

This Property Right Condemned

The Supreme Court's decision allowing government to take private property for the purpose of economic development is the latest in a series of rulings over the past half century that have undermined property rights. In the words of dissenting Justice Thomas, "something has gone seriously awry with this Court's interpretation of the Constitution."

"Government has no other end but the preservation of property." These are the words of John Locke, the 17th century English philosopher whose views greatly influenced the Founding Fathers. The belief that strong property rights are an essential component of liberty, and that a representative government therefore has a duty to preserve them, is embodied in the Fifth Amendment of the Constitution, which reads in part:

nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb, nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; *nor shall private property be taken for public use, without just compensation.* (Emphasis added.)

The last clause, known as the "Takings Clause," was at issue in the Supreme Court's recent decision concerning eminent domain. The case involved an effort by the city of New London, Connecticut, to seize the property of homeowners without their consent (but with compensation) in order to use the land for an economic development project. City planners claimed that the economic benefits, such as more jobs and increased tax revenue, would be enjoyed by the whole community, and therefore the property was being taken for a valid "public use." One of the homeowners fighting the plan is an 87-year-old woman who has lived in the house since she was born, and whose home has been in the family for over 100 years.

The Court ruled against her and the other homeowners, saying that the city's plan for economic development did indeed qualify as a "public use." The ruling has been almost universally denounced; the only people who seem pleased with it

are city planners, real estate developers, and their lawyers. It has upset not only property rights advocates but Americans across the political spectrum, who were surprised and unsettled to learn that the Constitution apparently provides far less protection than they thought against Big Brother taking their homes away.

It may be an even greater surprise to learn that this lack of protection is nothing new. The Supreme Court's decision did not represent a sudden break with its past rulings. The general public may not have been aware of it, but property rights have been eroding for decades. The government has been allowed to take property for the purpose of economic development since the 1950s, and when the Supreme Court has heard a case in the past 50 years involving eminent domain, it has usually ruled in favor of giving the government more power to use it.

A Slippery Slope

The Constitution has never provided absolute protection against the power of the government to take private land. The Supreme Court long ago permitted it to use the power of eminent domain to provide public roads, bridge, buildings, and parks. The common characteristic here is that when the land is put to its new "public use," it is open to the public, it directly serves the public, and it is usually owned by the government. Governments have also been allowed to seize property from one private owner and transfer it to another private owner, but only under limited circumstances, as when land was given to railroad owners in the 19th century. The reasoning was that even though the railroads were privately owned, the entire community used and benefited from them.

The Supreme Court gradually broad-

ened the scope of what constitutes a "public use" in the 19th and early 20th centuries. It ruled that land could be taken even if the general public would not directly use the property, as long as its new use still served the public. For example, in 1896 the Court allowed a local government to condemn private land in order to build an irrigation ditch. In another case that year, it allowed Congress to condemn private land in order to build battlefield memorials at Gettysburg. (For more on these and other historical examples, see the full text of the Court's recent ruling, especially the dissents by Justices O'Connor and Thomas. It is available online at <http://caselaw.lp.findlaw.com>, under "*Kelo v. New London*.")

The Court's modern reading of the Takings Clause, giving government drastically wider latitude to use the power of eminent domain, dates to 1954, when it first ruled that "economic development" qualifies as a valid "public use." The case, *Berman v. Parker*, involved a plan to redevelop a blighted area in Washington, D.C., by condemning the existing buildings and replacing them with new roads, schools, and low-cost housing. The Berman case involved slum housing whose terrible condition could arguably be construed as harmful to the general public. As Justice Douglas wrote in his opinion upholding that condemnation, "The misery of housing may despoil a community as an open sewer despoils a river." Removing such blighted conditions, the Court said, benefited the entire community.

That decision opened the door to thousands of similar attempts around the country to take land from private owners in order to "improve" communities. The Court left it to communities and their legislators to decide what constitutes an "improvement"—and over time the concept became ever broader. State and local governments began condemning property that was not genuinely blighted, sometimes with the only "public use" being the vague promise of future economic benefits.

Increasingly, governments take land from private owner A and transfer it to private owner B in hopes that owner B will put the land to better economic use. According to a study by the Institute for

Justice, the public interest law firm that represented the homeowners in the recent Supreme Court case, from 1998 through 2002 there were over 10,000 examples of condemnations or threatened condemnations for the benefit of private parties.

(For more on the work of the Institute for Justice, see *Property Rights: The Essential Ingredient for Liberty and Progress*, AIER Economic Education Bulletin, May 2005. This book includes the proceedings of AIER's November 2004 conference on property rights, at which Bert Gall, a lawyer for the Institute for Justice, was one of the speakers. Scott Bullock, the attorney at the Institute for Justice who argued the recent Court case on behalf of the homeowners, is an alumnus of AIER's Summer Fellowship Program.)

"Economic development" is a dangerously vague concept that invites misuse and abuse. As we noted last fall, "when politicians, bureaucrats, and businessmen organize themselves in the name of 'economic development,' they receive almost universal applause; however, their activities typically serve to advance special interests rather than the general well-being of the communities they purport to serve." ("Economic Development: Boon or Boondoggle?," *Research Reports*, October 11, 2004.)

The Supreme Court says it is up to state governments to restrict the use of eminent domain (some have already done so). It also says that state-level judicial review of eminent domain cases should help prevent abuses. But this presumes that individuals threatened with the loss of their property have the means to pursue a legal fight. As Justice Thomas noted in his dissent:

"Any property may now be taken for the benefit of another private party, but the fallout from this decision will not be random. The beneficiaries are likely to be those citizens with disproportionate influence and power in the political process, including large corporations and development firms. As for the victims, the government now has license to transfer property from those with fewer resources to those with more. The Founders cannot have intended this perverse result."

Moreover, judicial review is no protection against property seizure if the state courts agree that the public will actually benefit (however this is defined) from taking the property. As Justice O'Connor wrote in her dissent, "[W]ho among us can say she already make the most productive or attractive possible use of her property? The specter of condemnation hangs over all property. Nothing is to prevent the State from replacing any Motel 6

with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory."

Thomas Jefferson once said, "The natural progress of things is for liberty to yield and for government to gain ground." There is no better evidence of this than the steady

erosion of private property rights over the past 50 years. One suspects Jefferson would not be surprised by the Supreme Court's latest ruling; surely he would also be disappointed if citizens did not loudly protest. □

Eminent Domain Abuse

A 2003 report by the Institute for Justice found widespread use by state and local governments of the power of eminent domain to benefit private parties, such as politically-connected corporations and individuals. Use varies by state:

"In terms of sheer numbers of condemnations for private parties, California, Kansas, Michigan, Maryland and Ohio lead the pack for most private use condemnations filed. Pennsylvania, Florida and New Jersey also have high numbers of threatened condemnations for the benefit of private parties. Detroit takes first place as the worst city in terms of condemning property for private parties, while Riviera Beach, Florida, San Jose, California, and Philadelphia have placed the greatest number of private owners under threat of condemnation for private parties. With the assistance of a state agency, New York City has become the site of some of the most egregious condemnations for private use. Some states stand out. From a legal standpoint, New York, Missouri, and Kansas are the worst states to live in for owners who hope to avoid condemnation for private parties, while Idaho, Montana, New Mexico, South Dakota and Wyoming appear to be the best. Those states, as well as Alaska, Delaware, Georgia, New Hampshire and Washington, D.C. have no reported uses of eminent domain for private parties. Certain other states, like Arkansas, Illinois, Kentucky, South Carolina and Washington also appear to have a legal climate disfavoring private condemnations, but enforcement is either spotty or unknown."

Examples cited in the report include cases where governments have:

- Destroyed a black middle-class neighborhood in Atlantic City (including the home of a woman who lived on a street named after her father) in order to build a tunnel to a casino;
- Removed a woman in her 80s from her home of 55 years for the claimed purpose of expanding a sewer plant, but Bremerton, Washington actually gave her former home to an auto dealership;
- Condemned a family's home in Florida so that the manager of a planned new golf course could live in it;
- Condemned small businesses for The New York Times and the New York Stock Exchange;
- Threatened to condemn a Walgreens in Cincinnati to build a Nordstrom; condemned a CVS to relocate Walgreens; and condemned several small businesses to relocate CVS. The Nordstrom was never built and became a parking lot;
- Begun condemning a bus company in Edison Township, New Jersey, for a Walgreens. The Township's consultant said the bus company was "unproductive and stagnant," but actually it transports the local schoolchildren;
- Planned to force the relocation of 500 low-income seniors in Aurora, Colorado, over the next 10 years;
- Condemned property in Boston to help the owner get rid of its tenants and condemned property in Knoxville, Tennessee to help the tenants get rid of their landlord;
- Labeled as blighted one-tenth of the geographical area of San Jose, occupied by one-third of its citizens, making all homes and businesses within the area susceptible to condemnation.

The report tracked only private condemnations that were reported in public sources. These are only the tip of the iceberg, because many more condemnations go unreported.

The entire report, *Public Power, Private Gain*, is available online at the Institute for Justice's website, www.ij.org and its related site, www.castlecoalition.org.

A CLOSER LOOK AT FOREIGN AID*

Official assistance to developing countries increased to a record \$78.6 billion in 2004. Although organizations such as the United Nations advocate increased assistance, evidence suggests that foreign aid does not contribute to greater democracy, better governance, or market liberalization in recipient countries.

Why provide foreign aid? For several reasons, some of which place as much weight on the donor's interests as the recipient's needs. Besides providing humanitarian support following a natural disaster such as the Indian Ocean tsunami, aid may be motivated by the donor's foreign policy objectives. For example, the U.S. provided \$1.8 billion in total economic and military assistance to Egypt and twice that amount to Israel in 2003, presumably to maintain stability in the region.

Aid may also be motivated by commercial concerns. Many donors grant aid conditional on the funds being used to purchase goods and services from firms in the donor country. According to a report published by the United Nations, the U.S. on average gave less than 25 percent of "untied aid" annually between 1995 and 1999. Critics claim that obligating recipients to buy Caterpillar and John Deere tractors or purchase anti-AIDS drugs from U.S. manufacturers instead of generics from elsewhere reduces the value of aid. Successful drives to untie assistance, however, are also likely to result in less aid.

Foreign aid may also be aimed at promoting economic growth in poor countries by cultivating the institutional policies and governance practices consistent with development. Aid relationships create opportunities for donor staff to offer policy advice, either informally or in the form of technical cooperation. Aid relationships are also likely to increase the exposure of government officials in developing countries to the importance of market liberalization and good governance for achieving greater economic growth. Moreover, detailed policy advice and technical assistance are often required to help apply this knowledge, *e.g.* in the case of legal and judicial reform.

The Evidence

Does aid help alleviate poverty and promote growth? Growing evidence suggests that it may have perverse effects on economic policy and public sector management. Well before the massive aid programs

of the 1960s took off, Milton Friedman argued that because most aid goes to governments, it tends "to strengthen the role of the government sector in general economic activity relative to the private sector." Aid is commonly used for patronage purposes, by subsidizing employment in the public sector, or in state-operated enterprises, as foreign aid can provide funds for government to undertake investments that might otherwise be made by private investors. In Tanzania, for example, large and rising aid levels in the 1970s and 1980s helped sustain large government subsidies to state-owned enterprises.

A number of recent academic studies seem to confirm Friedman's criticism. Economist Peter Boone found evidence suggesting that aid does not increase investment or benefit the poor as measured by human development indicators, such as life expectancy and infant mortality. It does, however, increase the size of government. Using a "rule of law" index from the International Country Risk Guide, Stephen Knack found that higher aid levels are associated with significantly larger declines in the security of property rights. In a separate study, Knack concluded that aid does not promote democracy, as measured by Freedom House and Polity democracy indexes.

Aid programs also fail to result in market-oriented institutional and policy reform. Economists Bernhard Boockmann and Axel Dreher find that the effects of World Bank and International Monetary Fund (IMF) aid on economic freedom are ambiguous. During the 1990s, however, the *number* of World Bank programs in a country was positively associated with ratings on several specific aspects of economic freedom, whereas the *amount* of World Bank credit was negatively associated with these same criteria. The two researchers could not link IMF programs to changes in structural, growth-oriented policies in recipient countries.

In a collaborative effort, Knack and I found that aid discourages policy reform for sound money and regulation and has little impact on other types of market liberalization. The evidence, however, suggests donors' attempts to influence policy have become more effective (or less counterproductive) over time. This trend may be the result of the U.S. and other donors'

aid policies during the Cold War being dominated by strategic considerations at the expense of market-liberalizing reforms—*e.g.*, corrupt regimes such as Mobutu's in Congo-Zaire were propped up by aid. The 1990s witnessed an increased donor emphasis on the quality of governance, including protection of property rights.

The traditional approach used by international financial institutions such as the World Bank and IMF is to make "structural adjustment loans" conditional on recipient countries changing their policies and institutions. The logic of "adjustment lending" is that recipient governments can use aid to compensate politically-powerful groups who would suffer, at least in the short run, from policy and institutional reforms. Aid in effect purchases their acquiescence to liberalizing reforms, increasing the likelihood that reform-minded governments will survive. On the other hand, such aid might help non-reforming governments survive, by reducing the cost of not reforming. By providing an alternative source of revenue, aid can relieve pressure on recipient governments to establish the efficient policies and institutions necessary for attracting private capital.

A consensus has emerged in recent years that conditionality of this type does not work. If countries have to be bribed to reform, they have every incentive to implement the reforms to the minimum extent necessary to gain release of funds, and then to reverse the reforms—with the possibility of promising these same reforms again in the future in exchange for additional aid. One frequently-cited example, from a 1997 study by Paul Collier, notes that "during a 15-year period, the Government of Kenya sold the same agricultural reform to the World Bank *four times*, each time reversing it after receipt of the aid." In another, the IMF and World Bank made 22 loans to Pakistan between 1970 and 1997 tied to budget deficit reductions, which repeatedly failed to materialize. Several recent World Bank and IMF studies have concluded that policy reform is driven primarily by domestic political economy considerations, and that conditionality is likely to be effective only in the early stages of reform, when it can bolster the position of reform advocates in government.

This suggests that the international financial institutions may have learned from some of their early mistakes with structural adjustment lending and conditionality. Researcher Tony Killick notes that ratings by the World Bank's Operations Evaluation Department show large increases in the percentage of adjustment

* This article is by Jac Heckelman, Associate Professor of Economics and McCulloch Family Fellow, Wake Forest University. He was an AIER Visiting Research Fellow in 2004.

loans with “satisfactory” or better outcomes for the 1990s, relative to those obtained in the 1980s.

Clear Goals Are Needed

The bulk of the evidence suggests skepticism is warranted concerning donors’ ability to foster substantial reforms. One difficulty, though, in accepting these assertions at face value is that aid is not distributed at random, so teasing out the actual effects of aid is not straightforward.

For example, the World Bank’s International Development Association (IDA) lends about \$7 billion per year to its poorest members on highly concessionary terms, with allocations based in large part on the Bank’s assessments of the quality of policies and public sector management already in place. The U.S. Millennium Challenge Account is similarly based on a system for assessing the policies and institutions of poor countries, with the aim of directing aid to governments that “rule justly, invest in their people, and encourage economic freedom.” Selectivity of this sort can increase the incentives of developing-country governments to implement market-oriented reforms, in order to increase their aid allocations.

On the other hand, there are likely many other cases where donors focus their aid on countries with poor or deteriorating policy environments, either as an inducement to reform, or as a response to humanitarian crises in poor-performing countries. These complications can hamper the estimation of aid effects. On balance, it is a matter of conjecture whether the net effect of all sources of bias would be positive or negative.

Conclusion

Although there may have been some improvement during the 1990s, the overall evidence on the impact of aid programs, on democracy, the quality of governance, and market liberalization suggests donors should have modest expectations regarding their influence over political and economic reforms in poorer countries.

It is important to keep in mind, however, that donors often have other objectives instead of, or in addition to, policy reform intended to stimulate private sector development. Education and health policy, for example, are not directly reflected in any index of market liberalization utilized in academic studies. Other policy objectives, including humanitarian, gender equity, environmental, and donors’ foreign policy goals, may also drive some aid programs. Donors may view such programs as successful even if they are counterproductive in generating market-friendly policy reforms. □

U.S. Economic and Military Assistance to the World
(1982-84 U.S. Dollars, Billions)



Source: USAID. Latest data, 2003.

As Jac Heckelman’s accompanying article notes, many billions have been spent on foreign aid over the past 40 years, often with perverse results.

Prior to the Foreign Assistance Act (1961), U.S. foreign aid programs mixed military, nonmilitary, and technical assistance. The Act reorganized U.S. assistance programs to focus on developing nations, and separated military from nonmilitary aid. Development assistance consisted of two programs: (1) a Development Loan Fund to “develop economic resources and increase productive capacities” (*i.e.*, capital infrastructure), and (2) a Development Grant Fund for “assisting the development of human resources through such means as programs of technical cooperation and development” in poor countries. Of the total \$19.9 billion in U.S. economic assistance provided in 2003, 99.9 percent was in the form of grants.

The United States remains the largest aid donor in dollar terms, accounting for close to one quarter of all Official Development Assistance. However, its assistance in relation to the size of its economy is 0.16 percent—ranking it next to last among the 22 member countries of the Organization for Economic Co-operation and Development’s (OECD) Development Assistance Committee. The United Nations has set a target for Official Development Assistance of 0.7 percent. To meet that goal, the U.S. would have to increase its foreign aid between four and five fold.

If Heckelman’s conclusion is right—*i.e.*, that aid fails to bring about reforms that promote growth and often perpetuate policies and governments that impede it—the U.S. should not only resist pressure from the United Nations to increase aid, but consider reducing current levels. Cutting aid to corrupt and poorly governed countries might actually lead to progress.

—Editor

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