)



Source: *Public Land Statistics* and Forest Service *Annual Reports*, various years.

over time, but not as much as the amount of use by type. For example, livestock grazing has been essentially stable (Figure 6), timber harvesting has declined (Figure 7), and recreation has increased (Figure 8). These changes in use have had a major impact on agency revenues (Figures 9-11): receipts generally have declined. At the same time, agency expenditures have increased. As a result, agency deficits have grown.

Some idea of the magnitude of the deficits incurred by the four major land management agencies is illustrated by the Forest Service in fiscal year (FY) 2002. The Forest Service had about $541 million in revenue and about $5.4 billion in expenses, including the cost of fire suppression. The resulting operating deficit was about $5 billion.[12] Similar deficits exist for the other major land management agencies (Table 1). The deficits shown in Table 1 probably should be viewed as conservative estimates at present because it is unlikely that revenues have increased very much (if any), while expenditures probably have increased. In addition, General Accountability Office personnel have issued several reports that questioned agency accounting procedures. The deficits in Table 1 represent a net cost (deficit) of more than $5 per acre managed and suggest that generating net revenues is not a major objective of these agencies.[13] These deficits and related subsidies (see *Taking from the Taxpayer*) are some of the reasons why critics have suggested that federal lands be sold, given to state or local units of government, or, at the very least, managed differently.

Modern Allocation Issues

Only the most naive would contend that resources managed by the federal agencies are either efficiently or equitably allocated today, as is evidenced by the controversy associated with management of these lands. For example, "[F]ew would view the Forest Service as an elite agency. Local users of the national forest lands are highly disenchanted and discouraged. Recreationists, environmentalists, range users, and timber users also voice complaints. It seems that nobody is happy with the Forest Service" (Sedjo, p. 182). As a result, people have called for reforms and

Table 1. **Revenues Collected, Expenditures and Estimated Yearly Deficit for Fiscal Year 1997 or 1998**

Agency	*Year Reported*	*Revenues x $1,000*	*Expenditures x $1,000*	*Estimated Deficit ($)*
Bureau of Land Management	FY 1998	146,938	$582,080	Half Billion
Forest Service	1997	368,789	$1,307,000	Billion
Park Service	1997	not reported	$1,156,000	Billion
Fish and Wildlife Service	FY 1997	not reported	$587,000	Half Billion

abolition of the Forest Service. These suggestions have included sale or privatization of public lands, transfer of the lands to the states (the essence of the Sagebrush Rebellion), and their operation as a public corporation. Most of the recent criticism of public land management has focused on lands administered by the Bureau of Land Management and Forest Service. However, management of lands administered by the Park Service and Fish and Wildlife Service is just as susceptible to criticism. In fact, Gardner (1997a) believes that the "present system [for managing public lands] is untenable. The regulatory controls and allocation procedures associated with federal ownership and management are very costly since they are completely disassociated from economic efficiency criteria and rely instead on the exercise of political power." If these and other similar statements are correct, one may ask logically if there is evidence of "government failure."

Disposition Then and Now

The laws and methods used to dispose of public lands a century ago might not apply today. However, this does not mean that issues of disposition no longer exist. This is especially true when a more modern view of property rights, which includes economic as well as legal rights, is considered. Economic rights to assets

> consist of the rights, or powers, to consume, obtain income from, and alienate these assets. . . . Legal rights, as a rule of law, enhance economic rights, but the former are neither necessary nor sufficient for the existence of the latter. The rights people have over assets (including themselves and other people) are not constant; they are a function of their own direct efforts at protection, of other people's capture attempts, and of government protection. (Barzel, p. 2.)

This modern view of property rights suggests that public land management since the early 1900s was not a period of retention and management, as some have termed it, but one of disposition of economic if not legal rights. This also suggests that Gardner (1997a) was right when he indicated that public land law today is one of "bickering over entitlements." It also suggests that lessons from the past may be learned and used to explain why government may also fail to allocate resources efficiently. The history outlined above indicates why federal lands were retained, and the following discussion suggests that these same basic reasons are also present today.

Wilderness, Like Parks?

It is recognized that land in parks may or may not be included in the Wilderness system, but the effect of designating an area as wilderness is essentially equivalent to the establishment of the parks at the turn of the

last century—some uses are excluded. The motivation for designation of an area as wilderness is essentially equivalent to the logic that was used to establish the parks a hundred years ago— the logic includes unique characteristics such as: (1) mans's work is "unnoticeable," (2) "solitude" and opportunities for "unconfined recreation," and/or (3) unique or special features. Furthermore, the key legislative players in both episodes are similar (strong senators and representatives from eastern states) and are opposed by representatives from states where the lands are being designated. It should also be noted that the local opposition to the designation of parks at the turn of the century or wilderness areas today is not total because some designations may be justified and are supported by western as well as eastern legislators. In these cases, the question becomes not one of *if* an area is designated as a wilderness (or park at the turn of the last century) but one of *how much* land is designated as a wilderness.[14] Most of the modern discussion of wilderness has centered on designation issues. But how these lands are managed—judged by amount and type of use—will become increasingly important in the future.

Controversies associated with the use of wilderness areas in the future will likely become as heated as they are today concerning recreational use of parks (e.g., traffic and snowmobiles in Yellowstone). It also is likely that these controversies will focus on issues of preservation and use that were evident when the parks were set aside. These differences involved two strong personalities—John Muir (1838-1914), who favored and actively campaigned for "preservation" from 1889 on, and Pinchot, who thought "a resource should not be locked up for the future but used subject to regulation" (Gates, p. 571).

Monuments, Like Forest Reserves?

In 1896, the National Forest Commission recommended the formation of 13 additional national forests in seven states. President Grover Cleveland was so impressed with the report that he promptly issued proclamations establishing the reserves as recommended (1897). This caused "A storm of protest in the west, . . . that has rarely been equaled [because the recommendations were based on the opinions of] . . . theorists (Pinchot, [Charles Sprague] Sargent [1841-1927], et.al.) who knew nothing of the West" (Gates, p. 569). The negative reaction to these designations was not unexpected, and the result in terms of appropriations to the Forest Service as well as a significant change in how things were done occurred with the election of a new president (William McKinley, 1897-1901, then and George W. Bush now, after 2001). The parallels do not stop at that point because

> Those who came to support the conservation movement of 1908 and 1909 [and late 1990s] "were prone to look upon all commercial development as mere materialism,

and conservation as an attempt to save resources from use rather than use them wisely. The problem, to them, was moral rather than economic." It is also noteworthy that "The new interest in conservation, which dominated the movement between 1908 and 1910, came primarily from middle- and upper-income urban dwellers" and that "Most of the new conservation organizations recruited their members and obtained financial support from urbanites. . . ." This crusade "attracted many people interested in parks, and wilderness areas, in rural life, and in non-materialistic values." (Hays, p. 141-143.)

This suggests that the conservation movement that resulted in reservation of western lands as parks and Forest Service lands at the turn of the last century was nearly identical to the modern thrust to designate areas as wilderness and national monuments at the turn of this century. These actions clearly result in allocations that no longer allow the creation of legal or economic rights to use some areas of public land—opportunities to homestead some lands legally were terminated, starting with the designation of Yellowstone, and the opportunity for specified uses (e.g., the Wilderness Act specifies that no commercial enterprise, road, motorized vehicles or equipment, aircraft, mechanized transport, or structures are to exist in wilderness areas) can no longer occur legally on some public lands, starting with the Wilderness Act of 1964.

The controversy concerning which cabinet department, Interior or Agriculture, should administer Park Service, Forest Service, and lands later managed by the Bureau of Land Management in the early 1900s has close parallels today. The modern controversy not only includes conflicts over what agency should administer what lands, as evidenced by shifts in acres managed by the agencies just named, but also a common perception among users that guidelines on management of public lands is not uniform either between agencies or within an agency. There are numerous examples, such as the maintenance of fences, allocation of camping sites, or river running permits, where policies differ between agencies as well as between offices of the same agency. In addition, the rapidly rising problems of administering public lands today are associated with recreation. Controversies regarding recreational use have parallels to the grazing controversy and the failure of the homestead acts in the early 1900s.

Itinerant Recreation and Sheep

As noted above, grazing by livestock rapidly expanded in the West after the transcontinental railroad was completed in 1869. Similarly, the construction of interstate highways, expanded air travel, the introduction and improvement of recreation-related equipment (backpacks, sleeping bags, golf clubs, fly rods, travel trailers, four-wheel-drive vehicles, etc.), as well as increased disposable income, have made the real cost of recreation

decline for most Americans. As a result, recreational use of public lands has increased. This use has many of the comparative advantages that are analogous to grazing by sheep at the turn of the last century. First, recreation is by far the most mobile of the "multiple uses," just as sheep were a hundred years ago. Second, recreational users are able to use lands that are not usable by others. Third, recreational use is not tied to a "home base." As is noted above, most successful cattle operations and many sheep operations in the West had private lands (or "home" ranges) that produced forage or hay near to public lands, while itinerant or nomadic sheep herds were able to use lands without a "home base." Similarly, most people who use public lands for recreation earn their living elsewhere and are not tied to lands used for recreation. In both cases, the itinerant user has little incentive to maintain the quality of the lands used because, as Bromley noted, "[T]he problem with open-access resources is that there is no duty to aspiring users to refrain from use," which also results in the dissipation of rents.

The results of increased recreational use are not unexpected, and examples are readily apparent to almost anyone who visits public lands. First, the resource potentially is overused, and, just like overgrazing, the quality of the land would be expected to deteriorate—litter, fire rings, human waste, erosion from off-road vehicles (ORVs), trampling of grass, etc. These negative environmental impacts commonly have been ignored in the past because recreational use has been viewed as environmentally friendly and low-impact. However, the costs as well as the benefits associated with recreational use of public lands recently have been recognized in the popular press. For example, Morrison recently stated that recreationists may represent "the West's next environmental menace." Second, impacts on other users will increase—trespassing on private land, man-induced forest fires, poaching of wildlife, etc. Third, conflicts between users would be expected to increase, especially between existing and new users of an area. Evidence of these conflicts suggests that they can become nearly as intense as the cattle and sheep wars over a hundred years ago that have been portrayed in books and movies. Anyone who has attended most meetings that are designed to obtain public input for a land-use plan recognizes that strong differences of opinion exist between recreational users of public lands—e.g., snowmobilers vs. cross-country skiers, or wilderness advocates vs. ORV enthusiasts. Fourth, some users will reduce the non-fee costs of using these lands or capture some of the benefits of location by moving closer to the public lands, which may lead to a race for property rights. The race to establish new property rights also may lead to "developments," with consequences such as those described by Power and Barrett:

> Rapid expansion [of the western] economy has been accompanied by proliferation of

> part-time and seasonal minimum-wage jobs that cannot possibly support an individual, not to mention a family. Meanwhile, a new affluent class flaunts its wealth by building huge, prominently visible homes, driving outrageously expensive cars, shopping in exclusive boutiques, and frequenting restaurants that locals enter only through the back door, to wash dishes or bus tables (p. 142).

Fifth, agency resources will be strained as they try to manage these conflicts and effects, as suggested by the agency budget deficits noted above. Revenues have declined as uses have shifted from uses that pay (timber, grazing, and minerals) to the use that generally does not (recreation), while agency expenditures have increased.

Increased recreational use of public lands both can and does lead to the same issues of market failure that existed with use of public lands by livestock. First, recreational users of public lands are difficult to identify—just like sheep, they do not carry a brand, and some may hide intentionally if they have been involved in actions that are illegal or inappropriate. Second, and probably more importantly, there appears to be no feasible way of excluding[15] many types of users—even if it were desirable to do so. Difficulties related to regulation and exclusion of entry present some dilemmas that will challenge those who believe that recreation on public lands should be limited in an effort to reduce negative impacts.

Alternative Allocation Methods

All methods that might be used to allocate use of public lands involve obtaining economic, if not legal, right(s) to consume/use, obtain income from, and alienate these rights. These rights must then be enforced by either direct effort of the owners or by government. These allocative methods might be used to overcome some of the difficulties inherent in the disposition of property rights to use public lands, and all of these methods represent privatization of public lands to some degree.

One of the first alternatives used to dispose of lands in the early 1800s was sale. Land sales generally would be expected to transfer most of the property rights (enforceable claims to the benefit streams derived from the resource) associated with land. It is likely that many of the best public lands would be transferred to private ownership if offered for sale today. Furthermore, it is likely that the revenues that could be obtained from the sale of these lands would be large. But I believe that this is not a viable alternative for political reasons. Also, the costs of exclusion might limit the potential to sell some lands even if it were politically acceptable to do so. Nevertheless, land sales may be a viable alternative in some (perhaps many) cases.

The second way of allocating use is the requirement of a permit. Graz-

ing permits have a long and colorful history, but permits also exist for things as diverse as the operation of a ski resort, ownership of summer homes on Forest Service lands, operation of a concession on Park Service lands, and provision of hunting and guiding services. The issuance of grazing permits has resulted in inefficiencies that have been documented by numerous authors, and it is likely that these same types of inefficiencies exist with other permits to use public lands. Very little research has been done on this issue, but the limited amount of work that has been done suggests that these permits also can "take on value" if they result in profits/rents and can be transferred. One of the issues that has received very little attention in the literature (grazing is an exception) is how most permits to use public lands are allocated and what are the economic consequences of these allocations. Various methods have been used to allocate permits, including open access (no restrictions), queues, lotteries, priority based on experience, or other measures of presumptive deservedness, as well as competitive bids.

All of the methods that may be used to allocate permits to use public lands have advantages and disadvantages and may or may not require the payment of fees, even though the Federal Land Policy and Management Act of 1976 specifically states that the "fair market value" shall be paid for the use of "public lands and their uses unless [otherwise?] provided by statute." The policy of charging fees for use has been ignored and unevenly implemented. Charging fees for the use of public lands never has been popular[16] because it implies a restriction on use. Scott Phillips (a retired Forest Service outdoor recreation management specialist) noted, "Recreationists hate fees for all the right reasons. Fees will inexorably lead down the slippery slope to privatization and commercialization of our public lands. Fees are undemocratic, exclusionary, a regressive double tax and flat-out wrong" (*High Country News*, March 15, 2004, p. 16). Similar views were expressed in a letter to the editor (*Herald Journal*, Logan, Utah, 26 June 2003), "[Free?] Access to these [public] lands is one of the primary benefits of living in the west." It also is interesting to note the close correspondence between the resistance to paying fees by (itinerant) sheep men at the turn of the century and the (itinerant) recreationist of today. The ability to assess fees for some types of recreation (camping, hiking, sightseeing, etc.) is small, however, because the costs of exclusion and enforcement would be large. As a result, payment of fees might not be a viable option for restricting some uses. In other cases where access is limited (float trips, trailheads for some wilderness areas, etc.),[17] it may be possible to implement a fee system. Itinerant recreation, however, represents a growing allocation problem without a simple solution because the costs of enforcement make the occurrence of negative impacts/externali-

ties difficult to prevent.

What Now?

The discussion above suggests that the primary reason why lands were retained by the federal government within the last hundred years or so stemmed from failures for a market to allocate the resources involved efficiently or equitably. It must be remembered, however, that market failure is neither a necessary nor a sufficient reason for allocation by government. Furthermore, just because decisions are made in the public sector, such as the modern-day public land allocation decisions noted above, such decision-making methods do not ensure that these decisions are efficient. For example, Wallace Stegner (1909-1993, the "dean of Western letters") traced most of the environmental "woes of the west to government decisions" (Sagoff, p. 143). This suggests that governmental failures may be as destructive as market failures and, as McKean (1965) noted nearly 40 years ago, governments may fail to allocate resources efficiently for the same reasons markets fail (externalities, imperfect competition, etc.). White also noted that "[T]he most important question for policy makers and policy analysts is: How does the existing non-market decision making compare with an idealized non-market system [or even a market system]? This query has not been pursued in any systematic fashion." It is recognized that the complete disposition of public lands in the future is unlikely, but privatization of public lands has never stopped.

Given the existence of economic, if not legal, property rights for most uses of public lands, efforts by interest groups will be focused on the redistribution of existing property rights and not on either the definition or reorganization of existing rights. This suggests that controversies associated with allocating uses on federal lands probably will escalate and that resources will be devoted to "gain[ing] control of existing rights that currently belong to others. . . . [As a result, those seeking these rights must] invest valuable time and effort trying to take, and existing owners must invest valuable time and effort in trying to defend [their rights] from the taking. Whether the redistribution is effected through private actions such as theft or through governmental action such as taxation or regulation, the result is the same: resources are consumed and the overall size of the economic pie is accordingly reduced" (Anderson and Hill, 2004, pp 22-23). This emphasis on redistribution instead of redefinition or reorganization of property rights in the West provides a logical explanation of why controversies concerning the allocation of uses on public lands are so contentious. This misplaced emphasis also explains why these controversies are likely to escalate in the future as recreation displaces other uses that have existed in the long run. It also suggests that the dissipation of

rents that occurred during the era of homesteading probably is occurring today in the allocation of uses on federal lands. This rent-seeking behavior results in a net economic loss to society.

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Endnotes

* This paper is adapted from and an extension of a paper delivered as the presidential address of the Western Agricultural Economics Association at its meeting in Denver, CO, in July 2003. The original paper was submitted to the *Journal of Agricultural and Resource Economics*.

[1] This paper emphasizes issues surrounding federal lands in the western United States. It is recognized that public lands also are administered by state and local units of government in the West. There is no consideration

of public lands in Canada. Omission of discussion of state and provincial lands is intentional in an effort to limit the number and scope of issues considered.

[2] This 200-year period provides a convenient way to look at public land management from a historical point of view. This paper is designed to allow the reader to obtain some of the insights I learned and to outline some of the issues I see that will be important in the future.

[3] It should also be noted that federal land ownership is not evenly distributed throughout the West. For example, the percentage of federal land varies from about 10 percent in Morgan County, Utah, to nearly 92 percent in Garfield County in the same state.

[4] The act of "taking" lands from Native Americans, at least for uncompensated takings, has to be viewed as non-recognition of a previous government.

[5] The reasons for market failure in resource allocation are described in Randall (1983).

[6] Data to support these numbers may be questioned.

[7] The use of public lands by horses has not received the attention it deserves for at least two reasons. First, grazing by horses can be more destructive to vegetation than by any other grazing animal. Most of the wild horse herds that exist today are descendants of stallions introduced by wranglers and others that were used to breed wild mares. The resultant offspring were "rounded up" and used as work animals. No data are available on the number of "wild" horses that used public lands (the second reason why horses have received little attention) at the turn of the century because the horse herds were treated and managed as feral animals and were "owned" only through capture—they could be destroyed (as suggested by the Wild Free-Roaming Horse and Burro Act of 1971, Pub. L. No. 92-195), but they were not managed.

[8] Gates (1979) provides a detailed history of these acts. The first land grants west of the frontier of English settlement probably were made to soldiers, starting as early as 1675 (Gates, p. 249).

[9] For example, a liberal capacity of 5 acres per animal unit month (AUM) would yield enough foragefor about 10 cows (5 acres/AUM times 12 AUMs per cow would result in 60 acres per cow, versus 640 total acres, enough for 10.5 cows).

[10] Herds of sheep may be identified by owners using notched ears in a particular way, but such notches were not widely accepted or recognized

by other owners.

[11] Sheep herders in Texas were able to use fencing as a means of establishing ranches because precipitation allowed economically viable units to be fenced.

[12] This comparison is subject to at least one major caveat. It is not known how much, if any, of the revenues managed by the Minerals Management Service were from Forest Service lands. This agency administers essentially all mineral lease revenues from federal lands.

[13] Stevens (1993), pp. 269-278, outlines some of the reasons why government may maximize budget outlays and thereby incur deficits, particularly if revenues are not collected.

[14] This has some major implications for economic analysis of designations that are commonly ignored in these debates. Most of the discussions and much of the economic analysis have centered on the "value of wilderness" and not on the value or cost of wilderness "at the margin."

[15] The feasibility of exclusion is commonly a function of technology as illustrated by the development of branding and barbed wire, which allowed lands used by cattle to be transferred to private ownership. In the case of recreation, the required use of a global positioning satellite (GPS) unit that monitored and recorded the location of the person who held the unit might be a reasonable proxy for a fence, but it is doubtful that individuals would accept monitoring of movement to this degree.

[16] A recent letter to the editor (Herald Journal, Logan, UT, June 26, 2003) used the colorful language that the "gravy sucking pigs" had done it again when it was announced that a parking fee would be charged at a popular local recreation area that is administered by the Forest Service. However, a recent conversation with the local concessionaire indicated that visitors to this area have been more willing to pay than this letter would suggest.

[17] Charging fees for some types of recreation has the potential to generate considerable revenue (assuming the studies concerning willingness-to-pay are accurate) for two reasons. First, the demand is relatively inelastic for most forms of recreation associated with the use of public land. Second, most recreational users have above-average ability to pay—most have above-average income. In those cases where the actual use is by high-income users, the payment of fees would seem to be desirable because costs of providing recreational opportunities would be shifted from the relatively poor (taxpayers) to the rich.

WAR AND EMERGENCY POWERS:

The Extra-Constitutional Authority Used by the Federal Government to Control Natural Resources, Including Federally Held Public Lands Within States

Eugene Schroder

ON March 9, 1933, at the unanimous request of all 48 state governors, the United States Congress declared that a state of emergency existed within the United States. The Emergency Banking Relief Act of March 9, 1933, delegated emergency powers to the President to regulate and control banking, credit, and monetary issuance within the United States.

The Agriculture Adjustment Act of May 12, 1933, as amended May 27, 1933 (the "AAA"), delegated emergency powers to the executive branch to control agricultural production, distribution, and pricing within the United States.

The National Industrial Recovery Act of June 16, 1933 (the "NIRA"), delegated emergency powers to the executive branch to control industry and labor, as well as the authority to control natural resources.

It should be noted that each of these statutes and emergency actions purportedly was a national emergency measure, but with the exception of the NIRA, none of these measures was repealed or declared unconstitutional by the federal courts once the purported emergency of the 1930s was past. The first two measures (the Emergency Banking Act and the AAA) are still in the statute books, and the NIRA was declared unconstitutional in 1935 only as applied to industry and labor, *not* as applied to the control of natural resources. Also, the concept of a national economic emergency power outside a situation of declared war, foreign invasion, or armed insurrection was unknown prior to 1933.

There follow some relevant excerpts from these emergency statutes and executive orders as they apply to the control of land and natural resources in the American West. Unless otherwise noted, these excerpts are taken from the Franklin D. Roosevelt papers.

NIRA. Title I—Industrial Recovery

Declaration of Policy

Section 1. A national emergency productive of widespread unemployment and disorganization of industry, which burdens interstate and foreign commerce, affects the public welfare, and undermines the standards of liv-

ing of the American people, is hereby declared to exist. It is hereby declared to be the policy of Congress to remove obstructions to the free flow of interstate and foreign commerce which tend to diminish the amount thereof; and to provide for the general welfare by promoting the organization of industry for the purpose of cooperative action among trade groups, to induce and maintain united action of labor and management under adequate governmental sanctions and supervision, to eliminate unfair competitive practices, to promote the fullest possible utilization of the present productive capacity of industries, to avoid undue restriction of production (except as may be temporarily required), to increase the consumption of industrial and agricultural products by increasing purchasing power, to reduce and relieve unemployment, to improve standards of labor, and otherwise to rehabilitate industry and to conserve natural resources.

Administrative Agencies

Section 2(a). To effectuate the policy of this title, the President is hereby authorized to establish such agencies, to accept and utilize such voluntary and uncompensated services, to appoint, without regard to the provisions of the civil service laws, such officers and employees, and to utilize such Federal officers and employees, and with the consent of the State, such State and local officers and employees, as he may find necessary, to prescribe their authorities, duties, responsibilities, and tenure, and, without regard to the Classification Act of 1923, as amended, to fix the compensation of any officers and employees.

Schroder comment: It is this authority that has been used since 1933 to justify federal control of public land uses, including grazing, timber, and water rights.

The National Resources Board Is Established

Executive Order No. 6777, June 30, 1934:

By virtue of the authority vested in me by the [NIRA] . . ., I [President Roosevelt] hereby establish the National Resources Board, consisting of the Secretary of the Interior (chairman) [Harold Ickes], the Secretary of War, the Secretary of Agriculture, the Secretary of Commerce, the Secretary of Labor, the Federal Emergency Relief Administrator, Frederic A. Delano (chairman), Charles E. Merriam, and Wesley C. Mitchell.

An advisory committee, consisting of Frederic A. Delano (chairman), Charles E. Merriam, and Wesley C. Mitchell, is hereby constituted, to which additional members may be added from time to time by order of the President.[1]

There is also established a technical committee with no fixed member-

ship or tenure of office to be selected by the Board.

The functions of the Board shall be to prepare and present to the President a program and plan of procedure dealing with the physical, social, governmental, and economic aspects of public policies for the development and use of land, water, and other national resources, and such related subjects as may from time to time be referred to it by the President.

The Board shall submit a report on land and water use on or before December 1, 1934. The program and plan shall include the coordination of projects of Federal, State, and local governments and the proper division of responsibility and the fair division of cost among the several governmental authorities.

The National Planning Board of the Federal Emergency Administration of Public Works is hereby abolished, and all of its powers, duties, records, personnel, equipment, and funds are hereby transferred to the National Resources Board.

The Committee on National Land Problems, created by Executive Order No. 6693, of April 28, 1934, is hereby abolished.

The Federal Emergency Administration of Public Works is hereby directed to allot to the National Resources Board the sum of one hundred thousand dollars ($100,000), and such additional sums as may be approved from time to time by the President, to carry out its functions.

White House Statement on the Establishment of the National Resources Board

July 3, 1934

In order to grapple on a national scale with the problem of the millions of farm families now attempting unsuccessfully to wrest a living from worn-out, eroded lands, the President today issued an Executive Order creating the National Resources Board. The Board will study and plan for the better utilization of the land, water, and other national resources of the country.

The personnel of the Board includes the Secretary of the Interior, chairman, the Secretary of War, the Secretary of Agriculture, the Secretary of Commerce, the Secretary of Labor, the Federal Emergency Relief Administrator, Mr. Frederic A. Delano, Mr. Charles E. Merriam, and Mr. Wesley C. Mitchell. The last three named also constitute an Advisory Committee, of which Mr. Delano is chairman. The order at the same time abolished the National Planning Board, transferring its personnel, duties and records to the new organization. The relationships with State planning agencies heretofore established by the National Planning Board will be continued and

developed by the new National Resources Board. The order provided for a Technical Committee as well, with no fixed personnel or tenure.

The Board will prepare a program and plan of procedure to be submitted to the President dealing with all aspects of the problem of development and use of land, water and other resources, in their physical, social, governmental and economic aspects.

A report on land and water is called for in the order, to be submitted before December 1, 1934. The program and plan will include coordination of projects of Federal, State and local governments, defining the division of responsibility and costs among the various governmental authorities.

The new Board, which will coordinate the diverse efforts of several government agencies in attacking the problems, supersedes the Committee on National Land Problems, which is abolished by today's order.

As an example of the major problems facing the new Board, there is the imperative need of saving those lands of the country now rapidly turned into virtual deserts through wind and water erosion, and the relocation of those who are trying to wrest a living from this rapidly deteriorating land. Such lands include the flat prairie lands of the West where drought and wind combine to carry away the remaining fertile top-soil, and hill land where, after land has been cleared, rain has washed the formerly fertile hillsides clean of productive soil, with consequent gullying and virtual ruin of the land for productive purposes. Such lands can be saved by returning them to forest, or utilizing them for grazing rather than attempting to raise clean-tilled crops, which induce rapid erosion.

Coupled with this problem, of course, is that of relocating those farmers and their families on better land, where their efforts will bring them a better living and more certain economic security.

The program will be prepared with more in mind than better land utilization. It will give consideration to the better balancing of agricultural production and the solution of human problems in land use. It will aim to point the way to correction of the mis-use of land and water resources, thereby improving the standards of living of millions of impoverished families.

Many agencies of the Federal Government will cooperate in this broad program, including the following:

Interior Department: National Park Service, Office of Indian Affairs, the General Land Office, the Bureau of Reclamation, the Geological Survey, the Subsistence Homesteads Division, and the Soil Erosion Service.

Department of Agriculture: Bureau of Agricultural Economics, the For-

est Service, the Agricultural Adjustment Administration, the Farm Credit Administration, the Bureau of Chemistry and Soils, the Biological Survey, the Bureau of Agricultural Engineering, and the Extension Service.

Relief: The Federal Emergency Relief Administration and the Federal Surplus Relief Corporation.

In matters affecting navigable waters, the War Department will cooperate with the National Resources Board. Likewise, the Bureau of Fisheries of the Department of Commerce will cooperate in matters affecting that national resource.

A Typical Executive Order (No. 6910) on Withdrawal of Public Lands to be Used for Conservation and Development of Natural Resources (On the Taylor Grazing Act)

November 26, 1934

Whereas, the Act of June 28, 1934 [Taylor Grazing Act] . . ., provides, among other things, for the prevention of injury to the public grazing lands by overgrazing and soil deterioration; provides for the orderly use, improvement and development of such lands; and provides for the stabilization of the livestock industry dependent upon the public range; and

Whereas, in furtherance of its purposes, said Act provides for the creation of grazing districts to include an aggregate area of not more than eighty million acres of vacant, unreserved and unappropriated lands from any part of the public domain of the United States; provides for the exchange of State owned and privately owned lands for unreserved, surveyed public lands of the United States; provides for the sale of isolated or disconnected tracts of the public domain; and provides for the leasing for grazing purposes of isolated or disconnected tracts of vacant, unreserved and unappropriated lands of the public domain: and

Whereas, said Act provides that the President of the United States may order that unappropriated public lands be placed under national-forest administration if, in his opinion, the land be best adapted thereto; and

Whereas, said Act provides for the use of public land for the conservation or propagation of wild life; and

Whereas, I find and declare that it is necessary to classify all of the vacant, unreserved and unappropriated lands of the public domain with certain States for the purpose of effective administration of the provisions of said Act;

Now Therefore, by virtue of and pursuant to the authority vested in me by the Act of June 25, 1910, . . . as amended by the Act of August 24, 1912 . . .

[revisions of the Homestead Act of 1862], and subject to the conditions therein expressed, it is ordered that all of the vacant, unreserved and unappropriated public land in the States of Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Utah and Wyoming be, and it hereby is, temporarily withdrawn from settlement, location, sale or entry, and reserved for classification, and pending determination of the most useful purpose to which such land may be put in consideration of the provisions of said Act of June 28, 1934, and for conservation; and development of natural resources.

The withdrawal hereby effected is subject to existing rights.

This order shall continue in full force and effect unless and until revoked by the President or by act of Congress.

[President Roosevelt note]: The foregoing Executive Order was the first issued by me pursuant to the Taylor Grazing Act of June 28, 1934, 48 Stat. 1269.

The President Submits to the Congress Reports on a Comprehensive Plan for Control and Development of Water Resources

June 4, 1934

To the Congress:

On February 2, 1934, by resolution, the Congress requested me to report on "a comprehensive plan for the improvement and development of the rivers of the United States, with a view of giving the Congress information for he guidance of legislation which will provide for the maximum amount of flood control, navigation, irrigation, and development of hydro-electric power."

Pursuant thereto I requested the Secretaries of the Departments of the Interior, War, Agriculture and Labor to advise on the development of a water policy and on the choice of projects. I am sending herewith copies of their report, together with separate letters from the Secretary of War and the Secretary of Labor, and also:

(1.) List of Technical Advisory Committees of the President's Committee.

(2.) Review of reports of Technical Sub-Committees on water flow.

(3.) Review of report of Technical Sub-Committees covering additions in the Arid Section, prepared by the Bureau of Reclamation.[2]

(4.) Seven reports of Technical Sub-Committees covering various re-

gions.

I ask that the Congress bear in mind certain obvious facts relating to these reports:

(1.) That the time for the preparation of these reports was extremely

limited.

(2.) That the subject is one of enormous magnitude covering the whole of the United States .

(3.) That the Resolution of the Congress, covering the subjects of flood control, navigation, irrigation, and development of hydro-electric power automatically opened the door to all interrelated subjects which come under the general head of land and water use. This broader definition brings to our attention very clearly such kindred problems as soil erosion, stream pollution, fire prevention, reforestation, af-forestation, marginal lands, stranded communities, distribution of industries, education, highway building, home building, and a dozen others.

(4.) All of the reports were based primarily on information already at hand and further study is strongly recommended.

(5.) For the purpose of making a preliminary test, I requested a wholly tentative trial selection of ten specific projects. As I had expected, the report strongly doubts the advisability of recommending these projects, on the ground that any selection at this point must necessarily omit many meritorious projects which further analysis may show to be preferable.

(6.) The reports of the Technical Sub-Committees, covering various areas, are of definite value. But before any work is done, it is obvious that a competent coordinating body must go over all of these reports, as well as reports on other projects, and produce a comprehensive plan.

In view of the above, I, therefore, suggest that the Congress regard this message and the accompanying documents as merely a preliminary study and allow me, between now and the assembling of the next Congress, to complete these studies and to outline to the next Congress a comprehensive plan to be pursued over a long period of years. Further legislative action on this subject at this session of the Congress seems to me, therefore, unnecessary.

I expect before the final adjournment of this Congress to forward to it a broader outline of national policy in which the subject matter of this message will be presented in conjunction with two other subjects also relating to human welfare and security.

We should proceed toward a rounded policy of national scope.

A Typical Act for Protection and Conservation of Wild Life By Providing Suitable Refuges

Executive Order No. 6766, June 29, 1934

Whereas lands have been and are being acquired by the United States in order to provide suitable refuges for and to protect and conserve migratory birds and other wild life constituting depleted natural resources of the United States; and

Whereas the work and improvements necessary to be performed and made upon such lands to make them suitable and proper refuges for migratory birds and other wild life will provide protection for such lands from forest fires, floods, and soil erosion, and plant pest and disease, and aid in the restoration of the country's depleted natural resources; and

Whereas the restoration, improvement, and development of such refuges will provide employment for citizens of the United States who are unemployed:

Now, Therefore, by virtue of and pursuant to the authority vested in me [President Roosevelt], the sum of $2,500,000 is hereby allocated from the appropriations made by the said Deficiency Act of June 16, 1933, and the said Emergency Appropriation Act, fiscal year 1935, for carrying out the purposes of the said Act of March 31, 1933, to the Secretary of Agriculture, for the restoration, improvement, and development of such lands as wildlife refuges.

Statement on Signing Bill for Federal Regulation of Grazing on Public Lands

[Taylor Grazing Act]

June 28, 1934

The passage of this Act marks the culmination of years of effort to obtain from Congress express authority for Federal regulation of grazing on the public domain in the interests of national conservation and of the livestock industry.

It authorizes the Secretary of the Interior to provide for the protection, orderly use, and regulation of the public ranges, and to create grazing districts with an aggregate area of not more than 80 million acres. It confers broad powers on the Secretary of the Interior to do all things necessary for the preservation of these ranges, including, amongst other powers, the right to specify from time to time the number of livestock which may graze within such districts and the seasons when they shall be permitted to do so. The

authority to exercise these powers is carefully safeguarded against impairment by State or local action. Creation of a grazing district by the Secretary of the Interior and promulgation of rules and regulations respecting it will supersede State regulation of grazing on that part of the public domain included within such district.

Water development, soil erosion work, and the general improvement of such lands are provided for in the Act.

Local residents, settlers, and owners of land and water who have been using the public range in the past are given a preference by the terms of the Act to the use of lands within such districts when placed under Federal regulation so long as they comply with the rules and regulations of the Secretary of the Interior. The Act permits private persons owning lands within a district to make exchanges for Federally owned land outside a grazing district if and when the Secretary of the Interior finds it to be in the best public interests.

The Federal Government, by enacting this law, has taken a great forward step in the interests of conservation, which will prove of benefit not only to those engaged in the livestock industry, but also to the Nation as a whole.

Schroder comment: Even though the Taylor Grazing Act was passed by Congress, the following statement by then Secretary of Interior Harold Ickes indicates that it was unnecessary.[2]

Ickes Diary Entry on Background of Taylor Grazing Act

Thursday, January 25, 1934

Secretary Wallace and I lunched with the President today. We are both supporting a bill introduced in the House by Congressman Taylor, of Colorado, which would give the Secretary of the Interior authority to control grazing on the public range. This bill is a most important one if we are to stop the practices that are rapidly destroying the range in many parts of the West. Our advices are that this bill will not pass, on account of Western opposition, unless the President gets back of it. The President is in sympathy with the bill and told us to talk to the Senate and House leaders. He proposes to write a letter to the appropriate committees in the House and the Senate in support of the bill. Failing the passage of the bill we discussed with him the withdrawing of all public lands from entry. My solicitors advise me that the President has this power of withdrawal and probably, even if the Taylor bill does not pass, I can exercise sufficient control over the public range.

Schroder's Conclusion

Declarations of war or emergency which create and convey extra-con-

stitutional powers are intended as a temporary condition, to be terminated at the resolution of the crises from which they arose. The declarations of emergency of the 1930s that survived their initial court tests have never been terminated and account for the extra-constitutional power that the federal government exerts today.

An extensive review of these emergency powers needs to be conducted with the view of returning the control and use of natural resources to the state and local governments where they are located.

Endnotes

[1] Frederic A. Delano was a maternal uncle of the President and an original member of the Federal Reserve Board. Charles E. Merriam was a Chicago civic reformer and professor of political science at the University of Chicago; he was chairman of the American Planning Association and a leading light among progressive theorists. Wesley Clair Mitchell was a Columbia University professor of economics who was primarily responsible for the modern study of business cycles. He founded the National Bureau of Economic Research and was an early director of the New School for Social Research.—Editor

[2] Source: *The Secret Diary of Harold L. Ickes: The First Thousand Days, 1933-1936*, New York, NY: Simon and Schuster (1953), p. 143.

COMMENTARY

Howard Hutchinson

Professor Godfrey has presented a well thought-out overview of the issues of property rights and public land management. We are charged as discussants with the task of bringing on-the-ground perspectives and additional information to the conference attendees here in the East.

I have been engaged in discussions like this for the better part of 20 years. On one side, I have been an environmental protection advocate and activist, and on the other, I have been a champion of strict-construction constitutional interpretation and of property rights.

Prof. Godfrey has confined his comments to the 200 years since the Lewis and Clark expedition. In order to gain a better understanding of the history of the Southwest and how that history relates to the present federal land management, I have chosen to push that time frame back to 1606.

My comments are organized to conform to Prof. Godfrey's topic headings. In contrast to his use of the term "public lands," I have chosen to use the more descriptive and statutory term "federal lands." "Public lands" and the synonymous term "public domain" were defined as lands subject to sale or other disposal under general law.[1] The Federal Lands Management and Policy Act of 1976 (FLPMA) terminated public lands status and proclaimed that domain to be henceforth "federal lands."

A Brief Historical Overview

When Lewis and Clark returned to St. Louis on September 26, 1806, Santa Fe, New Mexico, already had been a capital city for two hundred years. Fifteen years later (1821), Mexico gained independence from Spain. Forty years later, in 1846, General Steven Watts Kearny accepted the surrender of Santa Fe to the United States without firing a shot.

Northern New Spain consisted of the present states of California, Nevada, southern Utah, Colorado, Arizona, New Mexico, and Texas. There will be further discussion of the Spanish legacy in the Southwest in the section dealing with methods of land disposal.

Indeed, it was Thomas Jefferson's and many other founders' intent that all land acquired by the United States would be disposed of into private ownership with exceptions listed in Article I, Section 8, clause 17 of the U.S. Constitution, which deals with forts, arsenals, military shipyards, and the like.

It is this principle (all public lands should be sold to private owners) that led to what was termed the Sagebrush Rebellion in the late 1970s. Western

states, beginning with Nevada, passed state statutes claiming the federal lands and asserting that the national government had violated the "equal footing doctrine" by retaining ownership of land as a condition of statehood.

As Prof. Godfrey correctly points out, the principle of disposal into private ownership was prevalent for the first one hundred years of the nation. It is ironic that Gifford Pinchot and Theodore Roosevelt implemented a federal policy of holding lands in common (1905) following the world-wide distribution of the Communist Manifesto (1848).

Methods Used to Dispose of Public-Land Land Claims

Not all of the problems associated with land claims existed in the East. As stated in the introduction, Spain had settled a large part of the Southwest, and land claims associated with Spanish and Mexican land grants are in contest to this very day. Spain adapted its land and water laws to the conditions encountered in Northern New Spain. Following the Pueblo revolt in 1680 (a massive uprising of the Native American Indian population against Spanish rule and against the Church), Spain enacted specific provisions recognizing and protecting indigenous land and water rights.

The Treaty of Guadalupe Hidalgo (1848) guaranteed the rights to water and land for the Mexican citizens and Indians who remained in the new territory acquired by the U.S. federal government. The treaty also assured protection of customs and religious practices. A provision of the New Mexico Constitution provides for recognition of this treaty in perpetuity.

Modern federal judges seem to have a difficult time adjudicating these matters, perhaps because few, if any, law schools in America teach sixteenth- and seventeenth-century Spanish land law.

Texas entered the Union as a republic in 1845 and retained all lands still under state control. As a consequence, nearly all land in Texas currently is privately owned. A portion of Texas was purchased by the federal government and is now part of New Mexico. This area is the land east of the Rio Grande to the Texas border. It is interesting to note that the flag of Texas is flown at an equal height with the U.S. flag, unlike the flag of any other state.

Land Grants

Beginning in the 1930s, the federal government began reacquiring land that had been granted or homesteaded. This was accomplished through purchase or mere capture in cases where property was abandoned.

Grants of Rights-of-Way and Easements

Alluded to in Prof. Godfrey's section on property rights for use of public lands but absent in specificity is a discussion of the various mecha-

nisms employed by the federal government to grant rights-of-way and easements. These methods are primarily applied to access to and use of water, forage, and minerals. Absent provisions for such access, much of the West would not have been settled since access was necessary for use of resources and private lands.

A number of federal laws have been passed granting rights-of-way and easements on federal lands. Revised Statute 2477 (RS 2477), section 8 of the Mining Act of 1866, granted an unconditional easement across federal lands for the construction of needful roads. All that was required under the law to perfect the easement was construction. RS-2477 was repealed by the FLPMA in 1976, but all rights-of-way constructed on lands not specifically reserved prior to the date of enactment were recognized.

Other laws passed under various settlement acts provided for livestock trails and driveways. Others passed under the water reclamation acts provided for the recognition of easements for irrigation works, wells, water storage facilities, and water delivery systems.

These easements and rights-of-way form the foundation of the takings claim filed by Nevada rancher Wayne Hage. Earlier this year the U.S. Court of Claims found that Hage did, in fact, own the rights to the water, the ditch rights of way, and the forage adjoining the ditches on federal land.

The Court recently concluded receiving testimony on the value of what was taken from Mr. Hage and his late wife. The Court postponed to December 3, 2004, a telephone conference to determine if a settlement can be reached between Mr. Hage and the government.[2]

Ranchers are not the only parties holding rights-of-way and easements across federal lands. State and county governments and individual citizens have jurisdiction and ownership of many thousands of miles of rights-of-way in the West. Railroads, mining claims, and other holders of rights-of-way and mineral rights crisscross and dot the West.

Ronald Reagan was given overwhelming western support in his 1980 presidential bid on his campaign promise to dispose of western federal land holdings. Adhering to his promise, he commissioned a study to determine the best way to proceed. The result of the study was a determination that, due to the presence of so many layers of easements, mineral claims, and rights-of-way, there was little chance of being able to grant clear title to most of the land.

Reasons Why Lands in the West Were Not Transferred to Private Ownership

Prof. Godfrey's discussion of market failures points to a painful reality

being experienced on the land today. Federal agencies have known of the easements and grants of rights and privileges since their origins. All federal statutes that address reservations of land contain clauses recognizing "preexisting rights." This knowledge is not shared throughout the agencies' structures, however, and many new-era managers are philosophically attuned to preservation instead of use.

One of the true ironies of this history is manifest in the plight of the modern federal land rancher. As Prof. Godfrey alludes to, it was cattle ranchers who called for and received the benefits of establishing a grazing permit system on forest lands and preference rights on Bureau of Land Management lands. The security and advantage of being able to exclude others at the time has been blurred by a steady increase in regulatory control.

The thesis that public ownership would permit rational development has proven to be fatally flawed. The nation is losing vast tracts of land to catastrophic fires and to insect and disease infestation. Watersheds are so overstocked with trees that delivery of water to human and ecological systems is being severely reduced. The three types of catastrophes just mentioned also are contributing to significant declines in water quality.

Another modern irony is that what the environmental movement is achieving is the destruction of what it professes to protect. The misguided efforts of environmentalists are more directed toward imposing socialism or communal land ownership than protecting natural functions. Achievement of this agenda requires the removal of federal land users who hold the numerous rights-of-way and easements that blanket the West.

Environmental activists are currently focused on expunging forage rights and mineral entry under the 1872 Mining Act, having already succeeded in obliterating the timber industry. They and other advocates of centralized command and control of resources and production are very concerned about the courts' disposition of the *Hage* case.

Prof. Godfrey stated that the "vision and the perception of the Forest Service was that 'every member of the Service realized that it was engaged in a great and necessary undertaking in which the whole future of the country was at stake.'" Given the current fire-fighting mission of the Forest Service, the modern motto should be, "A black forest equals a green wallet."

Property Rights to Use Public Lands

Prof. Godfrey has described accurately the usufruct system of access to resources on the federal lands. Wayne Hage's legal argument has now

established recognition of fee rights on federal lands. The whole West is atwitter with the implications of the *Hage* decision. The federal government has attempted to say that it has not taken property rights on the federal lands in the West because it never allowed them to come into existence in the first place.

The intuitive and intellectual perception in the West is that we have been placed in a colonial status where raw natural resources are extracted and exported, while we trade for higher value products that are processed and imported.

Public Land Management Today: Status and Trends

From the perspective of people living in the West who are dependent on access to the federal lands, the four major agencies—Forest Service, Bureau of Land Management, Park Service, and Fish and Wildlife Service—mismanage the federal lands. "Manage" is too generous a term to describe what the federal agencies accomplish. Prof. Godfrey's statement, "Local users of the national forest lands are highly disenchanted and discouraged," is very accurate if not an understatement.

Disposition Then and Now

Prof. Godfrey cites Gardner (1997a) as stating that users are "bickering over entitlements." Given that some of these uses were preexisting rights protected by federal laws, some of the bickering is really demands for protection of rights.

Wilderness, Like Parks?

Wilderness designations do not always preclude all uses. Shortly after the passage of the Wilderness Act in 1964, Congress issued clarification language to protect uses such as grazing leases. Other exemptions from the act have been built into a number of designations.

Alternative Allocation Methods

Prof. Godfrey states that he believes the sale of the federal lands is not a viable alternative for political reasons. As stated previously in these comments, most of the federal estate is layered with multiple rights-of-way and easements. The political obstacles are minor compared to the land title issues.

Conclusion

Prof. Godfrey's paper has accurately described many of the problems associated with federal lands. This audience should not assume that these problems are restricted to the West. The federal government has been

purchasing private lands in the East for nearly 100 years. Angry western legislators have recently attempted to restrict federal land purchase authorization to lands east of the Mississippi River.

Prof. Godfrey's dizzying depiction of the web of regulation by multiple agencies is only the tip of the iceberg. The cumulative impact of all of those regulations and more has western land users and state, tribal, and local governments struggling to remain viable.

The Spanish and Mexican land grant conflict with modern state or federal law has erupted into violent, live-fire battles in the near past in New Mexico. Efforts for congressional remedy have tempered the passion in the last few years but will not stop further violence if they fail.

Studies commissioned by the Coalition of Arizona/New Mexico Counties in the early 1990s disclosed that the transfer of the New Mexico federal lands to the state would generate a $200 million per annum increase in direct revenues to the state (in 1989 dollars). This is not the desirable ultimate course of action, but it would move federal lands closer to disposal.

The *Hage* case is going to change forever the federal land management of the surface estate. Once the major metropolitan centers realize that a large part of their water delivery problems is associated with mismanagement of the watersheds, there will be sufficient political will to amend the Endangered Species Act of 1973 and other restrictive laws to allow for watershed restoration.

Devastating wildfires have already prompted the modification of management of the federal lands. These and many other political and natural forces are coming together to compel change. We can only hope that the change comes in time to save the western ecosystems, economies, and cultures.

Endnotes

[1] Joseph R. Rohrer, L.L.M., *Questions and Answers on the United States Public Land Laws and Procedure* (Washington, DC: J.D. Milans & Sons, 1812), p. 9.

[2] A complete case history and detailed trial reports of Mr. Hage's case are available online at http://www.stewardsoftherange.org, among other websites.

COMMENTARY

Michael Nivison[1]

Gerald O'Driscoll: Well, ladies and gentlemen, Walker Todd has done it to me once again. I don't quite know how an Irish kid from New York City is chairing these particular panels on property rights in the American West. Our first speaker, Michael Nivison, who is an Otero County Commissioner in New Mexico, is not with us, and it is a tape recording. *(Playback of recording begins.)*

Walker Todd: I am told that, because of the water emergency in Mr. Nivison's town, they are hauling water into his town. Cloudcroft, NM, where he lives, is in the southern part of the state, in the Sacramento mountain range. Mr. Nivison tells me that he lives on 14 1/2 acres that are surrounded by forest. I've asked him to comment on various water and forest issues. So, Michael, would you explain what we'll call the origin of the water problem where you are.

Michael Nivison: My responsibilities are as the administrator of the village of Cloudcroft, but I'm also the County Commissioner for that particular area, which encompasses almost all of the southern half of the Lincoln National Forest. The problem that we've had is that we started addressing forest fires here locally during the early 1990s and eventually identified the problem of the fires as actually a forest health issue. Subsequently all the springs and all the wells in the communities dried up. I have several communities that are either in a state of emergency or at risk right now because of the degradation of the watershed. We have been working with Washington and with the other counties in the state to try to solve our water problems arising from federal control of forest use, even passing some state legislation in 2000, Senate Bill One.

Now, how do you get an ecosystem turned around that was created by 100 years of mismanagement? I talked to you earlier about what I see happening in levels of sovereignty from the federal to the state to county. Now, down in the county, our responsibility as commissioners is the health, safety, and welfare of the citizens. When you get up to the state level, they are ultimately the sovereigns for the water, and then the federal agencies, because of the Organic Act that was passed just before the turn of the century (1897), are responsible for the continued supply of wood to the American people and the good water flow.[2] Now there are some other extraneous duties that the federal agencies do, but that is what Congress directed them to do. At the time, Congress recognized that, in the Southwestern states and many other states, about 66 to 70 percent of the water that people live from comes out of these national forests. The forests were

set up as economic banks, instead of parks, because of their critical nature.

What has happened subsequently is that now we have about a billion too many trees in these forests in my part of Southern New Mexico. That equates to about one billion new families moving into my district. Up on the mountain, which is half that forest area, I have about 4,500 residents. Some people believe that we have a water problem because there are "too many straws in the ground," as they say, too many wells and too many people using them. However, each adult tree drinks as much water a day as a family.

We are in a situation now in which, because of poor management by the sovereign agency, the U.S. Forest Service, we now do not have water in the village that I administer. We have some water, but we have to supplement that by hauling. A larger issue in the state is that we have compacts covering both the Pecos and the Rio Grande rivers that have been reviewed by federal courts and found to dictate that our state deliver water to Texas. Now, the question that needs to be asked is, if water is a state sovereignty issue, and because we're giving water to Texas through adjudication, and if what the judge determined was that international treaties dictate that we give water to Texas, how can a state sovereignty be held accountable to those treaties?

International treaties between the United States and Mexico (which shares most of the Rio Grande Valley with Texas, into which the Pecos River flows) regulate the amount of water that may be withdrawn from the Rio Grande by both Mexico and Texas. At this writing, the standard allegation is that Mexico withdraws more water than it is entitled to under the treaties, which causes New Mexico officials to wonder why they should deprive their state of water that is going to be delivered primarily to benefit a foreign sovereign with which New Mexico shares no riverbank.

What it boils down to for me, on the county level, is my responsibility is the health, safety, and welfare of the people. If the allegedly sovereign manager does not manage to appoint properly, I believe that it has left a void in its sovereignty that I must address in my official capacity. Now we did something like that in 2000 with New Mexico Senate Bill One, where we county administrators said that we would work with the Forest Service and other appropriate federal agencies to try to address requirements of the counties' sovereignty. So far, we have made a little ingress into that problem, but it's a problem where we're so far behind the curve that we're going to have to address it, hopefully in the very near future, and in a much bigger way than I think people have even been thinking about or ever have thought about before.

Walker Todd: Tell us a little about the historical background of the particular water issues in your part of New Mexico and Texas. Weren't those issues covered by the Treaty of Guadalupe Hidalgo (1848)?

Michael Nivison: Well, yes, and to make it very simple, the way I read the Treaty, as well as several people with whom I've met who are real historians on the Treaty, the resources of the State of New Mexico, which was still a territory at the time of the Treaty, were to be used by the people who needed them in the stated areas. When we speak of resources in that context, we are talking about water and other natural resources, like wood. We've had some problems with allowing people to go out in the national forests in Northern New Mexico just to get firewood. The modern and restrictive reading of the rights guaranteed under the Treaty is reshaping the customs and traditional culture of a very Indian-Hispanic-Anglo mixture of people in New Mexico.

Walker Todd: Regarding the current water use issues, especially those regarding Mexico and Texas, you mentioned certain federal cases; did the current situation arise from some adjudication, and was that adjudication about new treaties, modern treaties with Mexico?

Michael Nivison: Yes, it is my understanding that these were actually modern international treaties.

Walker Todd: Let us talk a little about forest use. What is your understanding of who was allowed to control forest use in your part of New Mexico in the old days versus who, if anyone, is taking care of them today?

Michael Nivison: I think it has been well articulated in the news that we started suppressing fires and that we now have only two ways to fix this issue. It's either mechanical means, like cutting, or fire. The problem with having a forest fire right now, especially when you're in charge of people's safety, as I am, is that when you have that kind of unrestrained growth in the forest, instead of having a 450-degree fire, I have to deal with a 2,000-degree fire. That translates into a 12-mile fire in five hours that burned 70 structures. You cannot control that. We are at 30 tons per acre of biomass when we should be at 2 tons.

What is going to have to happen is that we'll go in and alter the forest mechanically so that we can get back to the traditional, what we call pre-settlement, treatments of fires and start doing the right things again. Now, we all know that once you get into a certain kind of budgetary gridlock, we're talking about a million dollars to alter 1,000 acres. So how do you overcome that cost obstacle? There has been reluctance to face reality all the way through. With the legacy of the Endangered Species Act (1973) and with it coming up for review, there has been a reluctance by the federal

government since the mid-1980s to go into the forests and do anything. All the management practices and treatments have been shut down, really, by the radical environmental community to not allow forest management.

From the standpoint of what our county did, we realized that we couldn't go forward without cooperative efforts: we couldn't go forward without good science. So we started collecting science, and it shows that we should have 40 to 60 trees per acre where we have 800 per acre. Because of the fires we've had, I think that all the groups in our collaboration have come closer together, also because of the water problems we that we have. But I think anybody can understand the simple proposition that, if you don't manage, whatever it might be, even if it were just your yard at home; if you don't manage it, it becomes a mess. If you don't manage your finances, they become a mess. So, we need to get back to a mosaic treatment of the forest, treating for all the endangered species, treating for the social structures, for our customs and cultures, and we need to put all that into the mix. We, the people, have been left out of the current process to an extent, regarding necessary attention by the political parties.

Walker Todd: That point ties into my next point, which is simply a question from the Godfrey paper. He has a nice section that describes the origin of the national forests in the West. He largely ascribes it to a 1907 proclamation by President Roosevelt that he, Roosevelt, apparently was talked into by Gifford Pinchot, who essentially was a theorist back East instead of someone who understood the Western forests from first-hand experience, like John Muir. The argument was that Muir understood better the idea of mixed use, the mosaic idea that you were just discussing. Pinchot essentially said, "Western forests are out there, and they should be preserved for recreational use." Do you still see any remnants of Pinchot's vision in the U.S. Forest Service?

Michael Nivison: I absolutely think that the perceptions of most people today are that everything that is either a forest or a park is in fact a park. Meanwhile, it is absolutely clear, if you go back prior to the creation of the National Forest System in 1907, back to 1897, when Congress passed the Organic Act, that the Organic Act really was the congressional blueprint of how forests were to be treated. It is absolutely clear in those statutes that there were to be parks used for recreation and, on the other hand, national forests that were to be set aside for economic reasons. I think that we have lost an understanding of the wisdom of that arrangement with the passage of time.

Walker Todd: That is, basically no distinction is made any more between the forests on the one hand and the parks the other hand. Right?

Michael Nivison: I think the agency understands the distinction. I just don't think the people do; and then there comes a time, as I said, like the 1980s, when we could see scientifically that we were setting ourselves up for these recent fires. We're now setting aside 3.5 billion dollars for a national fire plan to fight fires, and we're putting very little into current efforts on the ground. We can fix this problem, but I think a critical factor regarding what you are discussing in your conference is that the remedial actions cannot be accomplished without the public sector. The public sector has to be involved, but there also has to be an economic benefit from the remedy. Yes, we do need logging; yes, we do need a source of biomass. All such activities are components of what to do. To just say, "You can't do logging, but you can do all the rest of the proposed remedial actions," then you're just throwing money on the fire. What we need to do is to bring in the public sector to provide its dollars for 1,000 acres, and make it economically sound for the public sector to do that. That in turn would promote rational logging, which is what has been taken out of the equation. That is why in New Mexico we only have 1 sawmill left out of over 123, 20 or 30 years ago.

Walker Todd: What are the predominant types of trees, by the way, where you are, down around Cloudcroft?

Michael Nivison: We have four ecosystems. Our sister town, really where you go to get big supplies, would be Alamogordo, and that's high desert, 4,300 feet. Then you go up through the pinion juniper, then through Ponderosa pine, and then finally up into the mixed conifers. So we have Douglas fir, aspen, and sugar pine, a vast variety of vegetation.

Walker Todd: Where is the tree line where you are? Are the trees all the way up to 10,000 or 12,000 feet?

Michael Nivison: We only have one nearby tall mountain, that would be Sierra Blanca, over that height for the tree line (12,003 feet), but in Northern New Mexico, the trees might stop at about 11,000 feet.

Walker Todd: Is there anything else you'd like to say in general about this conference, about Professor Godfrey's general history of Western land use, or about other issues that you see going forward that need to be resolved pretty quickly?

Michael Nivison: Our whole culture has forgotten its base. I think around the United States that there are only three or four counties, out of three thousand something, that don't have some sort of agricultural base. Our country was founded on hard work, by farmers and ranchers and dairy people, around our natural resources, and when you shut that engine down, that's why you have financial problems. We know that good principles of

economic development are that you should keep your existing business healthy and then diversify. I think what's happened out here a lot in the West is that we shut down our original business and tried to diversify, and to some extent we have failed. Now what happens, the way we look at this as county commissioners, is that you can do all the science you want from the bio side, but then you have to look at the indicators in socio-economics, indicators like what happens to the divorce rate and the alcoholism rate, and all those things that drive your customs and culture. If you take people out of the logging business, you can't bring them back after 20 years and say, "Oh, your families were loggers in the old days, now go get after it." We can't do that, so we have to maintain our customs and cultures somehow to address future needs.

The reason why everybody wants to come to the Southwest in the first place is because of our customs and culture. You can't cut off your nose to spite your face. Again, what we have to do is to keep existing businesses healthy, yet we are down to one sawmill, and still diversify. We could go into biomass production, and we have a lot of military bases in New Mexico, and a lot of other things. It's our duty as elected officials at the county level, in the trenches, to protect our customs and culture, to protect our people from a bad economy as best we can, to prevent them from having to move just for the sake of finding a job. That's what is precious to us here, to be able to wake up in the morning in the same place in which we went to sleep.

Walker Todd: All right. Thank you very much. I'm going to end the formal part of the presentation there.

Endnotes

[1] Michael Nivison is a retired San Diego fire captain who moved back to his native New Mexico and finds himself fighting forest fires. He was unable to appear physically at the conference because of a declared state of water emergency due to drought in Cloudcroft, NM, where he is the village administrator. These remarks were prerecorded.—Editor

[2] The congressional authorization for the President to create national forest reserves was enacted in 1891 and repealed in 1976. The congressional guidelines for management of the national forests are in the Forest Service Organic Administration Act of 1897 (the "Organic Act"). The modern National Forest System (U.S. Forest Service) was established in 1905.—Editor

COMMENTARY

R. Russell Grider

Relevance of NAFTA to Distress in Natural Resource Industries

As a comment on Professor Godfrey's paper, regarding an issue that he talked about, we no longer have a timber industry in this country of any significance. I think that we have to look backward: Prof. Godfrey said that in the last ten to twelve years, we've seen the industry disappear, and we need to review an event that had a major impact on our country at the beginning of that period.

The North American Free Trade Agreement (NAFTA, 1993) has greatly affected property rights. Once it was signed, NAFTA provided a huge incentive to transfer our extractive and timber industries into other countries. This was true for a couple of reasons. First, NAFTA allowed industries willing to move to Canada or Mexico to escape from practical enforcement of all regulatory and environmental controls and expenses that were becoming an ever-increasing burden inside the United States. Second, NAFTA enabled those companies, as well as multi-national companies headquartered outside North America, but willing to establish operations in Canada and Mexico, the opportunity to take advantage of currency devaluations against the U.S. dollar, which would put them in a far more competitive position. That was because the costs of most input factors, especially land, labor, and many raw materials (especially those produced locally), are paid for in (initially) depreciating local currency, while exported outputs typically are paid in U.S. dollars.

When NAFTA was agreed upon (late 1993), the Canadian dollar was worth about 76 U.S. cents, and there were 3.1 Mexican pesos per dollar. The decline set in almost immediately in 1994. By late 2001, the Canadian dollar was worth 63 U.S. cents, and there were 9.1 Mexican pesos per dollar. NAFTA was sold to the American public on the promise of our selling our products to our new partners; instead, for an entire decade, NAFTA has been an arrangement that only permits us to produce things there to sell back here.

We saw the impact of events like NAFTA in New Mexico with Kennecott Copper, with the transfer of Kennecott operations at Silver City, in Grant County, to Brazil. Remember that current high prices for copper in the United States (which closed 2004 at $1.45 per pound, up 39 percent for the year) at least partly reflect the fact that Kennecott's copper has to be imported from Brazil. Brazil isn't covered by NAFTA, but it did undergo two large currency devaluations of the same magnitude as Mexico in 1999 and 2001-2002. The shift of Kennecott's operations devastated Grant

County. So now the county winds up devoting attention and resources to some of the things that Mike Nivison was talking about (divorce, alcoholism, etc.), regarding the impact of all of these issues on the tax base and the ability of the county to provide necessary services for public health, safety, and the general welfare.

New Mexico Response to Issues Arising from Exclusive Federal or Shared Federal-State Authority

I believe that these issues are so intertwined that we cannot ignore any one of them. County governments and municipal governments are saddled with obligations to provide certain services to the people. But the ability of those governments to do so depends on the tax receipts with which they operate. And that was one of the reasons why, in 2000, the New Mexico Legislature passed Senate Bill One. Senate Bill One essentially delegated the state's police power to the counties in covered areas. Regarding the forests, that police power essentially is construed as saying that in a time of great and generally perceived emergency, a county may declare that an emergency exists and take over control of the national forests, directly supervening federal authority.

Now obviously, our New Mexico Attorney General said that this matter probably would wind up in the federal courts as a constitutional issue. But nonetheless, the state proceeded because we have spent billions of dollars, tax dollars, in New Mexico fighting fires over the last five years, with no response from the federal government. It's as though their house is the one that's burning down, but we have to pay the costs to put out the fire. So the financial impact of these fires has been great on our state, and the only offsetting thing that we have to recoup the costs are the increased taxes generated from the higher price of a barrel of oil extracted within the state.

As the United States continues to devalue its currency, primarily only since early 2002, and as China continues with its high growth rate and a currency still pegged at 8.27 yuan per dollar, the increased demand upon energy continues to increase the price of oil. We have increased tax revenues in the states of New Mexico and Wyoming. I think that we are the only two states in the nation that have a positive cash flow now. Everybody else is in the red.

My comments, in addition to what I have just said, on the Godfrey paper would be that because New Mexico has so much federal land, the federal payments to the state in lieu of real estate taxes are not enough to meet the state's requirements. What happens is that, although you can tax private property, if it's federal property, the government makes a payment in lieu of taxes. But the payment is not enough anymore to cover the costs for the

counties that include federal land to operate.[1] This means that the private industries that we have, whether it be lumber, agriculture, or whatever, have become increasingly important as sources of tax revenues as time passed. Growing urban areas, a condition typical throughout the West, tend to generate increased demands for state and municipal services, but continued federal land ownership or control deprives the state, counties, and local municipalities of necessary tax revenues while increasing the burden of paying for new, urban-style public services by the diminished body of remaining landowners.

Impact of Trade Agreements on County and State Government Revenues

Now I'd like to talk about some things that NAFTA and other recent trade agreements have done to our county and state governments regarding revenues. I'd like to focus on the impact that they've had in New Mexico over the last five years.

Here are some quotes from recent newspaper articles. This one is by David Bacon of the San Francisco Bay Guardian, who writes, "Since December 1994 and the devaluation of the peso, a whole chicken [in Mexico] went from four pesos to ten. When the peso was devalued, companies could pay the same wages with fewer dollars," Victor Diaz, the plant manager of the maquiladora company in question, said, "calling the devaluation sad for workers, but good for maquiladoras. The cost of operating here became much less," Diaz says, "because the company pays workers in pesos and sells its products to the United States in dollars. Our company's profits have increased significantly."

Now the next article is regarding the maquiladoras from Tijuana in the west to Juarez in the east and how they are fighting back against NAFTA. Well, what does that have to do with New Mexico or this conference? The Juarez border area is in a slump. This article is from a recent Albuquerque Journal. Since 2002, the major cause for the area's slump has been the loss of 65,000 jobs from the Juarez maquiladora assembly plants over the last 18 months, according to Mark Lautmann, Chairman of the State Economic Development Commission. "The jobs have gone to China and Central Mexico seeking lower labor costs. The Juarez economy has shrunk by 20 percent over the past year in sharp contrast to the roughly 15 percent annual growth that it had been experiencing. Dona Ana County [Las Cruces] and the state and federal governments have pumped approximately $120 million into border area infrastructure." Because NAFTA was supposed to work for us, a border state, we, the State of New Mexico and Dona Ana County in particular, invested lots and lots of money. Now, when we're making payments on those bonds, the businesses that were supposed to

reap the benefits of the NAFTA-related investments and make tax payments to pay back the bond issues are gone, so now we have more public debt with fewer resources to pay it.

Grass-Roots Response to Court Rulings Upholding Federal Government's Role

Regarding the effects of NAFTA, agriculture was the first to feel the impact of the trade agreements. A group of four farmers filed a complaint on these issues in the U.S. District Court for the District of Colorado in 2000. When the case was reviewed in 2001 by a panel of the U.S. Court of Appeals for the 10th Circuit in Denver, the complaint was dismissed as a non-justiciable political question; the court essentially said that our remedy lay in Congress and not the courts. Congress, meanwhile, has not only acquiesced in but affirmatively has adopted a departure from the parity pricing for agriculture that was mandated in the Depression-era acts. Thus, the 10th Circuit ruled, the actions of the President, the Secretary of Agriculture, and the Secretary of the Treasury regarding NAFTA and agricultural pricing issues cannot, as a matter of law, be found to violate the Agricultural Adjustment Act of 1933 (AAA).[2]

Gene Schroder said it awhile ago: We as farmers were placed under the AAA in 1933, and we've operated under that act for our entire lives.

Once the court made its ruling, we took the premise of New Mexico Senate Bill One (2000), which Michael Nivison was talking about earlier, and we came back to New Mexico to draft resolutions that would enable us to start doing the good science that he was talking about. We decided as a grass-roots effort that we would make presentations on the continuing impact of commodity prices below the costs of production on our county and state governments, and we carried resolutions about this that we had drafted to our county commissions in New Mexico and other states. The model resolution was endorsed and adopted by 30 of the 33 New Mexico counties, of which 12 of the 33 at the time were technically insolvent. The resolution also was endorsed and supported by a number of New Mexico organizations, including environmental groups, agricultural groups, and elected county officials. And that is a significant thing in New Mexico, to have all these disparate groups and local government elected officials saying the same thing: "We agree with your premise and we are going to support your effort to do something different." This was our premise: That the broad powers originally transferred from the people or the states to Congress, later often delegated to the President, especially after 1933, encompassed constitutional powers and sovereignty previously held by the states or the people, and that it is a rightful obligation of the states to oversee lawful implementation of these powers in

order to protect their citizens.

These powers and sovereignty include the property rights that Gene Schroder talked about earlier and that were discussed all day long during the first day of this conference. Essentially, we argue that these rights were transferred from the people and the states to the federal government, but the federal government (why should we expect otherwise?) is not providing oversight regarding its obligations to the citizens of New Mexico to insure that the federal government's powers, especially including these delegated powers, are implemented on our behalf.

In New Mexico, we went to the legislature again, and it passed Senate Bill 401 in 2003 to create the New Mexico Natural Resource Revenue Recovery Task Force. The task force is to review the AAA, the National Industrial Recovery Act, the Treaty of Guadalupe Hidalgo, and Kearney's Code (the New Mexico statutes). The Task Force will investigate the continuing consequences of the federally declared emergency declaration in 1933 on agriculture and natural resource industries and the impact of the failure to implement the emergency laws in their own terms, and then will make recommendations to the New Mexico State Legislature for further action.

Endnotes

[1] All or nearly all counties in New Mexico have federal lands, and all the other Western states have this same type of problem. Outside large urban areas, most of the land is federally owned or controlled. – Editor

[2] *See*, *Schroder v. Bush*, 263 F.3d 1169 (10th Circuit 2001), *cert. denied*, U.S. Supreme Court (January 7, 2002), Case No. 01-744. Walker Todd, the organizer of this conference, was counsel for the four farmer plaintiffs in this case.—Editor

SPECIAL COMMENT: SHOULD FEDERAL LANDS BE SOLD?

FOLLOWING the conference, participants from the western United States were asked for their views on a provocative question: Should Federal lands be sold into private hands?

The responses varied. As Prof. Godfrey noted, the original intention was that all Federal lands should be transferred to private ownership. Having struggled for years with issues of competing demands for range uses (by traditional users and recreational users) he is skeptical that any modern plan of sale would be successful. However, he also noted that the Federal government has never stopped selling (or giving away) economic and property rights for the use of Federal lands.

Howard Hutchinson, another critic of Federal land ownership, pointed out that sorting out competing land titles, easements, pre-Spanish settlement land and water uses, and the like all render the question of sale vastly more complicated than advocates of immediate sale might suppose.

Russell Grider and Michael Nivison said they favor the transfer of Federal lands in New Mexico back to the state or to counties. But they also said that any such transfer would require transitional payments from the Federal government, of at least several hundred million dollars per year, to offset the costs to New Mexico of absorbing those lands, the responsibilities accompanying them, and the costs of rectifying adverse situations (like the overgrown forests) that Federal policy created. Eventual private ownership would shift those costs away from the state and municipalities, but such costs played a role in the "market failure" that Lord Skidelsky pointed out in the original western land use and disposition policy under the Homestead Act.

Eugene Schroder agreed with the Grider-Nivison analysis as it would apply to Colorado. Richard Stroup agreed with the Godfrey-Hutchinson analysis that the transfer of land titles into private hands is complex, but he holds that outright private sale would bring so many benefits of reduced strife and increased productivity that sale is the model to be pursued (Godfrey agrees). Stroup and Godfrey added that similar models are more likely to succeed over time and should be encouraged. For example, long-term exclusive right-of-use contracts might be sold at auction periodically for designated public lands.

Jerry O'Driscoll shares Stroup's view, as does Lee Hoskins. All three prefer movement toward final outright sale as rapidly as possible. Godfrey also supports the fee-for-use model of allocating recreational uses of pub-

lic lands and auctions for the right to use Federal lands.

A concern for those who favor final outright sale is that, under existing circumstances, a transfer from the Federal government to the states, whether with or without a grant of transitional funds, would tend to stall final transfer (to local governments or private owners) indefinitely, for political reasons. It might be difficult to pry public lands loose from state hands in some states, such as California, Oregon, and Washington. In New Mexico, Colorado, and Arizona, however, counties probably would demand a rapid transfer to the local level, a prospect that should reduce such concerns.

EMINENT DOMAIN FOR ECONOMISTS AND THE GENERAL PUBLIC: MAY THE STATE TAKE PRIVATE PROPERTY FOR PUBLIC USE? FOR PRIVATE USE?

Joyce Anagnos, Esq.[1]

Introduction

GOOD morning everyone! Although I am an attorney, I am *not* a litigator, so my presentation is derived from a talk originally entitled, appropriately enough, "Eminent Domain for the Non-Litigator." It is comparatively easy to adapt such a presentation for economists and the general public. My colleagues on this panel will specifically address certain aspects of current eminent domain litigation. I am here to lay out a behind-the-scenes view of, basically, what led up to the litigation. My intent is to reveal to those of you with little or no eminent domain experience the world of the hard-working real estate professionals who are carrying out a mandate to acquire the necessary real property rights for a development or public improvement that is driven by a public need.

Before I begin, I should like to give you a little of my background to understand my experience and qualifications. I am a Toledo native and live there now, but for many years I lived and worked in Boston. In college I took a course in urban economics. My professor was an incredibly enthusiastic supporter of the Central Artery/Third Harbor Tunnel Project in downtown Boston, also known as the "Big Dig Project."

In case you do not know what the Big Dig Project is, it is a highway project in the heart of Boston's downtown. It involves, in its simplest elements, placing the existing, elevated interstate highway, I-93, below ground level in tunnels and completes the Greater Boston portion of the federal Interstate Highway System by extending Interstate 90 through Boston Harbor, again in a tunnel known as the Third Harbor Tunnel, to Logan Airport, with connections to major north-south traffic corridors.

The Big Dig is a highway project known for:

- Its enormous price tag (around 15 billion dollars);
- Its longevity (serious preliminary planning dates back to the early 1980s; the Final Supplemental Environmental Impact Statement was approved around 1991; construction began immediately and continues today, with the expected completion – including surface restoration – around 2006);
- Giving new definitions to "mitigating the Project's impacts" (for instance, the first project idea floated was the depression of the Cen-

tral Artery, and the Third Harbor Tunnel was added to the scope of the project as mitigation for the impacts of the Central Artery depression);

- Its incredible safety record, given its enormous size; and
- Its feats of engineering and construction never before seen in the United States and even in the world: slurry wall construction; never shutting down the elevated highway while tunneling below; and the world's largest asymmetrical cable-stayed bridge, which crosses the Charles River.[2]

Anyway, from my urban economics professor, I became hooked on the importance of public improvement projects, like a highway, for economic development, so I became interested in urban planning. I pursued my interests in urban planning and economic development at Harvard's Kennedy School of Government because I was not interested in attending a city and regional planning degree program that was based in a School of Architecture, as was the case pretty much everywhere, except at Harvard. So I used my public policy degree to obtain a once-in-a-lifetime job, combining my interests in urban planning, economic development, public policy, and the law (I was in law school at night): being part of the public sector management team administering the right-of-way, or eminent domain program, for the Big Dig Project. Our budget at the time was around 500 million dollars to cover all of the takings (big and small, permanent and temporary), dozens of business relocations, settlements, and litigation. In all I managed real estate acquisitions, relocations, dispositions, and property management for a number of Massachusetts government entities, including the Massachusetts Highway Department, the Massachusetts Turnpike Authority, and the Massachusetts Bay Transportation Authority. So, inevitably I will be bringing up examples from Massachusetts!

Now I am going to open my remarks with a startling statement: Did you know that eminent domain is a sexy idea for a movie? Some of you may remember a movie released in 1997 called *The Castle*. It is actually an Australian film. When I saw it, I could not believe that I was watching a movie about eminent domain! And it was funny and touching to boot. Plus, it taught me some new jargon: instead of a "taking," Australians call it "compulsory acquisition"; instead of "just compensation," it is called "due compensation"; and, my favorite, instead of a "notice to vacate," it is called a "kick out notice."

There are a number of issues developed in *The Castle* that have relevance to us. Although a fictional account, *The Castle* addresses an all-too-familiar story. Daryl Kerrigan's home, along with his neighbors' homes, is

being "compulsorily acquired" by the airport commission for airport expansion and construction of a new freight handling facility. The homeowners are offered "due compensation" and given two-week "kick out notices." Kerrigan's response: "I don't care if it's been planned for 10 years"; "I don't care if people get their packages a little faster"; "Why can't they fill in the quarry instead?" "I don't care how much money is behind this project; it is right and fair that a family be allowed to live in their own home." Kerrigan attempts a *pro se* appeal, citing as his authority, "It's not just a house, but a home. And a man's home is his castle. You just can't buy what I've got. How can they call it an eyesore? Just because it doesn't look like a fancy mansion – it's a home. A place for the family to come together; where people love each other." Kerrigan perseveres in saving his home, even in the face of thugs, courtesy of the billionaire backers of the quasi-government entity building the project. "I don't care how big they are. They've just not met anyone yet willing to stand up to them." Kerrigan appeals each loss to a higher court and finally prevails before the High Court of Australia by arguing that, while government can acquire the house a man built, it only short-changes a man and the community to try to acquire the "home" and "family" created out of that house. It is a true Hollywood ending.

Definitions and Terms

Power vs. Act

I shall begin my formal remarks with the definitions and terms used in eminent domain. The first important distinction to understand is The Power versus The Act. The term "eminent domain" is actually identifying the power and authority that then gives rise to the act, such as a taking, or appropriation as it is known in Ohio, or "compulsory acquisition" in Australia. However, "eminent domain" is often used interchangeably (even I am guilty of that sometimes) in routine discussions to describe both the power and the act, so it is important to keep these distinctions in mind, especially when you are preparing to challenge a taking and simply want to stop "the Project."

There are two main sources of the Eminent Domain Power in the United States: on the federal and state levels. On the federal level, there is the Fifth Amendment of the United States Constitution (1791): "[N]o person shall be . . . deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation." The Fourteenth Amendment, section 1 (1868), brings the just compensation requirement to state and local government takings: "[N]or shall any state deprive any person of life, liberty or property, without due process of law."

On the state level, there are the bill of rights provisions of the various state constitutions, such as the Ohio Constitution. For instance, Article I, section 19, of the Ohio Constitution states: "Private property shall ever be held inviolate, but subservient to the public welfare. When taken in time of war or other public exigency, imperatively requiring its immediate seizure or for the purpose of making or repairing roads, which shall be open to the public, without charge, a compensation shall be made to the owner, in money, and in all other cases, where private property shall be taken for public use, a compensation therefor shall first be made in money, or first secured by a deposit of money; and such compensation shall be assessed by a jury, without deduction for benefits to any property of the owner." Also in the Ohio Constitution, Article XIII, section 11, states: "Any municipality appropriating private property for a public improvement may provide money therefor in part by assessments upon benefited property not in excess of the special benefits conferred upon such property by the improvements. Said assessments, however, upon all the abutting, adjacent, and other property in the district benefited, shall in no case be levied for more than fifty per centum of the cost of such appropriation."

Now that the sources of the eminent domain power have been identified, what are the forums for the Act of exercising that eminent domain power? Finding the answer to this question requires looking to the Separation of Powers Doctrine, where there must be proper delegation of eminent domain power, the exercise of which must comply with the conditions of the delegation of the power. There are three branches to our government: the executive, legislative, and judicial branches. The primary delegation of the eminent domain power is to the legislature.

The legislature's inherent authority usually is expressed in one of two forms: standing legislation and special legislation. Standing legislation, in this instance, is often referred to as the "Eminent Domain Statute," which is permanently a part of the state's laws until it is repealed. In Ohio, the eminent domain statute is Chapter 163 of the Ohio Revised Code (ORC), entitled "Appropriation of Property." The Eminent Domain Statute lays out all of the due process matters with respect to takings, and such due process matters may be further supplemented by regulations promulgated by an entity of the executive branch, such as the DOT (Department of Transportation). Various ORC statutes specify the authority to purchase or appropriate property by the Director of Transportation, boards of county commissioners, and municipal corporations for state highway purposes, county road grade crossing improvements, and railroad rights-of-way, crossings, or lands.

Special legislation, on the other hand, is needed to plug holes or gaps in the Eminent Domain Statute that arise on a case-by-case basis. For ex-

ample, if the Eminent Domain Statute does not address takings on behalf of another government entity, special legislation is needed. For instance, the state's department of transportation might require certain land for state highway construction, but, in the end, the city would need to own and maintain relocated roadways and sidewalks as a result of the state project. A state-level, DOT taking on behalf of the city is often an efficient, cost-effective approach in project management to iron out jurisdictional confusion between two bodies of government.

The legislature also identifies which executive branch entities are delegated eminent domain power. For example, in the federal government, the Federal Highway Administration is empowered to condemn land within its public mandate, and in fact is also the lead agency for promulgating the Code of Federal Regulations (CFR) regarding acquisitions and relocation assistance. On the state level, Ohio DOT is empowered to appropriate land within its mandate. And the list grows to other state and regional entities, counties, agricultural districts, school districts, cities, townships, villages, and the like.

The legislature may also delegate eminent domain power to non-government entities, including private companies. The most common examples are railroad and utility companies. One railroad example involving the Union Electric Interurban Terminals reads: "Union electric interurban terminal and depot companies may appropriate private lands for the purpose of connecting their main tracks, terminals, and depots with their own tracks and with the tracks of any other interurban electric railroad company, for acquiring depot sites, and for the construction of main track to avoid dangerous or difficult curves or grades or unsafe or unsubstantial grounds or foundations, or to extend or shorten their railroad lines. Such power to appropriate property shall be exercised in the manner provided for in sections 163.01 to 163.22, inclusive, of the [Ohio] Revised Code."

One utility example covers electric companies pursuant to ORC section 4933.15, which reads: "For the purpose of making preliminary examinations and surveys, any company transmitting or distributing electricity in the state for public or private use may enter upon any land held by any individual or corporation, whether acquired by purchase, appropriation proceedings, or otherwise, unless such land is owned by and essential to the purposes of another corporation possessing the power of eminent domain. The company also may appropriate so much of such land, or any right or interest in the land, including any trees, edifices, or buildings on the land, as is deemed necessary for either of the following purposes: (A) The erection, operation, or maintenance of an electric plant, including its substations, switching stations, transmission and distribution lines, poles, towers, piers, conduits, cables, and wires and other necessary structures

and appliances, but excluding its generating stations; (B) Rights-of-way over such land and adjacent lands for the purpose of access to any part of such land. The right of appropriation shall be exercised in the same manner provided by sections 163.01 to 163.22 of the [Ohio] Revised Code."

What these examples demonstrate is that, when the legislature identifies what entity or corporate body may exercise eminent domain power, that entity is directed to the Eminent Domain Statute (in Ohio, ORC Chapter 163) for guidance on the appropriate use of that power.

There are many more examples of the delegation of the Eminent Domain Power by the legislature that will not be addressed here because of time and space considerations. ORC section 163.01 annotated contains an impressive list of cross references. [Omitted here—the list runs more than two single-spaced pages, including cemetery space, conservancy districts, and more usual utility and transportation uses.]

In the end, the role of the judicial branch, for the most part, is to determine the proper exercise of eminent domain power by the delegated agency and to determine just compensation. The most common inquiries center around whether a valid "public need" necessitated the taking and whether appropriate "just compensation" was paid to the property owner.

Some Definitions Regarding the Power vs. the Act

The term "Eminent Domain" is "the power of the sovereign to take property for public use without the owner's consent upon making just compensation." Nichols on Eminent Domain, section 1.11. Nichols is the undisputed authoritative treatise on eminent domain law.

Eminent Domain

Where did the term originate? "The term *'dominium eminens'* (eminent domain) seems to have been originated in 1625 by Hugo Grotius who wrote of the power in his work *De Jure Belli et Pacis* as follows: '[T]he property of subjects is under the eminent domain of the state, so that the state or he who acts for it may use and even alienate and destroy such property, not only in the case of extreme necessity, in which even private persons have a right over the property of others, but for ends of public utility, to which ends those who founded civil society must be supposed to have intended that private ends should give way. But it is to be added that when this is done the state is bound to make good the loss to those who lose their property. . . ." Nichols on Eminent Domain, section 1.12 .

Condemnation

As for the Act, one term is "Condemnation": "Webster's Third New

International Dictionary gives as a definition of 'condemn': 'To pronounce to be taken for public use under the right of eminent domain.' See, also, Black, Law Dictionary (4 Ed.); New Century Dictionary (1953)."[3]

A synonym for "Condemnation" is "Taking": "The term 'taking' is defined to include not only the actual physical taking, but also any interference with the right of ownership, use, enjoyment, or any other right incident to the property, such as an easement, easement of access."[4] Another synonym for "Condemnation" and "Taking" is "Appropriation": "Appropriations shall be made only after the agency is unable to agree, for any reason, with the owner, or if more than one, any owner, or his guardian or trustee, or when any owner is incapable of contracting in person or by agent and has no guardian or trustee, or is unknown, or is not a resident of this state, or his residence is unknown to the agency and cannot with reasonable diligence be ascertained." ORC section 163.04.

Inverse Condemnation

The prior definitions generally presume a direct action by the acquiring entity. What about when all but a formal condemnation action occurs? Encroachments are a common example. This is called an "Indirect" or "Inverse" or "Constructive" or "Regulatory" Taking: "'Inverse condemnation' has been defined as 'a cause of action against a governmental defendant to recover the value of property which has been taken in fact by the governmental defendant, even though no formal exercise of the power of eminent domain has been attempted by the taking agency.'"[5] Some argue that an example of inverse condemnation is the standing legislation granting a right of agency entry onto private property for the purpose of surveys.[6]

Public Use (specific vs. general)

A key element in the definition of the "Eminent Domain" power was "Public Use." My colleagues on this panel today address the term "public use" as distinguished from "private use" in more detail in the context of current litigation, so I shall just briefly touch on a few examples of "public use."

> "The 'public use' requirement is . . . coterminous with the scope of a sovereign's police powers. . . . [T]he Court has made clear that it will not substitute its judgment for a legislature's judgment as to what constitutes a public use 'unless the use be palpably without reasonable foundation.'"[7]

I already mentioned the movie *The Castle* and the public use comprised of the airport expansion and freight handling facility.

Using the example of a traditionally accepted "public use" (interstate

highways), how far are federal and state governments willing to go to relieve highway congestion and to complete the interstate highway system in Boston? The Big Dig Project has triggered a broad scope of mitigation, together with large-scale real estate requirements: the Third Harbor Tunnel mentioned earlier; the Charles River Crossing that underwent more than two dozen distinct design changes; the Rumney Marsh wetlands replacement—an area about two miles beyond the Project limits in Revere, MA, was designated to be a key area for replacement of the cumulative impacts to wetlands. Other extensive environmental mitigation also is occurring, such as separating "dirty dirt" from "clean dirt" and using the clean dirt as backfill, capping landfills or creating parks where possible, disposing of the really bad "dirty dirt" and treating the treatable "dirty dirt" for reuse. One hundred years worth of spaghetti utility lines were relocated into manageable utility corridors; surface restoration and joint development plans have been undertaken to "reknit" downtown with its surrounding neighborhoods; construction staging and staged work zones have been used, requiring many, many temporary easements, sometimes capped with vertical elevations to avoid impacts to the adjacent owners; noise and other physical impacts have triggered temporary business relocations. Temporary roads and bridges, traffic patterns, signage, and monitoring cameras have been installed – again requiring more temporary easements or licenses; replacement parking has been opened while the City of Boston operates under a "parking freeze"; "fish startling," has been regulated; etc. Total project cost: nearly $15 billion.

Economic Use as Public Use

The legality of defining economically beneficial use as public use depends on where you live, according to research by the Institute for Justice. The reality is that public/private partnerships are necessary for many cities to avoid dying slow deaths. The problem is that a developer could secure the threat of eminent domain from the city to use as a negotiation tool to force down the asking prices of property owners approached in the negotiation stage.

What about "redevelopment to improve the tax base" as public use? That is the City of Lakewood, Ohio, case, which probably is very well known by all of you. Lakewood passed Ordinance No. 146-02, entitled West End Blight Designation, to make way for high-end condos, restaurants, and offices that were expected to pay more in property taxes than the commercial and residential structures they were to replace. Just as in *The Castle*, some property owners fought back. CBS News' *60 Minutes* on July 4, 2004, exposed the absurdity of what Mayor Madeline Cain defined as "blight": homes without three bedrooms, two baths, an attached two-car

garage, and central air. In the end, a grass-roots movement, spearheaded by an advocacy group called the Institute for Justice, from Washington, DC, succeeded in ousting the mayor and other elected proponents of the project from public office. A similar case has moved its way up to the U.S. Supreme Court, *Kelo v. City of New London (CT)*, and you will learn more about the Lakewood and New London cases from the other panelists.

Are potential economic benefits enough of a public use? Not in Michigan. You will also learn more about the Michigan cases from the other panelists. The Michigan Supreme Court decided in *County of Wayne v. Hathcock* on July 30, 2004, to reverse its earlier *Poletown* decision (1981), now stating that eminent domain is not an appropriate tool for Wayne County (Detroit) to use to clear out an area for the speculative public benefits of the Pinnacle Aeropark, a high-technology park that was expected to make Wayne County a hub of international high-tech development linked to the airport.[8]

Close to home for me is Toledo's version of *Poletown*. As in Lakewood, the Toledo City Council designated an urban neighborhood as blighted (Toledo Ordinance 994-98), and condemned 160 acres of residential (83) and commercial (18) properties to make room for the expansion of a Daimler-Chrysler Jeep plant in 1999 as part of a $300 million subsidy package to induce the automaker to remain in Toledo. By the way, National Public Radio reported just the other day [late October 2004] that the U.S. Court of Appeals for the Sixth Circuit (Cincinnati) has ruled that the tax incentives given to Daimler-Chrysler were unconstitutional under the Interstate Commerce Clause. Anyway, of the 4,900 workforce that Chrysler promised the city and on which the city relied to increase the tax base to help finance the condemnations and relocations, only 2,100 jobs were retained in Toledo. Kim and Herman Blankenship, owners of Kim's Auto & Truck Service, a local vehicle-repair business, have appealed the city's taking, which the Sixth Circuit previously upheld, to the U.S. Supreme Court on the basis of the city's alleged abuse of its Eminent Domain Power.

Just Compensation

Another key element in the definition of the Eminent Domain Power is "Just Compensation." The basic concept is that "Just compensation, as defined by the US Supreme Court, 'includes all elements of value that inhere in the property, but it does not exceed market value fairly determined.'"[9]

Fair Market Value

Closely related to "Just Compensation" is the concept of "Fair Market Value": "The fair market value of property is the price on which a willing

seller and a willing buyer would settle in a voluntary sale. The determination of the fair market value of appropriated property must be made upon consideration of 'what it is worth generally for any and all uses for which it might be suitable, including the most valuable uses to which it can reasonably and practically be adapted.'"[10] The purpose of "just compensation" is not to make a person better off, but rather to make him "whole" after the taking.

Damages

One cannot discuss "Just Compensation" without also discussing the distinction from compensation for "Damages": "The basic principles concerning the amount of compensation and damages when there is a partial taking of one's property are well stated in the case of *Norwood v. Forest Converting Co.* . . . As stated therein: 'Once there has been a taking of property, the owner is entitled to a remedy consisting of two elements – 'compensation'for the property actually taken and 'damages' for injury to the property which remains after the taking, *i.e.,* the residue. Compensation and damage to the residue are two distinct concepts. The difference is explained as follows: 'Compensation' means the sum of money which will compensate the owner of the land actually taken or appropriated; that is, it is the fair market value of the land taken, irrespective of any benefits that may result to the remaining lands by reason of the construction of the proposed improvement. 'Damages,' in the strict sense in which the term is used in an appropriation proceeding, means an allowance made for any injury that may result to the remaining lands by reason of the construction of the proposed improvement, after making all permissible allowances for special benefits, and the like, resulting thereto.'[11]

Before-and-After

A discussion of "Damages" gives rise to a discussion of the "Before-And-After" measure of "Damages": "The ultimate measure of the permanent damages sustained by an owner from the establishment of an underground pipeline easement across his premises is the difference between the fair market value of the whole premises immediately before the taking and the fair market value thereof immediately afterward, including therein separate determination of compensation for the estate actually taken and damages resulting to the residue of his property."[12]

Consequential Damages

A discussion of "Damages" also gives rise to a discussion of "Consequential Damages": "'There is substantial authority that when there is an actual partial take of private property for a public use, which public use creates elements of personal annoyance and inconvenience such as set

forth in the foregoing instruction, which particularly affect the market value of the residue of the property, such elements may be considered in determining the market value of the residue and indirectly the damages thereto.' In summary, when there is a partial take, damage to the residue may properly be considered in accordance with the fair market value rule, despite the fact that other property owners located in the vicinity from whom no land was taken may not recover any damages."[13]

Special Benefits

A mitigating factor when discussing "Compensation" and/or "Damages" is "Special Benefits": "The property owner is not entitled to an increased value to the land taken resulting from the improvement, nor should he be made to suffer for any diminution in value to the land taken resulting from the improvement. The rule also applies to valuation of the residue since Section 19 of Article I of the Constitution of the State of Ohio states that there shall be no deduction for benefits to any property of the owner except that the property owner may show that the market value of the residue is diminished by virtue of the use to which the land taken is put by the condemnor, and the condemnor may show special benefits accruing to the residue of the property."[15]

Business Goodwill

Frequently there is confusion regarding the role of "Business Goodwill" in a discussion of "Compensation" or "Damages"—but it has no role, really: "'In the United States it is uniformly held that the loss or diminution of the goodwill of a business, caused by the condemnation of the land on which the business is located, is not an element of damages or compensation. The 'going'or 'efficiency' value of an established and successful business, estimated upon anticipated profits for carrying on such business, cannot be taken into consideration in arriving at the amount which the owner is entitled to recover.'" *City of Bellevue v. Stedman*.[15] This rule also is stated in *Dorsey v. Donohoo*:[16] "[A]s a rule, profits from commercial businesses on premises cannot be shown in an appropriation proceeding for the reason that such profits are too speculative, depending as they do upon the acumen and skill of the one who carries on the business. . . ."

Total Loss of Access

Is the Total Loss of Access a compensable damage?: "[I]n order for a business owner to recover from the state for interference with the right of ingress and egress, the business owner must prove by a preponderance of the evidence that there was substantial, material, and unreasonable interference, amounting to an absolute cutting off of access to the property."[17]

Liquor License

In the arena of regulatory taking, what about denial of a Liquor License as a compensable damage? "'A prohibition simply upon the use of property for purposes that are declared, by valid legislation, to be injurious to the health, morals, or safety of the community, cannot, in any just sense, be deemed a taking or an appropriation of property for the public benefit. Such legislation does not disturb the owner in the control or use of his property for lawful purposes, nor restrict his right to dispose of it, but is only a declaration by the state that its use by any one, for certain forbidden purposes, is prejudicial to the public interests.'"[18]

Zoning

In another regulatory taking issue, what about "Zoning" changes as a compensable damage? An entire seminar could address this issue alone. Generally, there is a high threshold to be met. "While it is true that the zoning restrictions did not affirmatively permit plaintiff to build on his property, this does not constitute a 'taking.' Plaintiff may have been inconvenienced by not being able to build on his property until completion of the legal process, but mere inconvenience is not sufficient. Even if plaintiff were able to show that he suffered a monetary loss due to a decline in market value of his property, . . . it is still not enough to constitute a 'taking' which would require compensation. Here, there was no deprivation of continued enjoyment of use to which the property had been devoted. Rather, the issue was and is whether plaintiff can create a new use of his property."[19]

Trees

Is the physical impact on "Trees" a compensable damage element? Not usually. "In general, items such as mineral deposits, standing crops, and timber are not subject to valuation in an appropriation proceeding separate and apart from the land upon which they are located. *Board of Park Commrs. v. DeBolt*.[20] Valuation of such items is generally excluded on the basis that the determination of market value is too dependent upon speculation as to future events. *Id.* Thus, appellant is correct in its statement of the general rule that trees are not properly subject to valuation apart from their effect on the value of the land."[21]

Flooding

What about the physical impact of "Flooding" as a Compensable Damage? Yes. "'Damages in the strict sense in which the term is used in an appropriation proceeding, means an allowance made for any injury that may result to the remaining lands [*i.e.,* the residue] by reason of the con-

struction of the proposed improvement, after making all permissible allowances for special benefits, and the like, resulting thereto.' Flooding of landowners' property during and immediately after every rain can constitute a *pro tanto* taking of property where it deprives the owners of the use of their property."[22]

Noise

Noise can take the form of a physical impact arising to a compensable taking: "There exists a 'taking' in a constitutional sense under Section 19, Article I of the Ohio Constitution, whenever air flights 'are so low and so frequent as to be a direct and immediate interference with enjoyment and use of the land.' And we think that a person's residence is a use for which he is entitled to compensation whenever he can prove a direct and immediate interference with that use."[23]

Relocation and the Displaced Person

You may have noticed that the definition of "Eminent Domain" does not address the right to be relocated. The displaced person's right to relocation assistance is a right derived from legislative authority, such as, on the federal level, the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, Public Law No. 91-646. The Federal Highway Administration is the lead agency for promulgating regulations interpreting the Uniform Act. Thus, there is guidance for relocations on projects that have some federal role, such as federal funding, even if only a portion is federal.

The definitions begin with who is a Person (a person covered by the regulations): "The term 'person' means any individual, family, partnership, corporation, or association." 49 CFR section 24.2. Then the Uniform Act definitions go on to define a Displaced Person: "The term 'displaced person' means, except as provided in paragraph (2) of this definition, any person who moves from the real property or moves his or her personal property from the real property: (This includes a person who occupies the real property prior to its acquisition, but who does not meet the length of occupancy requirements of the Uniform Act as described at [sections] 24.401(a) and 24.402(a)): (i) As a direct result of a written notice of intent to acquire, the initiation of negotiations for, or the acquisition of, such real property in whole or in part for a project; (ii) As a direct result of rehabilitation or demolition for a project; or (iii) As a direct result of a written notice of intent to acquire, or the acquisition, rehabilitation or demolition of, in whole or in part, other real property on which the person conducts a business or farm operation, for a project. However, eligibility for such person under this paragraph applies only for purposes of obtaining reloca-

tion assistance advisory services under [section] 24.205(c), and moving expenses under [sections] 24.301, 24.302 or 24.303." 49 C.F.R. section 24.2.[24]

Who Exercises Eminent Domain Power

I have already touched on the issue of Who Exercises Eminent Domain Power (via the Act of Condemnation). Most obviously, there are the typical government entities, such as the United States of America, the State of Ohio, the County of Cuyahoga, or even the City of Cleveland. When talking about "the government," there are many, many levels of the government to be aware of for the exercise of the Eminent Domain Power. Not as clearly "governmental" are the quasi-public entities, such as redevelopment authorities, regional authorities, turnpike commissions, sewer districts, school districts, etc. (ORC sec. 163.01 et seq.). And as already mentioned, there are non-public (or private) entities that can be bestowed with Eminent Domain Power, such as railroad companies (ORC sec. 4955.02), and various types of utility companies (ORC sec. 4933.15).

What Can Be Acquired

Through the condemnation Act, what can be acquired? The full spectrum of property rights in a parcel. Because of the awesome power of eminent domain, the condemning entity needs to take great care to acquire only what is absolutely necessary to fulfill the public need. Sometimes, the minimum necessary is, in fact, real property held in fee simple absolute – the whole parcel, or merely a fee simple interest in part of the parcel, simply because the Project, upon completion, leaves no residue fit to reconvey to the original owner.

Typically if less than a fee simple interest in the entire parcel is required, a permanent Easement will do. "'As between the public and the owner of land upon which a common highway is established, it is settled that the public has a right to improve and use the public highway in the manner and for the purposes contemplated at the time it was established. The right to improve includes the power to grade, bridge, gravel, or plank the road in such a manner as to make it most convenient and safe for use by the public, for the purposes of travel and transportation in the customary manner, which is well understood to be by the locomotion of man and beast and by vehicles drawn by animals, without fixed tracks or rails to which such vehicles are confined when in motion. These constitute the easement which the public acquires by appropriating land for the right of way for a highway, and these, in legal contemplation, are what the owner is to receive compensation for when his land is appropriated for this purpose. The fee of the land remains in the owner. He is taxed upon it; and, when the use or

easement in the public ceases, it reverts to him, free from encumbrance."[25]

It is inevitable that, if a public improvement, like a highway, has a particular permanent footprint, then there might be an area outside that footprint needed for construction staging, access, etc. Temporary easements related to these purposes can come in all shapes and sizes:

- Dimension restrictions (e.g., vertical limits, or even 3-D dimensions);
- Use restrictions (only for construction, only for sidewalks, only for access);
- Right of Entry (for temporary access, such as surveys, appraisals, monitoring wells or other monitoring devices), often merely a license, not an easement; and
- Right of Way (temporary roads).

Functional Replacement is a method of paying the cost necessary to replace the facility being acquired with a similar facility that offers the same utility, including betterments and enlargements required by present-day local laws, codes, and reasonable prevailing standards in the area for similar facilities. A facility includes the land where it is relocated. Functional Replacement is not meant to be used for temporary relocations, but necessity might require it. The guidance for functional replacement can be found in 23 CFR Part 710.509 (Functional Replacement of Real Property in Public Ownership). This is a program developed by the Federal Highway Administration to address the loss of potentially essential public services, such as schools, police and fire stations, and parks.

Essentially, whatever is necessary so that the entity would not be trespassing on property not under its ownership or control can be acquired through the exercise of the power of eminent domain.

Understanding the Eminent Domain Administration Process—Generally

Because a person does not often find himself or herself faced with a condemnation action, condemnation usually is viewed as a mysterious activity that results in the little guy getting the short end of the stick. It is unfortunate that this perception prevails, so a lot of work needs to go into public relations when administering a condemnation program. If anything, administering a condemnation program is all about due process. A chart, "So You Want A Highway," was provided to me by my mentor when I first joined the Big Dig Project. The authors of the chart do a great job of visually conveying the idea that the decision to acquire any John Doe's property usually is not a last-minute, "Oh by the way, let's take Joe's

property" type of decision. From original idea to placing the first shovel, it is an eight-year process. That seems like a long time to the average person. Who would not want the pain of construction to end as quickly as possible? When the average person understands certain sequential elements of a construction project, he or she might appreciate what the real estate acquisition and relocation professionals are trying to accomplish and the benefits of cooperating with them.

Impact of Project Sponsor and Funding Source on Process

How a program of condemnation is implemented depends on how the project is funded. As mentioned before, if federal funding is involved, then the minimum requirements, especially time frames, set forth in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, P.L. 91-646, will be required.

If only state funding is involved, then only the state requirements need to be met. This can be helpful in compressing some of the notice and waiting periods that are required under the Uniform Act. Many taking entities have produced manuals providing guidance for the condemnation process, such as the Ohio Department of Transportation Real Estate Manual. In a state like Ohio, litigation is an integral part of an appropriation act, especially in triggering when actual possession can occur. In contrast, Massachusetts does not require the filing of litigation in order to authorize a taking—the taking is authorized by the governing body of the entity empowered to so act and upon the recording of the Order of Taking in the registry of deeds. The property title vests with the taking entity at that point and possession is taken; there is no filing of litigation required to arrive at the point of possession.

And if only county funding is involved, then only the state requirements need to be met, such as those set forth in the Ohio County Commissioners Handbook. The legislative grant of Eminent Domain Power to the county level can be found at ORC section 307.08. Other sections of the Ohio Revised Code identify the delegation of Eminent Domain Power for specific public uses.

And as with any analysis of the different levels of government and jurisdictions, even down to the local level, if only local or municipal funds are involved, then only the procurement procedures attached to such funds require compliance. At any time, however, if the taking entity wishes to go beyond the minimum requirements, it may do so.

Please note that if a public or quasi-public entity simply does not have Eminent Domain Power delegated to it, then it can only act through its powers of persuasion and negotiation in making a land deal, just like any

other ordinary person.

Project Planning Stage

What is happening at the Project Planning Stage? Quite a bit, actually, including typically:

a. Public reviews and feasibility hearings;

b. Declaration of public need;

c. Site identification;

d. Project design/ Environmental Impact Statements;

e. Archaeology/ Historical Registries Impact Reviews;

f. Budgeting/ Cost Estimates/ Funding;

g. Rights of entry coordination;

h. Scheduling; and

i. Interagency agreements and coordination.

Right-of-Way Acquisition Stage

What about the actual Acquisition Stage? Please note that, despite attempts to be as straightforward and as linear as possible, sometimes the taking entity has to multi-task or fast-track its acquisition activities, so there may be overlap in these tasks:

a. Prepare Right-of-Way Plans: property lines, project limits, and work zones;

b. Title exams and reports;

c. Appraisals: remainder, severance damage, and consequential damage concerns; replacement cost, comparable sales, income approach; following USPAP (Uniform Standards of Professional Appraisal Practices); contaminated land. For example, Massachusetts highway department (MassHighway) policy is that, for acquisitions likely to cost over $2,500, two independent appraisers are hired. Both appraisals are given to an independent Appraisal Reviewer, who will either accept one of the two prepared appraisals or reconcile the two appraisals through the Reviewer's own final conclusion of value. The recommended appraisal then makes its way through the chain of command from the head of the Appraisal Section, to the head of Right-of-Way Operations, to the Chief of the Right-of-Way Bureau. MassHighway goes even further by requiring, since 1956, that all takings, no matter how small, be presented to an independent body

called the Real Estate Review Board (RERB). Only after the RERB adopts the appraisal valuation for the taking is the matter then presented to the Highway Commissioners for a vote.

d. Offer;

e. Negotiation;

f. Condemnation order documents and related plans;

g. Acquisition/ conveyance/ court petition/ quick takings;

h. Title outcomes of eminent domain takings;

i. Payment pro tanto/ trust account deposit; interest;

j. Settlements;

k. Property management;

l. Relocation/ possession: commercial vs. residential occupants;

m. Statute of limitations: MA: 3 years from date of taking (recording the Order of Taking). OH: Depends on the form of litigation for the taking, varying from 4 years for a physical or regulatory taking, through 6 years for a complaint based on an unwritten contract or a "compelling appropriation," and extending to 21 years for adverse possession.

Construction and Post-Construction Stages: Right-of-Way Needs

In a perfect world, all of the property rights are acquired before construction begins! But there can be property needs arising even at that stage:

a. Land development/ construction;

b. Temporary easement expirations/ extensions (changed conditions or changed staging requirements or more equipment and inventory than previously anticipated)—it all has to go somewhere;

c. Additional takings: additional uses vs. additional dimensions (the same changed conditions can require changed uses: not just a state highway, but also a utility corridor or a vent shaft for a tunnel);

d. Surplus property: looking back at the public use doctrine and the requirement to only take as little as possible, one would think that there would not be any surplus and that any surplus property indicates an abuse of taking authority. But please consider this example: a partial taking in fee of a property with the remainder as an "Uneconomic Remnant"—so the acquisition of the entire parcel is justified, and then the remainder can possibly be offered to the adjacent prop-

erty owner because there is some value to adding to that parcel;

e. Disposition: Taking surplus property to the ultimate level, if the public improvement is abandoned or discontinued, then, depending on the characteristics of the land, there may be stand-alone development possibilities or assembly for redevelopment with the adjacent property owner or owners.

Pre-Litigation Settlement Strategies

The goals to be sought during pre-litigation settlement strategies are to maximize compensation, minimize impacts, and successfully prevent an unwarranted appropriation. Attorneys might have to risk being pro-active on behalf of their clients because the clients might not know that they need to contact their counsel early enough. Waiting for the offer of compensation can be too late for the property owner. Starting as early as the preliminary Project Planning Stage is best because attorneys then would have an opportunity to act favorably in their clients' best interests at this stage. Some illustrations of this point directed to attorneys are the following:

- Attend Hearings: If you and your client know when and where public meetings occur, then attend, ask questions, and make contact with and become familiar with the people who will be your sources of information throughout this process. Obtain hearing transcripts, if possible.
- Initiate Communications and Obtain Documents: Again, if you can make contact with certain helpful people or government employees early on, your access to information will improve. Some sources of information to consider include the right-of-way or engineering division of the entity charged with the project, the project's real estate department, and the project's planning department. Pay attention to newspaper reports and announcements; contact the reporters (for example, the Toledo Blade newspaper always lists the reporter's e-mail address at the end of an article). If you run into any road blocks, do not hesitate to use the Freedom of Information Act appropriate to the entity with which you are dealing. If it is a federal entity or if there is federal entity involvement (e.g., Federal Highway Administration aid to a state highway project), then there is the federal Freedom of Information Act. The Freedom of Information Act requires disclosure of records requested in writing by any person. However, agencies may withhold information pursuant to nine exemptions and three exclusions contained in the statute. The Freedom of Information Act applies only to federal agencies and does not create a right of access to records held by Congress, the courts, or state or local government

agencies. Each state has its own public access laws that should be consulted for access to state and local records. Ohio's Public Records Law requires state agencies to provide public records for inspection upon request to citizens promptly at reasonable times during regular business hours. Ohio, too has exemptions from disclosure, such as trial preparation records, confidential law enforcement and investigatory records, medical records, and records whose release is prohibited by state or federal law.

- Project Design Alternatives: For example, what if the policy is for a 20-foot right of way buffer around the highway facilities, but the 20-foot buffer is the first 10 feet from another property owner? Perhaps there are design alternatives that can avoid impacting the additional property owner.
- Cost-to-Cure Alternatives: For example, a road widening project eliminates the sole driveway into a shopping plaza, thus potentially making the taking hugely expensive in severance damages. But for the relatively nominal cost of a new driveway and turn signal, those severance damages can be avoided. Then the cost-to-cure approach can be very attractive.
- Special Legislation: Sometimes it can pay to have friends in high places. If your client can make things happen through the legislature or other influential politicians, then go for it! Of course, do this only within the proper limits of the law.
- Expedited Actions/ "Quick Takes" (where timing can be a win-win situation).

During Right-of-Way Acquisition Stage

a. Establishing Property Values: Appraisals (provide as much information as possible); know the USPAP standards;

b. Communications/ Documents: obtaining information is key;

c. Cost-to-Cure Alternatives (as previously discussed);

d. Construction Coordination Alternatives (limiting hours of construction; noise barriers; construction methods—be creative);

e. Relocation Alternatives: temporary relocation to avoid a full taking if the structure can remain post-construction and the structure is important to your client—for example, construction is nearly surrounding your client, but there is a high emotional attachment to the home (e.g., the movie *The Castle*);

f. Alternate Dispute Resolution Procedures: mediation, mini-trials, binding arbitration.

g. Releases: determine whether a partial release, rather than a full release, can get your client over a certain obstacle with the taking entity or generate some goodwill and evidence a cooperative disposition.

Endnotes

[1] This article is adapted from the author's presentations on the law of eminent domain to the AIER conference and to an Ohio lawyers' continuing legal education seminar in Cleveland on December 10, 2004, for Lorman Education Services.—Editor

[2] Shortly after the AIER conference on Property Rights concluded, press accounts emerged indicating some engineering difficulties with the Big Dig that allegedly caused water leaks in the tunnel.—Editor

[3] Carroll Weir Funeral Home, Inc. v. Miller, In re Appropriation of Easement for Highway Purposes, 2 Ohio St.2d 189, 192-193 (1965).

[4] Fountain v. Metropolitan Atlanta Rapid Transit Authority, 849 F.2d 1412, *1415 (C.A.11 [Ga.],1988).

[5] *Herrington v. Sonoma County*, 834 F.2d 1488, *1498 (C.A.9 [Cal.],1987), *quoting United States v. Clarke,* 445 U.S. 253, 257 (1980).

[6] *See* ORC section 163.03. Under the statute, entries onto real property may be performed for the following purposes: (1) to determine whether appropriation of the property is necessary; (2) to obtain a description of the property; and (3) to determine the value of the property, and such entries do not constitute a trespass. In order to qualify as an "agency" under the statute, the entity must meet three qualifications: (1) the entity must meet the definition of "agency" under ORC section 163.01(A); (2) the entity must be authorized to appropriate the property in question in accordance with ORC section 163.01(D); and (3) the entity must be appropriating or considering appropriating the property in question.

[7] *In re Bernier*, 176 B.R. 976, 993 (Bkrtcy.D.Conn.,1995), *quoting United States v. Gettysburg Electric R. Co.,* 160 U.S. 668, 680 (1896).

[8] *County of Wayne v. Hathcock*, 471 Mich. 445, 684 N.W.2d 765 (2004). The *Hathcock* decision stated, "We overrule *Poletown* in order to vindicate our [state] constitution, protect the people's property rights and preserve the legitimacy of the judicial branch as the expositor, not creator, of fundamental law." Thus, land seized and transferred to a private party still may occur, but only if the public need is extreme and the property remains subject to public oversight. This decision was a reversal of *Poletown Neigh-*

borhood Council v. Detroit, 410 Mich. 616 (1981), where a close-knit residential neighborhood of mostly second-generation Polish-Americans and African-Americans was targeted by the City of Detroit for clearance to benefit General Motors.

[9] U.S. v. 14.38 Acres of Land, More or Less Situated in Leflore County, State of Miss., 80 F.3d 1074, 1077 (C.A.5 [Miss.],1996), quoting Olson v. United States, 292 U.S. 246, 255 (1934).

[10] *Cincinnati v. Banks*, 143 Ohio App.3d 272, 279-280 (Ohio App. 1 Dist.,2001).

[11] 16 Ohio App.3d 411, 16 OBR 481, 476 N.E.2d 695 (1984); also, *id.* (*idem*, or same citation) at 415, 16 OBR at 485, 476 N.E.2d at 700. Quoted in *Hurst v. Starr*, 79 Ohio App.3d 757, 762-763 (Ohio App. 10 Dist.,1992).

[12] American Louisiana Pipe Line Co. v. Kennerk,103 Ohio App. 133, 134 (Ohio App.1957).

[13] *Hurst v. Starr*, 79 Ohio App.3d 757, 763-764 (Ohio App. 10 Dist.,1992), *quoting Masheter v. Yake*, 9 Ohio App.2d 327, 331 (1967).

[14] *Masheter v. Kebe*, 34 Ohio App.2d 32, 34-35 (Ohio App. 1973).

[15] 63 Ohio App. 150, 155 (Ohio App.1940).

[16] 83 Ohio App.3d 415, 420 (Ohio App. 12 Dist.,1992), c*iting Sowers v. Schaeffer*, 155 Ohio St. 454 (1951). *See also*, *Toledo Edison Co. v. Roller*, 46 Ohio App.2d 61, 63 (1974).

[17] *West v. Ohio Dept. of Transp.,* 112 Ohio Misc.2d 10, 11-12 (Ohio Ct.Cl.,2001).

[18] Bar-Tec, Inc., d/b/a Zeno's, Allen Miller Zeno Partnership, Richard M. Allen, Chris N. Miller, Steven C. Zeno v. Ohio Department of Liquor Control, Michael A. Akrouche, Director, 1996 WL 87437 (Ohio App. 10 Dist.), quoting *Mugler v. Kansas,* 123 U.S. 623 (1887). [WL = Westlaw. – Editor]

[19] *State ex rel. Pitz v. City of Columbus*, 56 Ohio App.3d 37, 41-42 (Ohio App.,1988).

[20] 15 Ohio St.3d 376, 378 (1984).

[21] *Dorsey v. Donohoo,* 83 Ohio App.3d 415, 421 (Ohio App. 12 Dist.,1992). *Compare with, Dailey v. State*, 51 Ohio St. 348 (1894): "[The court finds that] the owner of the adjoining land was the owner of the trees, and had the right to their full enjoyment, subject only to the convenience of public travel; that his property in the trees was a legitimate subject of protection

by state legislation, and that the criminal arm of the law was properly invoked for his protection."

[22] *Wray v. Stvartak*, 121 Ohio App.3d 462, 478 (Ohio App. 6 Dist.,1997) (citations omitted).

[23] State ex rel. Royal v. City of Columbus, 3 Ohio St.2d 154, 158 (1965).

[24] The Ohio equivalents can be found at Ohio Administrative Code Section 5501:2-5-01, et seq. "(A) General: The purpose of rules 5501:2-5-01 to 5501:2-5-06 of the Administrative Code is to amplify sections 163.51 and 163.58 of the Revised Code and to implement the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended (42 U.S.C. 4601 et seq.), in accordance with the following objectives: (1) To ensure that owners of real property to be acquired for federally assisted projects are treated fairly and consistently, to encourage and expedite acquisition by agreements with such owners, to minimize litigation and relieve congestion in the courts, and to promote public confidence in federally assisted land acquisition programs; (2) To ensure that persons displaced as a direct result of federally assisted projects and state transportation projects are treated fairly, consistently, and equitably so that such persons will not suffer disproportionate injuries as a result of projects designed for the benefit of the public as a whole; and (3) To ensure that agencies implement rules 5501:2-5-01 to 5501:2-5-06 of the Administrative Code in a manner that is efficient and cost effective."

[25] *Dailey v. State*, 51 Ohio St. 348, 356-357 (1894).

COMMUNITY REDEVELOPMENT, PUBLIC USE, AND EMINENT DOMAIN

Patricia E. Salkin[1]

Introduction

WHEN government converts private property for public use, there are often dissatisfied property owners who may resent that government determined that their property was needed for a public purpose, and they may resent the level of compensation that government determined was due for this conversion. The Fifth Amendment of the U.S. Constitution makes it clear that when government takes private property, it must do so for public use, and it must pay just compensation.[2] The concept of what constitutes a public use has evolved over the decades from traditionally accepted uses such as public roads, buildings (e.g., government buildings and schools), and utilities to urban redevelopment. The broad concepts of community redevelopment have been stretched to encompass needed economic development projects that promise jobs, tax revenue, and other public benefits. Furthermore, and perhaps central to the current debate before the U.S. Supreme Court, is the critical question of whether government may condemn private property for use by private developers to advance a public purpose. According to the Institute for Justice, seven states allow for condemnation for private business development[3] while eight states prohibit this practice.[4]

This article begins by briefly examining the development of the "public use" clause with respect to eminent domain. The next section discusses a recent policy guide adopted by the American Planning Association (APA) on community redevelopment. This guide represents a sensible approach to planning for, and supporting the implementation of, community redevelopment initiatives. The article then examines three significant cases from 2004 that have crystallized around the question of what constitutes a valid public purpose under eminent domain when the underlying governmental motivation is to promote economic development in the municipality. One of these cases, *Kelo v. City of New London, Connecticut*, is headed for oral argument before the U.S. Supreme Court in early 2005.[5] A second case, *County of Wayne v Hathcock*, decided by the Michigan Supreme Court, reversed a long-standing national precedent,[6] narrowing under state law the circumstances allowing private property to be taken by the government to be transferred to another private owner for the purpose of economic development. The majority in *Kelo* at the state court level relied in part on the case that was overturned in *Hathcock*. The third case involved an effort by elected officials in Lakewood, Ohio, a Cleveland suburb, to

condemn certain property for the purpose of bringing commercial development to the city's West End. The Lakewood litigation was halted after the citizens spoke at the ballot box, defeating the redevelopment initiative and the public officials who supported it. All three cases involved, at varying levels of intensity, plans by the government to promote community redevelopment by promoting commercial development that was expected to bring jobs and revenue into the impacted communities. In all three cases, however, there was significant community opposition to the use of eminent domain to accomplish these goals. Finally, the article concludes that the U.S. Supreme Court should confirm that economic development is a valid public purpose for application of eminent domain principles and that the public-private partnerships that have evolved to assist governments in meeting redevelopment[7] needs are a necessary and appropriate strategy that foster a valid public use.

The Concept of "Public Use"

The debate over what constitutes a "public use" in the context of takings pursuant to the Fifth Amendment is a fiercely contested one.[8] Relying on a trilogy of landmark cases—*Berman,*[9] *Poletown,*[10] *and Midkiff*[11]—courts across the country routinely review condemnation actions where the government's strategy involves transfer to a private entity to further the underlying public use for which the eminent domain action was instituted. In the cases that have allowed these condemnations, the justification has been that, although the property is being used by a private entity, it is serving a "public purpose." These decisions more recently have sparked a debate over the difference, if any, between a "public use" and a "public purpose" or "public benefit."

In their article "Sources of 'Public Use' Limitations—Takings or Due Process?" Sullivan and Cropp analyze the different interpretations of the Takings Clause which have been employed by the courts. They set forth the notion that, although many courts have interpreted the inclusion of the term "public use" as a prerequisite for the taking, this is not the only way to interpret the language of the Fifth Amendment. "By saying 'nor shall private property be taken for public use without just compensation,' the clause states that, when a government takes property for public use, it must compensate justly. . . . The clause *does not* specifically say what happens when a government takes for private use. . . ." Sullivan and Cropp state that property owners making the argument that the condemnation is not justified because it is not for a "public use" will face much resistance due to the expansive interpretation of the term by the courts.[12]

Berman v. Parker is often cited as one of the leading cases in the exercise of the power of eminent domain for a public use. The appellants in

this case attacked the constitutionality of the District of Columbia Redevelopment Act of 1945. Under this Act, the government was authorized to take property in order to eliminate substandard housing and blight. Section 2 of the Act stated that "the acquisition and the assembly of real property and the leasing or sale thereof for redevelopment pursuant to a project area redevelopment plan . . . is hereby declared to be a public use."

The Act created the District of Columbia Redevelopment Land Agency, which was granted the power to acquire property through the use of eminent domain in order to redevelop the blighted areas. The National Capital Planning Commission was directed to "make and develop 'a comprehensive or general plan' of the District, including 'a land-use plan' which designates land for use for 'housing, business, industry, recreation, education . . . and other general categories of public and private uses of the land." Once the plan was adopted and approved by the Commissioners, the Planning Commission was to certify it to the Agency, which was then authorized to acquire and assemble the real property in the area. After the land was acquired, the Agency was authorized to transfer the land, which was to be used for public purposes such as schools, streets, and utilities, to public agencies. The remainder of the land was to be leased or sold to a redevelopment company, individual, or partnership. The contracts were to provide that the land would not be used in any way that does not conform to the plan. Preference was to be given to private enterprise over public agencies for the execution of the redevelopment plan.

The appellants in the *Berman* case owned a department store located on property acquired through the Act. They claimed that their property could not be taken constitutionally because "it is commercial not residential property; it is not slum housing; it will be put into the project under the management of a private, not a public, agency and redeveloped for private, not public, use." The District Court defended the Act "by construing it to mean that the Agency could condemn property only for the reasonable necessities of slum clearance and prevention, its concept of 'slum' being the existence of conditions 'injurious to the public health, safety, morals and welfare.'"

The U.S. Supreme Court affirmed the decision of the District Court in *Berman*, holding that "once the question of the public purpose has been decided, the amount and character of land to be taken for the project and the need for a particular tract to complete the integrated plan rests in the discretion of the legislative branch." Therefore, the Agency was permitted to acquire whatever property it deemed necessary in order to implement the redevelopment project.

While the Court in *Berman* set precedent for the redevelopment of

blighted areas, the Court in *Midkiff* recognized that the regulation of oligopoly and the evils associated with it gave rise to a valid public use of the condemned land. The court in *Midkiff* addressed the issue of whether the Public Use Clause prohibited the State of Hawaii from taking, with just compensation, title in real property from lessors and transferring it to lessees in order to reduce the concentration of ownership of fees simple in the state.

The Hawaii legislature enacted the Land Reform Act of 1967 to remedy land distribution problems responsible for "skewing the State's residential fee simple market, inflating land prices, and injuring the public tranquility and welfare." The Act was enacted after the legislature discovered that, due to the way land in Hawaii had been distributed when it was first settled, 49 percent of the land was owned by state and federal governments, while another 47 percent was owned by only 72 private landowners. The Act authorized the condemnation of residential tracts in order to transfer ownership to existing lessees. Under the Act, tenants living on single-family residential lots within development tracts at least five acres in size were entitled to ask the Hawaii Housing Authority (HHA) to condemn the property on which they lived. A public hearing would then be held by the HHA to "determine whether acquisition by the State of all or part of the tract will 'effectuate the public purposes' of the Act." If the condemnation was approved, the land would then be sold to the existing lessees.

The Supreme Court held that the Act was constitutional. In its opinion, the Court stated that "the mere fact that property taken outright by eminent domain is transferred in the first instance to private beneficiaries does not condemn that taking as having only a private purpose." The court found that the "public purpose" served by the Act, the regulation of oligopoly and the evils associated with it, was a classic exercise of a state's police powers.[13]

Until it was overruled by *County of Wayne v. Hathcock* in 2004, the Michigan Supreme Court's decision in *Poletown* (1981) was one of the leading cases cited for the proposition that the acquisition of property through the use of eminent domain for economic development was permissible. In the *Poletown* case, the Detroit Economic Development Corporation planned on acquiring, by condemnation if necessary, a large tract of land to be conveyed to General Motors Corporation as a site for construction of an assembly plant. The plaintiffs in the case brought suit in Wayne Circuit Court to challenge the project on a number of grounds. Judgment was granted for defendants, and the plaintiffs' claim was dismissed. The Michigan Supreme Court granted a motion for immediate consideration.

The main question addressed in the appeal was whether "a municipality [can] use the power of eminent domain granted to it by the Economic Development Corporations Act, to condemn property for transfer to a private corporation to build a plant to promote industry and commerce, thereby adding jobs and taxes to the economic base of the municipality and state."

The appellants argued that, in the law of eminent domain, there must be a distinction between "public use" and "public purpose." Appellants challenged the constitutionality "of using the power of eminent domain to condemn one person's property to convey it to another private person in order to bolster the economy." In holding that the use of eminent domain was permissible, the court stated that "the power of eminent domain is to be used in this instance primarily to accomplish the essential public purposes of alleviating unemployment and revitalizing the economic base of the community. The benefit to a private interest is merely incidental." Citing *Berman*, the court stated that "the United States Supreme Court has held that when a legislature speaks, the public interest has been declared in terms 'well-nigh conclusive.'"

These three cases did not settle this area of the law of eminent domain and public use; rather, the landscape in this area has become increasingly controversial and divisive in the courts. Cases such as *Hathcock* and *Kelo* are proof that the rules governing this area of law continue to evolve.

The Validity of Public-Private Partnerships Has Long Been Recognized

Many states and local governments have contracted with private entities to manage facilities such as prisons, with an estimated average annual saving between 20 and 50 percent.[14] Philadelphia, for example, saved $26.6 million by privatizing its nursing homes, a 54 percent cost reduction. Private corporations are most often able to manage state facilities in a more efficient way because they are faced with competition. Governments have also created partnerships with private corporations to provide services to the public. These partnerships are aimed at lowering the costs of providing the public services and also can be used to generate financial gains for the municipality. Some examples of these partnerships include:

- New York State has leased Stewart and Niagara Falls airports to private operators.
- New Hampshire and Georgia have leased state parks to private firms.
- Indianapolis awards city contracts to churches to maintain neighborhood parks.

- Bryant Park in New York City was revitalized by a voluntary local business association.
- New York's Central Park is maintained by a private nonprofit organization.
- Riverside County in California contracts with a private company to manage its library system.
- City Municipal Services, Inc., a private company in Michigan, is serving as the public works department for several towns.
- NASA uses private contractors to monitor its unmanned satellites in space.[15]

The creation of partnerships with the private sector has encountered opposition in some places. For example, in 1995, in response to threats from the Seattle Mariners that they would leave the state, the Washington State legislature passed the Stadium Act, which appropriated $445 million for the building of a new stadium with a retractable dome to be used by the baseball club. This legislation was in response to a countywide referendum rejecting the same proposed sales tax on residents of King County. Despite a state constitutional ban on public loans to private corporations, the Washington law culminated in a series of private and public partnerships designed to spur economic development. The authorization of public funds for private development in Washington State has given rise to several legal challenges.

Many states have amended their laws to allow for partnerships between municipalities and private companies. For example, the school board in Falls Church, Virginia, was able to contract with a group called Public Private Alliances to take over the entire process of building the city a new middle school instead of going the traditional route of acquiring land and then soliciting bids for design and construction. This procedure resulted from a new state law allowing local governments to partner with private developers to build schools and other public facilities.

Community Redevelopment

In April 2004, the APA adopted a policy guide on public redevelopment, stating that "Government-initiated redevelopment activities serve a valid public purpose when the public agency can demonstrate through an adopted plan or other public process that existing conditions make it impractical or impossible for market forces to act in the public's best interest."[16] The guide explains that often times the private sector is better equipped to accomplish community redevelopment goals, and when public-private partnerships exist, they may best promote the larger public

interest. The guide asserts that, "Given traditionally distinguishable skill sets, and the mixed experience of success and failure of governments acting as redevelopers, it has become increasingly popular for governments to act in concert with private developers to effectively take advantage of the best that both have to offer." The guide further notes that the public and private sectors each have things that they may separately be better suited to address, but that, "Working together, the public and private sectors can achieve more than working independently or at cross purposes."

The APA supports a statutory requirement that redevelopment areas may be established only where the local government agency performing the redevelopment has adopted a local comprehensive land use plan and where the redevelopment plan for the area conforms to this comprehensive plan. The APA also supports state legislation that includes specific authority to engage in redevelopment projects that include both the prevention and elimination of blight, and the policy guide also contains a provision for the use of public-private partnerships. The policy guide encourages state legislation aimed at "preserving the ability of cities to use redevelopment tools and techniques, including eminent domain, when appropriate to achieve a well-defined public purpose adopted through an inclusive public process."

Eminent Domain Reaches Public Referendum, State High Court, and U.S. Supreme Court in 2004

A. The U.S. Supreme Court Agrees to Hear Connecticut Case in 2005

In March 2004, the Connecticut Supreme Court decided *Kelo v. City of New London,* addressing whether the Public Use Clauses of the federal and state constitutions can be used to justify the exercise of eminent domain power in furtherance of a significant economic development plan that is expected to create jobs, increase tax and other revenues, and revitalize an economically distressed city.[17] In a 249-page opinion (including appendices), by a 4-3 majority, the Connecticut court handed a strong victory to the city. The court concluded, among other things, that the goal of economic development can be a valid "public purpose" to justify the use of eminent domain and that a city may delegate its power of eminent domain to a non-profit, private economic development corporation to further the city's goal of economic development. Following the Connecticut Supreme Court's denial of a motion to reconsider, the petitioners filed a petition for writ of certiorari to the U.S. Supreme Court in July 2004, asking the Court to review "the limits under the public use requirement of the U.S. Constitution when government takes land for private economic development." The Court granted certiorari in September 2004.

1. Background

The New London Development Corporation (hereinafter referred to as "Development Corporation"), a private, non-profit economic development corporation, was established in 1978 to assist the city of New London in planning for economic development. The State Bond Commission authorized bonds in 1998 to support, among other things, planning activities in the Fort Trumbull area of the city and property acquisition to be undertaken by the Development Corporation. In February 1998, Pfizer, Inc., announced that it was developing a global research facility on a site adjacent to the Fort Trumbull area. In April 1998, the city gave initial approval for the preparation of a development plan for the Fort Trumbull area, and one month later the city authorized the Development Corporation to proceed. In June 1998, the city conveyed the New London Mills site to Pfizer.

In July 1998, a consulting team began working on the development plan for New London. The development plan area consists of approximately 90 acres on the Thames River, adjacent to the proposed Fort Trumbull State Park and the Pfizer facility, which opened in June 2001. The area consists of about 115 lots, including both residential and commercial uses. In the preface to the development plan, the Development Corporation stated that its goals were to create a development that would complement the Pfizer facility, create jobs, increase tax and other revenues, encourage public access to the waterfront, and work toward revitalization of the city. The development plan organized the area into seven parcels of land, designating parcel 1 for a waterfront hotel and conference center, as well as marinas for tourist and commercial vessels and a walkway along the waterfront; parcel 2 as the site of 80 new residences organized into an urban neighborhood and linked by a public walkway to the rest of the plan, including the park; parcel 3 for 90,000 square feet of high technology research and development office space and parking; parcel 4 for parking or retail services for the adjacent state park and for the renovation of an existing marina; parcel 5 for 140,000 square feet of office space, parking, and retail space; parcel 6 for a variety of water-dependent commercial uses; and parcel 7 for additional office or research and development use. The Development Corporation planned to own the land and lease parcels to private developers, requiring that developers comply with the terms of the development plan.

The development plan was expected to generate a significant number of jobs,[18] together with increased tax revenue for the city.[19] What made the development plan more significant was the fact that, with the exception of the new Pfizer facility that recently had been built, the city had experienced a major economic decline with the loss of almost 2,000 government

jobs in 1996, and the State had designated the city as "distressed."[20] The city approved the development plan in January 2000 and authorized the Development Corporation to acquire properties within the development area. In October 2000, the Development Corporation voted to use the power of eminent domain to acquire properties within the development area whose owners had not been willing to sell, and in November 2000 they filed condemnation proceedings that led to the present action.

The trial court noted that "each of the plaintiffs testified and said they wished to remain in their homes for a variety of personal reasons. Two of the people referred to the fact that their families have lived in their homes for decades. . . . Several have put a lot of work into their property and all of them appeared . . . to be sincerely attached to their homes. . . . All testified that they were not opposed to new development in the Fort Trumbull area. . . . [T]wo of the plaintiffs own their property as business investments – the rental of apartments." After the trial court issued a decision upholding some of the condemnation proceedings and dismissing others, both the petitioners and the city appealed.

2. The State Supreme Court Ruling

Finding that in each case the Development Corporation had proper authority to institute condemnation proceedings, the Connecticut Supreme Court held that the Public Use Clauses of the state and federal constitutions (which are identical) authorize the exercise of eminent domain power in furtherance of a significant economic development plan that will result in benefits to the distressed city. The plaintiffs argued that the condemnation of property for economic development by private parties (e.g., the Development Corporation) is inconsistent with prior relevant court decisions on the following two grounds: 1) the new owner would not be providing a public service or utility; and 2) the condemnation would not remove blight conditions.

In addressing first the constitutionality of Chapter 132 of the Connecticut General Statutes, which authorizes the use of eminent domain for private economic development,[21] the court noted a history of taking a "flexible approach to the construction of the Connecticut public use clause." Citing earlier precedent to define what is meant by a "public use," the court reiterated, "'Public use' may therefore well mean public usefulness, utility or advantage, or what is productive of general benefit; so that any appropriating of private property by the state under its right of eminent domain for purposes of great advantage to the community, is a taking for public use." The court went on to uphold the deferential approach that is afforded to legislative declarations of public use, noting that it is difficult to draw a precise line between what is a public use and what is a private use, prefer-

ring to follow precedent stating that "The power requires a degree of elasticity to be capable of meeting new conditions and improvements and the ever increasing necessities of society." The court also noted that prior Connecticut case law stands for the proposition that, when the government exercises its eminent domain power and allows the condemned land to be sold or leased to private developers, so long as the initial public purpose for the action was for a public use, then that same public use continues after the property is transferred to private persons. Furthermore, the court noted that any benefit to the private developer is secondary to the public benefit that results from economic growth and community revitalization. The court concluded that, where the legislative body has rationally determined that an economic development plan will promote significant economic development, this constitutes a valid public use for the exercise of the eminent domain power under both the state and federal constitutions.[22] In addressing concerns over the potential for abuse as to what constitutes a valid public purpose, the majority concluded "that responsible judicial oversight over the ultimate public use question does much to quell the opportunity for abuse of the eminent domain power."

The court also concluded that a valid public purpose is not defeated when the condemnation plan includes a transfer of land to private entities. Noting that integral to the plan was Pfizer's decision to locate in the city, the court relied on testimony from the record below that Pfizer was key to the plan because it was unusual for a major employer to move into a "brown site" in a major urban area, which offered a unique opportunity to the city to take advantage of a number of things that would happen at the site as a result of this move. In upholding the trial court's determination that "in the context of severe economic distress faced by the city, with its rising unemployment and stagnant tax revenues, the benefits to the city will outweigh those to Pfizer," the Connecticut Supreme Court determined that the takings were not primarily intended to benefit a private party. In fact, the court noted that, in response to criticism, the city responded to Pfizer's specific development requirements and that, "had the development corporation failed to consider demands by the Pfizer facility, its planning would have been unreasonable." The court makes clear that its holding in this case does not give a license for eminent domain simply for the purpose of greater tax revenues; rather, the holding is that "rationally considered municipal economic development projects such as the development plan in the present case pass constitutional muster."

The court next rejected plaintiffs' claim that the condemnation must fail because there was no assurance of future public use. In upholding the trial court's finding that the city's lack of future involvement does not mean that the Development Corporation and the developers are not bound to use

the property in accordance with the approved plan, the court relied on the existence of sufficient written agreements to this effect. The plaintiffs next noted that the city's delegation of the eminent domain power to the Development Corporation was unconstitutional. The court dismissed this claim, finding that the Development Corporation is the statutorily authorized agent for the implementation of the development plan, a valid public purpose, and that the Development Corporation is not acting to further its own operations. In applying a three-pronged test (1, whether the development entity is a private entity; 2, whether a public purpose is being advanced; and 3, whether the benefit of the property taken is considered to be available to the general public), the court noted that there was no disagreement over the private entity status of the Development Corporation, that the public purpose was advanced by giving the Development Corporation authority to acquire property to implement the development plan, and that the public as a whole benefits from the actions of the private Development Corporation, which turns the property over to private developers and tenants.

2a. The Dissent in the State Supreme Court Case

The dissenting judges (*Kelo* was a 4-3 decision), while concurring with the majority's opinion regarding the applicability of the state statute and the constitutionality of delegating the eminent domain power to the Development Corporation, argued that private economic development is not a valid public use under the state and federal constitutions. While the dissent does "conclude that the legislature should be accorded great deference in determining what constitutes a public use" and that courts have a limited role in reviewing this determination, they assert that, "as the category of public use changes from one of direct public use to indirect public benefit in the form of private economic development, the level of judicial inquiry must increase in order to protect the legitimate interests of the condemnee."

The dissent "agreed with the conclusion of the majority" that "private economic development projects . . . which create new jobs, increase tax revenue, and contribute to urban revitalization, satisfy the takings clauses of the federal and state constitutions." The dissent also conceded that there was "very little evidence" that the development plan "was executed primarily for the benefit of private interests." However, the dissent viewed the analytical process employed by the majority as too deferential. In place of the majority's "purposive" test, the dissent called for a heightened degree of judicial scrutiny to ensure that a taking for economic development would result in a public benefit. The dissent offered a four-part test in which the burden of proof shifts. The first inquiry, the dissenting justices asserted, should be whether the statutory scheme is facially constitutional,

and the party challenging the constitutionality should shoulder the burden of proof. Second, where the court concludes that the proposed economic development is a valid public use, the party challenging the condemnation should further shoulder the burden of proof to show that the primary intent of the plan is to benefit private, rather than public, interests. Third, should the court conclude the plan is constitutional at this level of inquiry, the dissent continued that, as a next step, the burden should shift to the government to prove that "the specific economic development contemplated by the plan will, in fact, result in public benefit." The dissent suggested that the standard of proof should be one of clear and convincing evidence. Fourth, where the court finds that the condemned property will be used for a public purpose, the dissent asserted that the burden should shift to the party opposing the action to prove that the specific condemnation is not reasonably necessary to implement the plan. Applying this test, specifically when the dissent reached the third prong—the clear and convincing evidence standard—the dissent parted company with the majority. The dissent conceded that there was an intent for the project to have a public benefit but argued that the government could not in fact prove that such benefit would materialize by clear and convincing evidence. The practical effect of the third prong, or the clear and convincing evidence standard, is that it would bar government from engaging in economic development using eminent domain unless it, or the proposed developer, could guarantee that the anticipated revenues from the project would materialize.

3. Petition for Writ of Certiorari to the U.S. Supreme Court

In their petition for a writ of certiorari, petitioners (the plaintiff homeowners) argue that this case presents a vital constitutional question that has not been addressed by the U.S. Supreme Court: whether the Public Use Clause of the Fifth Amendment authorizes the exercise of eminent domain to help a government increase its tax revenue and to create jobs. Petitioners claim that the Connecticut Supreme Court's use of *Berman* and *Midkiff* as precedents is improper because *Berman* addressed the use of eminent domain to clear slums and blighted areas, while *Midkiff* addressed the ability of Hawaii to alleviate oligopolistic patterns of land holding. Petitioners claim that, by allowing urban renewal condemnations in an area that is not a slum or a blighted area, the Connecticut Supreme Court has allowed the broadest expansion of eminent domain authority yet realized. Petitioners urged that, because this is an issue that has been dealt with differently in many states, the U.S. Supreme Court must step in to set a uniform standard.

Respondents (the city) argue that, unless the proffered public use is "palpably without reasonable foundation," a reviewing court should not go

beyond its established role and second guess the legislature's determination of public use or a city's good faith attempt to achieve it. Respondents emphasize that the Connecticut legislature has declared economic development to be a public purpose and, therefore, the legislature's declaration is entitled to great deference from a reviewing court.

The question presented to the U.S. Supreme Court, as defined in the Petition for Certiorari, is, "What protection does the Fifth Amendment's public use requirement provide for individuals whose property is condemned, not to eliminate slums or blight, but for the sole purpose of 'economic development' that will perhaps increase tax revenues and improve the local economy?"

B. County of Wayne v. Hathcock—*"Public Use" in Michigan*

1. Background

After investing approximately $2 billion to renovate the Wayne County (Detroit), Michigan, airport, including the addition of a new terminal and jet runway, in an effort to obviate perceived problems related to noise from increased air traffic, Wayne County, funded by a partial grant of $21 million from the Federal Aviation Administration (FAA), began a program of purchasing neighboring properties through voluntary sales to accomplish noise abatement. The county purchased approximately 500 acres in scattered, nonadjacent plots throughout an area south of the airport. The agreement between the county and the FAA provided that any properties acquired through this program were to be put to economically productive use.[23] To meet this mandate, the county supported the concept of developing a large business and technology park with a conference center, hotel accommodations, and a recreational facility, known as the "Pinnacle Project." Construction of this state-of-the-art business and technology park was proposed in a 1,300-acre area adjacent to the airport, and it was believed that it would create thousands of jobs, generate millions of dollars in tax revenue, and accomplish the goal of broadening the county's tax base from predominantly industrial to a mixture of industrial, services, and technology. In an effort to acquire more land needed to assemble the 1,300-acre site, the county again sought voluntary sales from landowners, resulting in the purchase of an additional five hundred acres.

The county determined that an additional 46 parcels, distributed in a checkerboard fashion throughout the project area, were needed and that these parcels were not likely to be acquired through the voluntary program. Therefore, in July 2000, the Wayne County Commission adopted a Resolution of Necessity and Declaration of Taking, authorizing the acquisition of the remaining 300 acres. Twenty-seven property owners accepted writ-

ten offers of purchase from the county, leaving 19 additional parcels still needed for the project. In April 2001, the county formally initiated condemnation actions for each of these parcels, resulting in the litigation challenging the public necessity for the eminent domain action and challenging the constitutionality of the action on the ground that this project would not serve a public purpose.

Both the trial court and appellate court upheld the county's actions and, relying on the Michigan Supreme Court's *Poletown* decision, found that there was a valid public purpose served by the Pinnacle Project. The Michigan Supreme Court directed the parties to brief the following three issues, which were also briefed by the 14 *amici curiae*, "friends of the court": 1) Whether the county had the authority to take the property under state statute; 2)

Whether the proposed takings were for a public purpose, given that the property was likely to be transferred to private entities; and 3) Whether the "public purpose" test in *Poletown* was consistent with the state constitution,[24] and if not, whether that precedent should be overturned. The case was argued before the Supreme Court of Michigan on April 21, 2004, and on July 30, 2004, the court handed down its decision.

2. The Decision

a. Review Under the Michigan Statutes

In reviewing the statutory authority for condemnation, the Michigan Supreme Court noted that it must "determine only whether the proposed condemnations are *necessary* for *public purposes*, whether those purposes are *within the scope of the county's powers*, and whether the takings are *'for the use or benefit of the public. . . .'"* Turning first to the question of whether the statute authorizes the county to exercise the power of eminent domain in general, the court quickly concluded that it does. The second inquiry focused on whether the particular condemnation action was within the scope of the county's powers, and the court again concluded that it was.

The court next examined whether the county exercised its power in accordance with the statutory requirement of advancing a "public purpose." Concluding that they did, the Court found, "A transition from a declining rustbelt economy to a growing, technology-driven economy would, no doubt, promote prosperity and general welfare. Consequently, the county's goal of drawing commerce to metropolitan Detroit and its environs by converting the subject properties to a state-of-the-art technology and business park is within this definition of public purpose."

Under Michigan statute, the exercise of eminent domain must also be

found "necessary." The condemning authority must make the determination of public necessity, which can be overturned only with a showing of "fraud, error of law, or abuse of discretion." The defendants advanced the following three arguments: 1) That the county impermissibly was stockpiling land for speculative future use because specific purchasers were not identified for the parcels to be condemned and there was no proof that these parcels would be put to productive use. The court found this argument unpersuasive because the county had a definite plan of erecting a "business and technology park as soon as possible," and the acquisition of the needed parcels would enable the county to assemble the critical mass of property needed. 2) That the condemnations were unnecessary because the county had not cleared all procedural hurdles for the project.[25] The court found that this argument did not relate to what was "necessary" to advance one of the specified purposes. 3) The county did not prove that a business and technology park was necessary for the public. The court determined that this argument, too, was unpersuasive and that it impermissibly shifted the burden of proof to the county.

Next, the court addressed the statutory requirement that condemnation powers must also be for the "use or benefit of the public." The court had no difficulty in finding that the Pinnacle Project would benefit the public, noting that the project would bring jobs to a struggling economy, add tax revenues to increase resources available for public services, and attract investors and business to the area to reinvigorate the local economy. The defendants argued that the benefit that private parties would receive under the project outweighed any benefit the public might receive and that, therefore, the action was outside the "public use or benefit" requirement of the statute. The court found this argument unpersuasive, stating that the defendants simply did not prove that the condemnations would fail to provide a "public benefit."

b. Review Under the Michigan State Constitution

Concluding that Wayne County acted in accordance with applicable statutory provisions, the court turned to the state constitution, which also limited the state's power of eminent domain, to determine whether the condemnations met the constitutional requirement of "public use." Determining that the phrase "public use" is a legal term of art, the court noted that the meaning had to be discerned respecting the intent of the drafters and the meaning of the phrase at the time it was ratified in 1963. The court identified the constitutional issue as whether the condemnation of the subject properties and the subsequent transfer of those properties to private entities was within the common understanding of the "public use" requirement at the time of ratification.

Noting that the constitutional "public use" requirement does not prohibit the transfer of condemned property to private entities, the court stated that the constitution does prohibit the transfer of condemned property to private entities for private use. Citing the dissent in *Poletown*, the court stated that there are three factors that have been identified to determine whether a private entity is putting the condemned property to public or to private use. These are: 1) Whether the exercise of eminent domain involving private enterprises is limited to those enterprises whose very existence depends upon the use of land that can be assembled only by the coordination of a governmental body (e.g., "collective action is needed to acquire land for vital instrumentalities of commerce"). Such undertakings have included highways, roads, canals and other instrumentalities of commerce. 2) Where the private entity remains accountable to the public in its use of the condemned property (e.g., where the entity is subject to public oversight). 3) Where the selection of the land for condemnation is based upon a public concern (e.g., where there are "facts of independent significance" that turn on the act of condemnation itself rather than on the use to which the property might ultimately be put).

The court concluded that the subject condemnations did not meet any of these criteria and therefore were unconstitutional under what the public would have understood the phrase "public use" to mean at the time of the ratification of the 1963 constitution. Specifically, the court determined that: 1) The business and technology park was "not an enterprise 'whose very existence depends on the use of land that can be assembled only by the coordination central government alone is capable of achieving.'" 2) The Pinnacle Project was not subject to public oversight, and after the parcels were sold, it was intended that the private entities would use the property to pursue their own financial welfare. 3) There was nothing about the act of condemning the property here that served the public good.

Addressing the *Poletown* case, the court found that the decision was a "radical" departure from the court's pre-1963 eminent domain jurisprudence, departing from the "common understanding" of "public use" at the time of ratification. The court further determined that *Poletown* inappropriately concluded that a generalized economic benefit was sufficient to justify the transfer of condemned property to a private entity, and consequently the *Poletown* decision and the proposition that it established that alleviating unemployment and revitalizing the economy of a community constitutes a public use are specifically overruled. As a result, the court finally concluded that its new decision in *County of Wayne v. Hathcock* shall have a retroactive effect upon all pending cases that have raised and preserved a *Poletown* challenge.[26]

One of the practical effects of this new ruling is that it will likely cost taxpayers more when government exercises its eminent domain power. Municipalities in Michigan will also face a much greater challenge in implementing sorely needed community redevelopment projects.

C. Lakewood, Ohio—The Public Speaks at the Ballot Box

1. Background

Residents have been moving out of Cleveland's inner city for decades, relocating first to outlying areas, or inner ring suburbs, like Lakewood, Ohio, in order to escape the growing urban poverty and decay. Lakewood, one of the first suburbs established in the greater Cleveland area, has been described as a "new urbanist" style city where residents can live comfortably within walking distance of small businesses and other attractions.[27] However, in recent years, this "City of Homes"[28] has fallen victim to many of the ailments that plagued Cleveland in previous decades, suffering from an outdated infrastructure, aging housing stock, decreased commercial investment, and an eroding tax base.

In order to update its infrastructure and to keep residents from leaving Lakewood, in 2003 the city council unanimously approved a draft proposal for a development agreement with two developers, focusing on commercial development of the city's West End. Specifically, the proposal called for the construction of a new shopping center, movie theater, and upscale townhouse complex. The developers were required "to make diligent efforts for six months to attract national, 'mid-scale to upper-scale' retailers" as well as to commit "more than $100 million in private financing." The city, in turn, agreed to spend $35 million to raze West End houses or to purchase them through eminent domain and to build new roads. To further this objective, the Lakewood city council officially designated the West End as "blighted" in order to begin eminent domain proceedings against homeowners who refused to sell.

The designation of the West End neighborhood as "blighted" incited a tremendous amount of opposition from property owners. The West End is described as a "cute neighborhood"[29] that consists of over fifty colonial-style homes (which homeowners regularly invest in and improve), an apartment complex, several small businesses, and approximately 1,200 residents. The West End also has a vibrant business community without a single commercial vacancy—compared with more than 100 commercial vacancies in the rest of Lakewood. According to one account, using the criteria adopted by the city council, a home in Lakewood could be deemed blighted if it did not have two bathrooms, three bedrooms, an attached two-car garage, central air-conditioning, or if the house or yard did not meet

minimum size requirements.[30] Accordingly, 90 percent of the homes in Lakewood could have been considered "blighted," including the home of the then-mayor and all seven city council members.

In addition to the homeowner opposition to the designation as a blighted area, many residents were angered by the private nature of the negotiations between the city and the developers, and they alleged that this was an abuse of the eminent domain power because homes were being taken for the sole purpose of handing the property over to private developers. Despite vocal opposition, negotiations among the city, the school board, and the developers were initially successful, and the plan was approved by the city council in May 2003. Although many West End homeowners had agreed to sell their properties to the developers, a determined minority vowed to fight the plan, enlisting the help of the Institute for Justice.[31] The Institute filed suit in Cuyahoga County Court of Common Pleas in Cleveland, seeking an injunction against the West End development plan. In addition, a grassroots organization of Lakewood residents, the Committee for Lakewood, successfully collected signatures and filed a petition to place a referendum (Issue 47) on the November 2003 ballot that asked voters to approve or reject the official development plan. Another petition for the same ballot was also approved in September 2003 (Issue 48) to require all future development projects to be approved by voters. Finally, the homeowners' group succeeded in getting another referendum on the March 2004 ballot that, if approved, would remove the West End's blighted status.

2. The Case for Redevelopment

Former Mayor Madeline A. Cain, the Lakewood City Council, the Greater Cleveland Growth Association, and the Cleveland business community all supported the proposed development plan for Lakewood's West End, and the city council actively promoted the project by initiating the "Campaign for Lakewood's Future." The main reasons for approving the development plan were financial ("Tax base is the bottom line," said the mayor), but, aside from increasing the city's tax revenue, these supporters also stressed that the redevelopment would increase the "quality of life" and "[create] a vibrant and attractive community." They also claimed that the development project would lead to the creation of new jobs within the city and slow the migration of residents to other outlying suburban areas (locally called the "outer ring suburbs"). Although it was argued that information in this respect was somewhat speculative, Bonne Bell, a cosmetics manufacturer located in the West End and one of the biggest employers in Lakewood, announced its intention to establish its world headquarters in the new development.

As for the "blight" designation, the mayor maintained that it was a term of art or a statutory phrase generally invoked to describe whether or not the structures in the area "meet today's standards" and that the designation was necessary to enable the city to exercise its eminent domain powers. Ultimately, the mayor said it all came down to whether or not the West End could be used for a better or higher purpose than its current use, concluding that such better or higher use was a public good.

The development proposal received some support from West End homeowners. City council minutes from the spring of 2003 show that many people had "concerns [about] Lakewood's tax base, further deterioration of streets, future of schools, and need for jobs," and that the opponents of the project were a "vocal minority." The city's position also received support from the building trades in organized labor, which counted on increased construction jobs, and from experts including Ned Hill, a professor at Cleveland State University's Levin College of Urban Affairs, who asserted that Lakewood had to act assertively to "grow its tax base" in order to preserve the town.[32]

3. Opposition to the Plan

The main opposition to the plan came from an organized and persistent group of Lakewood residents. Complaints focused on the City's tactics and the development's implications for the City. The opponents claimed that the expected increase in tax revenues and jobs was speculative; they resented the fact that the city was going to be paying private entrepreneurs with taxpayer funds; and they believed that approving the plan would give bureaucrats unlimited power to seize property in the future. Council minutes show that residents also voiced concerned about increases in traffic and the loss of safe, clean, and affordable homes for families with modest means.

As for the "blight" designation, this was probably the most emotional aspect of the plan for many residents. Newspaper accounts report that some residents felt shamed and humiliated by the designation. They asserted that Lakewood traditionally had been a bedroom community of working class communities and that long-time residents were being forced out to accommodate a growing upper-class ("yuppie") population. Consequently a deep schism across class lines became a defining characteristic of the battle over the West End.

4. Election Day 2003

On July 21, 2003, the Lakewood City Council voted to place the referendum about the West End redevelopment project on the ballot for the November 4, 2003 general election. On Election Day, 15,000 citizens

voted, and Mayor Cain lost by 1,134 votes. Issue 48 (the petition to require voter approval of future development projects) lost by 608 votes. Issue 47 (the petition calling for voter approval of the West End development project) initially was too close to call—8,252 against Issue 47 (50.14 percent) vs. 8,205 (49.86 percent) in favor, a difference of only 47 votes. The results triggered an automatic recount, and on December 4, 2003, Issue 47 ultimately was defeated. On March 2, 2004, Lakewood residents overwhelmingly voted to remove the West End's blight designation.[33]

5. The Fallout/ Practical Outcome

The experience in Lakewood has led to many newspaper reports and other media accounts focusing on eminent domain abuse across the United States. The Committee for Lakewood was credited with executing a grassroots campaign that won the hearts and minds of a majority of Lakewood voters in less than six months. In addition, the Committee's success in getting the blight designation removed in March 2004 was also seen as a major victory for the opposition. Many of the opposed homeowners also credited the early work of the Institute for Justice with getting the opposition ball rolling, ultimately leading to a public outcry over the plan. Today Lakewood is cited as an example of how a grassroots effort can succeed in the fight against eminent domain abuse.

Where Do We Go From Here?

While it is impossible to predict what the U.S. Supreme Court might decide in the *Kelo* case and related cases, the following list of arguments describes some avenues that the court could take to reaffirm the eminent domain power as a vital tool for needed community redevelopment while at the same time articulating some guiding principles to minimize the potential for abuse:

1. The court specifically could uphold the exercise of the eminent domain power for economic development as a valid public use under the federal constitution.

2. The court could recognize that governments need flexibility to enter into public-private partnerships to accomplish certain legitimate goals, such as economic development. Government itself is not in the "business of economic development" but, rather, more appropriately provides a regulatory climate to enable economic development to occur, and the use of the eminent domain power is one tool that governments have to help create this climate.

3. When government enters into public-private agreements, they do not unconstitutionally delegate their eminent domain powers to a private

enterprise where government retains control over the approval and adoption of the redevelopment plan and where contracts/agreements memorialize how the plan will be implemented. There are numerous examples of public-private partnerships/privatization across the country, and it has been settled that these are not illegal delegations of government authority to private entities.

4. Partnering with the profit-driven private sector will actually benefit the municipal goals of successful implementation of redevelopment plans. When this occurs, the public as a whole benefits.

5. Limitations on the use of eminent domain are best left to the states, and a number of states already are addressing their own concerns through statutory reform. For example, legislative proposals introduced recently in Arizona and California have sought to prohibit or restrict the authority of local governments to sell condemned property to local developers, and in Maryland, the legislature created a Task Force on Business Owner Compensation in Condemnation Proceedings to, among other things, examine the circumstances in which condemnation can be used.

6. Require that the government have a duly adopted economic development plan for the subject area demonstrating the public purpose of the use of eminent domain powers and indicating the continuing public use of the subject property. While government should not be required to prove that these plans, when adopted, will guarantee the anticipated results, the development of these plans with full citizen participation and a competitive selection of the key private sector partner(s) will further the likelihood of success.

7. By adopting an ad hoc factual inquiry to determine the validity of the economic development plan in furtherance of the Public Use Clause, the *Kelo* majority correctly asserts that "judicial oversight over the ultimate public use question does much to quell the opportunity for abuse of the eminent domain power."

Conclusion

The outcome of the *Kelo* case undoubtedly will have a profound impact on municipalities and their interactions with private business and real estate sectors, as well as municipal finance.[34] Given the facts of the case and the absence of evidence of abuse, the U.S. Supreme Court is unlikely to overturn the Connecticut Supreme Court decision below.[35] The court probably will apply the ad hoc factual inquiry approach that it has adopted in regulatory takings cases to determine when the exercise of eminent domain powers has stretched the limits of the Fifth Amendment too far.

Endnotes

Editor's Note: These notes have been greatly abbreviated from the original legal citation format. A fully cited version, containing the full text with the endnotes in historical citation format, is available from AIER upon request.

[1] Patricia E. Salkin is Associate Dean and Director of the Government Law Center of Albany Law School. Dean Salkin gratefully acknowledges the research assistance of Albany Law School students Michael Donohue, Allyson Phillips, Alejandra Rosario, and Stacey Stump.

[2] "[N]or shall private property be taken for public use without just compensation." Fifth Amendment, U.S. Constitution (1791). *See*, Edward J. Sullivan and Nicholas Cropp, "Sources of 'Public Use' Limitations – Takings or Due Process?" *Zoning and Planning Law Report*, vol. 27, no. 8 (September 2004), p. 1.

[3] Connecticut, Kansas, Maryland, Michigan, Minnesota, New York, and North Dakota. According to the Institute for Justice, there have been more than 10,000 filed or threatened condemnations involving transfers of property from one private owner to another in 41 states between 1998 and 2002. Dana Berliner, Institute for Justice, *Public Power Private Gain,*1-2, at http://www.castlecoalition.org/report/.

[4] Arkansas, Florida, Illinois, Kentucky, Maine, Montana, South Carolina, and Washington.

[5] *Kelo et al. v. City of New London*, 04-108. (Oral argument was held February 22, 2005; the U.S. Supreme Court had not decided the case at this writing. – Editor.)

[6] The *Hathcock* court overturned *Poletown Neighborhood Council v. City of Detroit* (1981), discussed in detail below.

[7] The American Planning Association's (APA's) Policy Guide on Public Redevelopment explains, "Public agencies believe that these partnerships present the most legitimate, effective and successful practices of implementing public objectives, public purposes, and public benefits." *See*, http://www.planning.org/policyguides/redevelopment.htm (cited hereafter as "APA Policy Guide [2004]").

[8] In fact, scholars point to the fact that there is no precise or fixed definition within the context of eminent domain. *See*, P. Nichols, *Eminent Domain*, 3rd ed., J. Sackman, ed., vol. 2A (rev. 2003), sec. 7.02[1], pp. 7-24, as cited in *Kelo v City of New London* (dissenting opinion).

[9] *Berman v. Parker*, a 1954 case holding that condemnation was permis-

sible in order to revitalize a blighted area in Washington DC. The court in *Berman* noted, pp. 33-34, "The public end may be as well or better served through an agency of private enterprise than through a department of government — or so the Congress might conclude. We cannot say that public ownership is the sole method of promoting the public purposes of community redevelopment projects."

[10] *Poletown Neighborhood Council v. City of Detroit* (1981).

[11] *Hawaii Housing Authority v. Midkiff*, a 1984 case holding that condemnation was necessary in order to remedy the evils of concentrated property ownership in Hawaii. In this case, the court stated, "[W]here the exercise of the eminent domain power is rationally related to a conceivable public purpose, [this] Court has never held a compensated taking to be proscribed by the Public Use Clause."

[12] For example, according to one leading treatise, many courts have construed the Public Use Clause broadly to include actions that further the public good or general welfare. *See*, Nichols, vol. 2A (2003), at secs. 7.01[1] and 7.02[3], note 8 above.

[13] The dissent in the *Kelo* case, note 5 above, notes that "under this more expansive interpretation of the term, the United States Supreme Court has held that the scope of eminent domain is 'coterminous with the scope of the sovereign's police powers.'"

[14] Paul Kengor, "Pennsylvania: The Privatization State; [Governor] Ed Rendell Is Uniquely Placed To Bring About The Most Important Reform," Pittsburgh Post-Gazette, January 17, 2003, at A15. *See, however*, Martha Minow, "Public Values in an Era of Privatization: Public and Private Partnerships: Accounting for the New Religion," *Harvard Law Review*, vol. 116 (2003), p. 1229, who cautions that these agreements may lead to the diminution of public accountability for services.

[15] The bulleted list contains examples of privatized services described in E.S. Savas, "Privatization and The New Public Management," *Fordham Urban Law Journal*, vol. 28 (2001), p. 1731.

[16] APA Policy Guide (2004), note 7 above, ratified by the APA's Board of Directors, April 25, 2004. The policy statement was precipitated by, among other things, the increasing complexity of redevelopment that now requires a large and complex team of financing specialists, underwriters, fiscal analysts, and others; the opportunity to redress issues of environmental justice; a desire to avoid abuse and the perception of abuse of process; and a desire to promote effective planning for redevelopment.

[17] *Kelo* (Sup. Ct. 2004); *see* note 5 above. The significance of this case is

underscored by the fact that it is the first eminent domain case in fifty years that the U.S. Supreme Court has decided to hear.

[18] The city stated that there would be between 518 and 867 construction jobs, 718 and 1362 direct jobs, and 500 and 940 indirect jobs. The court later noted that the plan would generate hundreds of construction jobs, approximately 1,000 direct jobs and hundreds of indirect jobs, commenting how significant this was for a city that, not counting those employed by Pfizer, only employs about 2,000 people. The city's unemployment rate is close to double the rate of the rest of the state.

[19] The city stated that property tax revenues were expected to rise between $680,544 and $1,249,843. This represents a significant increase for an area that currently produces about $325,000 in property taxes.

[20] These jobs were lost when the U.S. Naval Undersea Warfare Center closed and 1,000 jobs were transferred to Newport, Rhode Island.

[21] Specifically, sec. 8-186 provides, "[T]hat the economic welfare of the state depends upon continued growth of industry and business within the state; that the acquisition and improvement of unified land and water areas and vacated commercial plants to meet the needs of industry and business should be in accordance with local, regional and state planning objectives; that such acquisition and improvement often cannot be accomplished through the ordinary operations of private enterprise at competitive rates of progress and economies of cost; that permitting and assisting municipalities to acquire and improve unified land and water areas and to acquire and improve or demolish vacated commercial plants for industrial and business purposes . . . are public uses and purposes for which public moneys may be expended; and that the necessity in the public interest for the provisions of this chapter is hereby declared as a matter of legislative determination."

[22] The court cited a laundry list of holdings in other states' courts that essentially support the outcome in *Kelo*, e.g., *Oakland v. Oakland Raiders* (CA 1982) (a city can take a professional football franchise by eminent domain to keep it from moving to another city; the case was remanded for a determination of the public benefit involved); *Shreveport v. Chanse Gas Corp*. (LA 2001) (economic development in the form of a convention center and headquarters hotel satisfies public purpose and public necessity requirements of the Louisiana constitution); *Prince George's County v. Collington Crossroads, Inc.* (MD 1975) (condemnation for an industrial park where the plan is reasonably designed to benefit the general public by significantly enhancing economic growth, is a public use); *Poletown* (MI 1981), note 6 above; *Duluth v. State* (MN 1986) (construction of a large

privately operated paper mill that would alleviate unemployment and contribute to local economic revitalization was a valid public purpose); *Kansas City v. Hon* (MO 1998) (airport expansion is a valid public use where the land is transferred to a private aviation corporation); *Vitucci v. New York City School Construction Authority* (NY 2001) (where a municipality determines that a new business may create jobs, provide infrastructure, and stimulate the local economy, these are all legitimate public purposes that justify the use of eminent domain); and *Jamestown v. Leevers* (ND 1996) (acquisition of non-blighted property for the purpose of stimulating commercial growth and economic stagnation satisfies the public use and purpose requirement of the constitution). The court distinguished as irrelevant cases from Arkansas, Florida, Kentucky, Maine, New Hampshire, South Carolina, and Washington that maintained that economic development alone might not be enough to demonstrate a public use for eminent domain purposes.

[23] According to expert testimony at trial, it was asserted that the project would create 30,000 jobs and add $350 million in tax revenues for the county.

[24] "Private property shall not be taken for public use without just compensation therefor being first made or secured in a manner prescribed by law." Michigan Constitution, Article 10, sec. 2 (1963).

[25] The defendants (property owners) cited the facts that the county needed a special exclusion from the FAA to use the land for the project, that environmental issues had to be reviewed, and that a local district financing authority, along with a tax increment finance plan, had to be established and implemented.

[26] In overturning this significant precedent, the court said, "[B]ecause *Poletown* itself was such a radical departure from fundamental constitutional principles and over a century of this Court's eminent domain jurisprudence leading up to the 1963 Constitution, we must overrule *Poletown* in order to vindicate our Constitution, protect the people's property rights, and preserve the legitimacy of the judicial branch as the expositor — not creator—of fundamental law." Two of the judges in their concurring opinions indicated that they would apply this ruling only prospectively and not retroactively.

[27] Economic Development Futures Web Journal, "Lakewood, Ohio: Struggle to Get Land for Development" (October 20, 2003), at http://www.doniannone.com/edfutures/2003/10/lakewood -ohio-struggles-to-get-land.html.

[28] Jen Melby, *Eminent Domain Abuse in Lakewood*, Buckeye Institute (Sept. 30, 2003) at http://www.buckeyeinstitute.org/Articles/

2003_09_30Melby.html (stating that is the city motto).

[29] Institute for Justice, "Ohio's 'City of Homes' Faces Wrecking Ball of Eminent Domain Abuse," *Litigation Backgrounder*, at http://www.ij/media/private_property/ohio/bzckground.shtml (quoting former mayor Madeline Cain), from V. David Sartin, "West End Deal Going to Lakewood Council," The Plain Dealer (Cleveland), April 21, 2003, at B1.

[30] A 60 Minutes Special Report, "Eminent Domain" (broadcast September 28, 2003).

[31] The Washington, DC, based Institute for Justice is a nonprofit, public interest law firm (www.ij.org) that routinely engages in litigation opposing the perceived abuse of eminent domain for the benefit of private parties. The Institute has created The Castle Coalition (www.castlecoalition.org) to provide a central bank of information that helps activists connect with each other in fighting eminent domain.

[32] Blaine Harden, "In Ohio, a Test for Eminent Domain," Washington Post, June 22, 2003, at A03.

[33] Committee for Lakewood, "We Won," at http://www.forlakewood.org/index.html.

[34] *See*, Matthew Vadum, "An Eminent Concern?: Case Could Change Redevelopment Landscape," *The Bond Buyer* online (October 1, 2004), available at www.bondbuyer.com: "The case . . . is of interest to cash-strapped localities that want to condemn land in order to clear the way for redevelopment projects that promise jobs and increase revenues. It is also of interest to the municipal bond market because municipal debt is often used in redevelopment financing packages, so any narrowing of the criteria used in eminent domain cases could have an impact on that market."

[35] See note 5 above.

COMMENTARY

Bert Gall[1]

Introduction

Walker Todd: Finally, we have a caller on the speaker phone, Bert Gall, who is a staff attorney with the Institute for Justice, Washington, DC, which, as Professor Salkin characterized it, litigates eminent domain cases for the property owners, but it also does much more than that and organizes grass-roots campaigns.

Bert Gall: Thank you. I apologize that I couldn't be with you in person today. I'm actually embroiled in some more eminent domain litigation in Ohio, this time in Cincinnati, where the same developer who was behind the West End Project in Lakewood, outside Cleveland, is trying to do something very similar in Cincinnati. So, I'm working on that right now with a flurry of motions. But I do want to talk with you today about Lakewood and eminent domain generally, particularly the concept of public use.

Before I started working with the Institute for Justice (IJ), I did general commercial litigation and had pretty much a layman's understanding of eminent domain. I thought it was for bridges, roads, a jail, a police station, things of that nature, but then in 1998, I heard about a case that IJ had taken up. I wasn't working with IJ at that time.

Eminent Domain on the Boardwalk

That case involved a situation where a certain casino owner (let us call him Mr. T) wanted to build a parking garage for his high rollers in Atlantic City, and he thought that was a public use, lining his pockets. So, in order to do this, Mr. T was going to get Atlantic City to condemn a woman's home (let us call her Ms. X), plus the owners of some stores. I just thought this was particularly outrageous. I mean, here was an example of corporate welfare at its lowest. Here was Mr. T, trying to coerce these people out of their homes and businesses, and the fact that the power of government was being used for this was particularly offensive to me. That case led to my interest in eminent domain and property rights work generally, particularly situations where the eminent domain power is used to transfer property from one private owner to another. Now thankfully, in that case, there was a Hollywood ending. Mr. T lost. For him, it was like being fired. Ms. X and the store owners got to keep their places, and they are still there to this very day. They are proof, just as the Lakewood case is, that you can fight city hall and that you can win.

Public Use vs. Private Use, and the "Despotic Power"

Basically, the Lakewood outcome and the *Kelo v. City of New Lon-*

don case, which IJ also is litigating, are really good illustrations of the key issues for determining what public use actually means. If public use can be expanded so far as to mean that economic development is a public good, standing alone, then we essentially have drained the public use requirement of any real meaning. We might as well put an eraser to the Constitution and write the words "private use" instead of "public use."

As early as 1795, in the case of *Vanhorne's Lessee v. Dorrance*, the U.S. Supreme Court referred to eminent domain as the "despotic power." The Supreme Court of that time recognized that the ability to remove someone from his home was a big deal! It is a very traumatic event and something that should not be undertaken lightly. For that reason you have the Public Use Clause, which limits the government's power to remove a property owner only in certain situations. Of course, that's what the present debate is all about, "What are those situations?" Until the Supreme Court case of *Berman v. Parker* (1954), although there might have been some deviations here and there, courts generally had the understanding that public use was something that the public would literally own and use, like a road or a bridge, a jail, something along those lines. But *Berman v. Parker* involved a portion of the southwestern District of Columbia that was literally a slum. The disease rates, the mortality rates, I don't think I'm exaggerating here, were ten times as high as everywhere else. It looked bombed out, it was awful. The land was going to be transferred from the owners to private developers who would attempt to revitalize the area. You can judge for yourself how successful they were, but the Supreme Court, in that instance, said, "These slum conditions are so bad that the very act of removing them would constitute a public purpose."

Slippery Slope and Wiggle Room

You need to watch the magician's hands in that synopsis of the *Berman* case because all of a sudden, instead of talking about public use, we're suddenly slipping into the realm of public purpose, and that's important because it leaves more wiggle room for municipalities. And wiggling is exactly what municipalities proceeded to do over the next 50 years, particularly with the amount of judicial deference that has been accorded to them. Municipalities moved not just from urban renewal projects where they'd be taking true slum properties, but into situations where areas began to be called "blighted," not as bad as slums but, they would argue, still pretty bad, and then they would move on to take areas that were not so bad. After that, they would take areas where there's really nothing wrong with them at all physically, but you begin to get into a pure economic develop-

ment taking, as with the *Kelo v. New London* case.

Lakewood, Ohio

The problem when you have these kinds of takings, when private property is transferred from one private party to another for private benefit, and of course it is always assumed that there's a trickle down effect so that what's good for the developer is a good fit for the community, is that you invite all sorts of abuse, and we at IJ see it all the time. For example, developers approach cities, just as happened in Lakewood, and say, "This is a really attractive area of town; it would be great if we could put up a Pottery Barn, a Crate and Barrel, and some luxury condominiums there because we need to attract young urban professionals ("yuppies") to the town to increase the tax base. You know that yuppies are attractive potential residents because they pay a lot of taxes, they don't have kids in school; that would be terrific. So, we want that land, and we need a reason to take it." Now, in *Kelo v. New London*, the city went ahead and said, "We can take the land purely for economic development." In the Lakewood case, they additionally needed to call the area blighted because that was what was required under Ohio law, to actually have blighted property so that its removal and replacement could constitute a valid public purpose.

This is where the Lakewood story almost becomes comical, because there was really nothing wrong with this neighborhood, and honestly, when the story first started, reporters would call me and say that they were in Lakewood and wanted to talk to the residents. They thought that they were in the right neighborhood, but nothing at all looked wrong with it, and was I sure that they were in the right place? They asked me this because the West End neighborhood looked just like the rest of the town, and I assured them that they were, indeed, in the right place, that this was a really nice middle- class neighborhood. The only sin of the people that lived there was that they lived right along the edge of the Rocky River and had a great view of it. If you built some high rise condominiums there, the people who lived there would have a view of the Rocky River and Lake Erie, so that was considered very desirable property by the developers. They wanted to clear-cut this neighborhood of about 60 homes and 12 small businesses and apartment buildings, just drive them all out, and replace them with hopefully more affluent residents and some upscale shopping. The tragicomedy part comes into play from what the redevelopment proponents said constitutes a blighted area and some of the blighting factors that were applied.

Now you should prepare yourselves for a parade of horribles: the blight was said to consist of things like, "Oh my goodness, many of the homes don't have three full bedrooms, they don't have two full bathrooms, they

don't have even a two-car attached garage, so that must mean that they are thoroughly unlivable." Well of course, the homes of the mayor and the city council members would have been blighted under such criteria, as well as the homes of most people who live in the City of Lakewood. The only thing that would have been worse here was if the developer had bought and paid for the redevelopment study himself. But he learned his lesson in Lakewood, and in the Cincinnati case that I'm going to describe for you, he actually did that: He bought and paid for the study to make sure that he got the conclusion that he wanted. He got the same conclusion that he wanted in Lakewood anyway, but that type of fact situation is exactly what happens in these cases.

I argue that the deference that courts have shown in many cases toward the more advanced interpretations of public use has, in many instances, amounted to complete and total abdication of judicial responsibility, but there is supposed to be a difference between deference and abdication. When the courts allow condemnations or takings to proceed almost as if there were no restraints on how municipalities can use the power of eminent domain, you're going to find situations like Lakewood, where it becomes clear that this was not a condemnation really undertaken to eliminate conditions of physical blight, but simply for the developer's benefit.

Certainly the City of Lakewood thought it was going to receive a lot of great benefits; in fact, municipalities always think that they're going to receive a great benefit, because the lower-income municipalities always are offered this promise. So, these new projects are going to generate increased tax dollars for them, they're going to create new jobs, and that's going to be great for them. Developers love the fact that eminent domain is going to be used, so much so that, at least when they are approaching the city, they will typically bypass the homeowners completely. They do this at least initially, in the planning stages, going directly to the city because they want to have the power of eminent domain as a threat lined up before they enter into negotiations. They want that power behind them so that property owners will not resist and also so that the price of acquisition can be driven down. That's why eminent domain for private benefit can be thought of really as a form of corporate welfare for developers. And of course, developers are happy to have access to tax-free financing, the cities are happy about that as well (it reduces costs), and also there are typically a number of tax subsidies and tax benefits that save the developer some money.

From the position of municipalities and the developers, cases like Lakewood are a win-win proposition. The only people whom public takings for private use leaves out are, of course, those who actually live in the neigh-

borhood. For example, one couple had lived in their home, which was paid for, for about 40 years. They had raised their family there, and they woke up one morning to find out in the newspaper, with no notice to them, that there was going to be a project sitting right on top of where they lived. Something was clearly wrong with the process if the system allows that kind of flaw to take place.

Stricter Scrutiny and a Division Among the States

The answer to all this, obviously, in my mind, is to take a stricter look at these kinds of private-to-private condemnations. Otherwise, we're going to continue to see more of these types of condemnations take place. At IJ, we did a study from the years 1998 through 2002 and found that, across the nation, there were over 10,000 examples in that five-year period of condemnations or threatened condemnations for the benefit of private parties. That's a lot! Unsurprisingly, condemnations happen the most for the benefit of private parties in those states where the courts probably have shown too much deference and where municipalities have really been pushing the envelope over time as to what constitutes an actual public use. The facts in *Kelo v. New London* do not involve blight and do not involve a traditional urban renewal concept. However, we hope that the Supreme Court would use *Kelo* to resolve a lot of the chaos (at least we hope so) in the state courts to clarify and obtain more understanding as to what is a public use, some baseline protection that would be available when you move across the country.

Just to give you an idea of what is happening at the state level in the use of eminent domain for economic development, in states like Connecticut, Kansas, Maryland, Minnesota, New York, and North Dakota, their courts have all said that economic development, pure economic development, is a public use. So, if cities want to take your land for that, tough luck. States that have taken the exact opposite approach include Arkansas, Florida, Illinois, Kentucky, Maine, Montana, South Carolina, and Washington, so how safe your home is and whether your home really is your castle depends on what part of the country that you actually live in.

Grass-Roots Solutions: The Lakewood Approach

I'd be glad to talk more about the Lakewood case, and people can certainly feel free to ask questions about that. That was a case where the community became so outraged by what was happening that they did mount a successful campaign to not only defeat the project but also to remove the blight designation from the affected area in the West End. What was telling, and I think what really resonated with people during this campaign, was the idea that if it could happen to those people, it could

happen to us. There is no reason why you or I couldn't be next if the only thing protecting us is our political power and influence, but that's not really something you want to rely on for protecting your home or protecting your constitutional rights. I think that this public belief was a driving force in overturning the planned outcome in Lakewood, and I think that instinct is correct, because if pure economic development is determined to be a legitimate public use, then no one's home or business is truly safe.

Everyone's home could generate more tax dollars if you turned it into a small business, and everyone's small business could generate more tax dollars if you turned it into a big-box store. So there really needs to be a revival of the original understanding of the Public Use Clause, not only to restore constitutional protections but also, frankly, to root out a major source of corruption in local and state politics. Armed with approval of economic development as a public use, governments can act as a real estate agent holding a loaded gun in the form of eminent domain. Such a situation doesn't seem tolerable, and a lot of IJ's clients have said over the years, "What is happening doesn't seem right to me. This doesn't seem like America to me."

As I said, I'd be glad to talk further about the Lakewood situation. Yes, the mayor was voted out of office as a result of the grass-roots resistance after a particularly bad appearance on "60 Minutes," where she couldn't quite explain why that particular set of homes was blighted and when faced with the fact that her own house could have been deemed blighted under the same standards. I litigated the Lakewood case while it was still in the courts and also was involved in a lot of the grass-roots efforts. Thankfully, in that case, there was a Hollywood ending, somewhat like what Joyce Anagnos described in the movie *The Castle*. Good people really can fight city hall and win. Thank you for having me here.

Walker Todd: I can allow a one-minute rebuttal or comment from either of you (Ms. Anagnos or Ms. Salkin), and then we shall only have time to take a few questions.

Rebuttal by Patricia Salkin

Patricia Salkin: This is my opinion and my opinion only. I think that the U.S. Supreme Court is going to say that economic development under certain circumstances is a valid public use. I think that the court will set some parameters, such as those used lately regarding regulatory takings. In those cases, the court really is not making any categorical moves and instead is saying, "We're going to look at the facts of each case as it comes before us, and we're going to figure out what is reasonable and what is striking out away from the center of the spectrum." This is the first time in

about 50 years that the U.S. Supreme Court has considered a big eminent domain case, so I don't see this as the last case going to the court. Rather, I see this as the door opening up to perhaps other cases coming down the pike.

And along those lines, I think it's important for the Court to address this notion of public/private partnerships because governments are acting so much in concert with private developers that they are becoming developers themselves. It is the same whether the developer goes to the government, like Mr. T in Atlantic City, or the government goes to the developer first. There are governments all across the country that would kill for any developer to have interest in their communities to help with redevelopment and reinvigorating their economies, so I think it cuts both ways. There are a lot of local governments that really need developers, and then many times development corporations do come in. Somehow, we have to figure out how that can go hand in hand with adequate protection of property rights. I think that the court is likely to allow that type of development as a valid public use.

If the court does go in the direction I am describing, then we need to begin a conversation about required parameters for such public/ private agreements and about planning with sufficient notification so that homeowners don't wake up and read about plans to take their houses in the newspaper one day. Some effective oversight also will be needed so that, if government is involved with private development corporations, there is an adequate paper trail of agreements and the government gets to reexamine the development plan, not in 20 years, but in 18 months or 24 months. We shall need to establish appropriate benchmarks so that government is not abdicating its responsibility for oversight of public use by just deeding the oversight as well as the land over to a private corporation.

All of these elements need to be in the mix so that a workable eminent domain regime emerges, with minimal abuses. I also think there are a lot of things in this mix that would be attractive to state governments, and I hope that the court also will leave much of the resolution to the states. There is a lot of active legislation now in state legislatures, task forces being created, bills being introduced, etc., to look at the private development as public use issue, and in many cases such matters would be better resolved at the state level. Also, along with the state supreme court majority in the *Kelo* case, I note that "judicial oversight over the ultimate public use question does much to limit the opportunity for abuse of the eminent domain power." This means that, although I wouldn't take away the eminent domain power for public use, I don't disagree that there are a lot of examples of abuse of that power around the country. However, there are more examples of

situations where it has not been abused, and that is what the courts are for, to have an appeal to the judiciary when the state and local government systems cannot resolve these matters themselves.

*Walker Todd:*Mr. Gall, do you want to respond briefly?

Bert Gall: Sure, I'll comment very briefly on that.

*Walker Todd:*Also, do you think that what Ms. Salkin has described is how the U.S. Supreme Court will decide the *Kelo* case and related cases?

Response by Bert Gall

Bert Gall: Although I don't want to end up like the exit polls in the recent presidential election, which mispredicted the probable outcome, what I will say is that, to the extent that I can predict it, I do think that the Supreme Court is going to offer some real guidance on the private development as public use issue and that it will offer some set of standards. But I don't know what those standards are going to be for finding an actual public use when there is a private-to-private transfer. It would be nice to see more objective criteria laid out by the court.

I think the court's real concern will be making sure that the Public Use Clause is not drained of any actual meaning, and the more subjective the test is, the more dangerous a situation that is. Frankly, under the Connecticut Supreme Court's reasoning, only the most incompetent of city officials and development authorities couldn't pass the test as it was laid out by the *Kelo* majority, because all you have to do is to say that there will be some economic improvement going forward. It is just as easy as passing the "any rational basis" test in a lot of cases. I think that the court is going to raise the current standard, at least we at IJ hope that it will, and provide some really objective teeth in its ruling. The court should provide a way for lower courts to engage in effective oversight and review in this area. Higher standards of review are needed because, as of now, at least from the Connecticut Supreme Court's perspective, its review in the *Kelo* case was really just a rubber stamp, no matter what that court's majority may have said to the contrary.

Walker Todd: Bert, thank you. We've been going here for a day and a half, and we're wrapping up now, but we appreciate your calling in, and we appreciate everybody who attended and participated, and we thank you.

Endnotes

[1] Mr. Gall is a staff attorney at the Institute for Justice, Washington, DC (IJ), which has played a prominent role in challenging the expansion of the power of eminent domain to include governmental takings for private use.

Mr. Gall participated in this panel by telephone. He listened to both of the presentations by Anagnos and Salkin in full and then made the following remarks. Mr. Gall's colleague at IJ, Scott Bullock, is the lead attorney in the *Kelo v. City of New London* case. Subsequent to the conference, oral argument in that case was held before the U.S. Supreme Court on February 22, 2005. The court had not decided the case as of this writing. The IJ also represented the homeowners in the City of Lakewood, Ohio, case.—Editor

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