AN ECONOMIC ANALYSIS OF TAKINGS

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CERTIFICATE

Certified that the dissertation entitled "***An Economic Analysis of Takings***" submitted by Ashish Kumar Jha of School of Social Sciences, Centre for Economic Studies and Planning, Jawaharlal Nehru University, New Delhi, in partial fulfillment of the requirements for the award of the degree of Master of Philosophy (M.Phil.) is an original work and has not submitted in part or full for any other degree or diploma in any other University in best of my knowledge. This may be placed before the examiners for evaluation for the award of the degree of Master of Philosophy in Economics.

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Dedicated to my parents

Sri Ram Chandra Jha

&

Smt. Vibha

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INTRODUCTION

"Taking" is constitutional law's expression for any sort of publicly inflicted private injury for which the constitution requires payment of compensation. For a particular activity to be classified as taking, the nature of that activity and its causation of private loss are not themselves disputed; and so a court assigned to differentiate among impacts which are and which are not takings is essentially engaged in deciding when the government may execute public programmes while leaving associated costs disproportionately concentrated upon one or a few persons (Michelman 1967).

Takings can take place in 3 ways, namely,

1) eminent domain
2) Tax
3) Police power

The Fifth Amendment of the US Constitution demands that the government needs to compensate the property owners whenever the property is taken through its power of eminent domain. However when the government takes the property through taxes or reduces the value of the property with the help of police power, it need not compensate.

Of the three concepts namely: ED, taxes and police power through which taking can be effected, ED needs elucidation as taking through taxes and police power are very obvious concepts.

ED is the legal right to acquire property by forced rather than by voluntary exchange. When the buyer seeking to acquire a property has the power of ED, he must attempt to negotiate a voluntary sale. But if the highest offer of the buyer is rejected then the buyer can obtain a forced sale at a price determined in a court of law. It will be apt to quote the practices in the US, where the use of ED is constrained by constitutional provisions. The constitutional provisions require that the private property only be taken for "public use" and only after payment of just compensation. Legislatures in the US have the right to grant ED power while the main role of the judiciary is to determine just compensation. This is because of the provisions of just compensation that the curtailment of private property rights under the ED is less than that inherent in the taxing and regulatory power of the government.

After providing a brief elucidation of ED, it is important to discuss the forms of takings so that even a modicum of ambiguity regarding the clarity of the concept is done away with. Generally people believe that takings come in two forms: Physical and Regulatory takings. The third form of taking i.e. Derivative takings hitherto neglected by many has been analysed by Bell[1] in great detail. All the three forms of takings named above are analytically distinct. This point will be clear after explaining the three concepts in detail. A physical taking occurs when the state seizes a property interest in order to put it to public use. In a regulatory taking, the state does not seize the property interest but regulates the use of property in a manner that unduly diminishes property values. A

[1] Bell, Abraham & Parchomovsky, Gideon (2001): "Takings Reassessed", Virginia Law Review

derivative taking is present whenever the taking diminishes the value of surrounding property. Derivative takings are peculiar in the sense that they resemble yet are distinct from their close cousins. For example, they are distinct from regulatory takings as they may arise as a result of physical takings. They resemble regulatory takings in that they reduce the value of property without physically appropriating it.

If derivative takings occur it must have been preceded by physical takings or regulatory takings. But physical takings or regulatory takings might appear alone. The reason why I have delineated even the smallest thing is that proper understanding of these basic concepts is necessary in order to delve into this topic.

The Rationale of Collective Action

The pertinent question that arises here is that what is the rationale for collective action? And what is the need for compensating people whose property has been taken? What social purposes are achieved when the government intervenes? Thus a plethora of questions come to our mind.

The prominent social purpose for which the government intervenes is certainly efficiency. Efficiency is nothing else but the augmentation of gross social product where it has been determined that a change in the use of certain resources will increase the net payoff to society as a whole (Michelman, 1967). The concept does not focus narrowly on the total social output of tangible economic goods; rather it aims for the maximisation of the total amount of welfare, of personal satisfaction where not all satisfaction is material. The very definition of the concept poses a problem. The problem is of comparing one person's level or quantum of satisfaction with another. But this is necessary in order to compare the social welfare situations which are nothing else but the sum of several individual welfare situations.

In order to overcome this difficulty, efficiency is applied to proposed changes in the employment of resources. A proposed change is efficient if after negotiated compensations have been promised by those who stand to gain from the proposal to those who stand to lose by it, the proposal can win unanimous approval (Michelman, 1967).

Next job is to judge the ethical rightness of efficient social measures. But before dwelling into this topic, it is an apt time to give answer to our first question i.e. why collective action should ever be necessary for the attainment of efficiency? Why it cannot be the case that the gainers and the losers interact directly or indirectly through the third parties. One can elucidate this fact with the help of an example. Suppose an efficient activity benefits gainers more than losers then gainers can make offers to the losers which will be sufficient to induce the losers to quit their objections. Conversely, if an inefficient change costs losers more than it benefits gainers, the losers can make an offer to the gainers which will induce the gainers to quit that proposal. This can also be elucidated with the help of an example. Suppose brick-making activity is taking place on a piece of land and the neighbours are affected in a way so that the cost to the neighbours is more than the gain to the brick-makers. The neighbours can offer a sum of money to the brick-maker, enough to desist that brick-maker from continuing that activity. If everything is fine with the argument that the winners and losers can interact themselves then clearly there is no need for the government to intervene. But everything is not fine with the argument and it makes lot of unrealistic assumptions i.e.

1) each person is both enabled and required to take account of all the costs or all missed opportunities for mutual benefit
2) voluntary arrangements for negotiation are possible.

By making these assumptions, one overlooks the difficulties associated with arranging human affairs. Moreover it is very difficult to make voluntary arrangements despite knowing the fact that it is very difficult due to inertia of people willing to make arrangements, the resource cost of bargaining and strategic concealment. Thus

it will be very difficult on the part of gainers and losers to negotiate over certain issues because of the reasons cited above.

Secondly, there are certain investments which are in the nature of public investment e.g. construction of dams, airports and highways etc. The public investments are non-rival and non-excludable in nature. These types of investments have the problem that the willingness to pay is concealed by the gainers of that project. For example if someone gains worth Rs 10 from a project, he might claim that he gains marginally from that project. Everybody who gains from these projects has a tendency not to pay and has a tendency to free ride on others. Thus the private players can't undertake these projects because of difficulty of making people pay for the benefits received from that project. The private players also can't resort to taxation as this is the power of the sovereign. Thus the role of government becomes very pivotal at this juncture. The above arguments will help elucidating the brick-making case. There can be two cases namely (a) the government intervenes and (b) the government does not intervene. Suppose the government intervenes then it asks the brick-maker to desist from that activity. In other words, the government regulates the brick-maker's activity. The justification given for all these is efficiency. Now if efficiency is the justification for government's intervention, it is obvious that the neighbours stand to gain more than the loss incurred by the brick maker. Consider the second situation where the government does not intervene or the government's measures are deemed unnecessary as neighbours can offer brick maker the amount sufficient to desist from brick making. In this case where the government does not intervene there might arise a situation where the neighbours have not offered any

amount to the brick maker to desist from that activity. Some people might perceive that since no transaction of these sorts has emerged, therefore this measure is efficient. Certainly the argument has a flaw. That is no transaction is not sufficient to say that the measure is efficient. There can be host of other factors. The failure to transact might have been because of the inability of the people concerned to reach a consensus or it may be because of the free riding problem i.e. the impulse of each neighbour to be secretive about his true preference because of his expectation that the others will bear the whole burden.

After dealing a lot with the need for collective action and efficiency as the prominent social purpose we are going to divert our attention to the ethical justification for efficiency. There seems to be no justification for enriching one person at the expense of another even though the gain to one is greater than the loss to the other. So what is the problem all about? The problem with the efficiency argument is that it does not take into consideration the actual payment of compensation. The definition requires only hypothetical willingness to pay and accept. Thus the result of an efficient change may be benefit to some at the expense of another, a result not so appealing to ethical sensibilities.

Thus clearly from ethical perspective, there is a case for competition. Moreover from ethical perspective the collective action should be conducted in such a way that once you have conducted it, no one should be hurt while some might benefit. So the claim for compensation comes because it will be unjust on the part of the government to enrich one at the cost of another. If we don't compensate the aggrieved party we would

be faced with ethical uneasiness about social action which makes somebody richer and concomitantly somebody poorer.

Those who complain about ethical uneasiness believe that compensation should be given to the aggrieved parties. There are others who believe over the life of society, burdens and benefits will cancel out and thus there is no need for compensation [in technical terms this is called logrolling]. Thus it is obvious that those who fret about ethical uneasiness and demand compensation don't believe in logrolling. Now, interestingly, in order to calculate compensation, one needs to trace all impacts (though remote, arguable or speculative) and valuation of all burdens. As a result not only the calculation part becomes immeasurable but in many cases the costs associated come out to be huge. Due to this in many cases even the efficient measures will be inefficient and will not be undertaken. Another problem is that it may be quite impractical in advance to identify all the losses or to predict the values which a compensation settlement would assign them. Also this measure will deter the social planner from undertaking even an efficient project. But undertaking of project is necessary for development. Thus begins an exploration of powerful reasons supporting at least distinct presumption in favour of compensation to the limits of feasibility, even where efficiency without cost sharing is acceptable unequivocally as a good thing.

The issue that becomes critical now is that what projects will be undertaken and who will estimate the efficiency of the proposed measures. Who will say whether it is just to take a measure? The legislators or a social planner are a clear no-no. This is due to the

quality of people who are no better than us. But then we have to find some criterion which does away with problem of the inability of outside observers to appraise the efficiency of proposed social measures. Michelman (1967) was able to explore one such criterion. He put it in the following words:

For if no justification is claimed for a collective increase in aggregate welfare, then the measure is not demonstrably justifiable unless either

a) It has received unanimous approval or else

b) A bonafide hearing has been afforded to all claims of resultant loss, and a genuine effort made to compensate whenever a claim is intrinsically or apparently honest.

Even after violation of the above mentioned two conditions, if a project is undertaken; then this is nothing else but an act of pure spoliation by the majority.

Before moving on to the next section, it is important to reiterate that so far we have answered the questions like rationale for collective action, need for compensation and for attainment of what social purposes the government intervenes.

Tests of Compensation and Theories of Property

In the previous chapter we saw that there were some contradictions between the prominent social purposes i.e. efficiency and ethics for which the government intervenes. From the efficiency point of view, any project which is efficient should be undertaken. The implicit assumption being that over the life of a society burden and benefit will cancel out and thus there is no need for compensation. If ethical justification is taken into consideration, then obviously compensation needs to be paid since it is unjust to make somebody better at the cost of another. But concomitant with this concept is the problem of estimating in advance all the losses and values which a compensation settlement would assign. Thus based on this principle even an efficient project will not be undertaken. Therefore the imperative of the time is to find out the middle path. This means that in some cases compensation needs to be paid while in other cases compensation need not be paid. But any authority can't decide on his/her own whims. Therefore a proper structure is needed to test the compensability issue. Historically, the judiciary has been reckoned as the authority to decide about the compensability issue. Examination of the judicial decisions on compensability issue that the following four factors have been used to test whether an occasion is compensable or not:

a) **Physical invasion**

b) **Diminution of value**

c) **Balancing social gains against private loss**

d) **Private fault and public benefit**

The discussion of all these four tests will show that none of these four tests reveals a sound and self-sufficient rule of decision. None of the tests is adequately discriminating and reliable. Then we will begin the search for theory building by discussing the concept of property. After discussing the theories we will be able to develop more or less self-sufficient and sound rules of decision. At this point we start with Physical invasion - one of the four tests to identify whether an occasion is compensable or not.

Physical Invasion

In modern times the courts never deny compensation for a physical takeover. The claims for compensation become a must whenever a space or a thing under private ownership is taken away permanently or used regularly by the government. Compensation is due even though the appropriation is physically trifling from the owner's point of view. Now let us define the meaning of "takings" of "property" in layman's terms. Property means a thing owned and "taking" suggests physical appropriation. Thus compensation is a must whenever the taking of property has occurred. Although there are cases where compensation is not given for physical occupation e.g. owners proposing certain changes in the use of land are denied permits unless they dedicate specified portions of their holdings to street, park or other public uses. Some people believe that it is the obligation of the government to pay just compensation when it acquires title. But then the government might act in a clever manner and can physically appropriate a piece of land without acquiring the title. Thus the obligation to pay compensation should not escape

simply because the government has not acquired the title. It is apt to cite one example at this juncture. Suppose person A has a piece of land. The government asks A not to erect any structure on that piece of land. The reason why it has said so is that government benefits from that piece of land. Clearly the government has taken the property consisting of such an easement and it can't escape obligation to pay compensation by saying that it has not acquired any title. The government clearly prevented Mr. A from erecting any structure on his land. Now consider some more interesting cases. Suppose military aircrafts invade my airspace. Clearly they destroy value of airspace to me. Can we say that the government has taken my property? If any private party would have done that then clearly this would have been held as a nuisance. An act of nuisance does not, of course, lie against the government unless there has been a waiver of sovereign immunity to tort liability. This means compensation is paid whenever property is taken by the government not for maintaining the nuisance. But even going by the previous statement it will mean that the government must pay what a straight forward purchase would have cost Moreover compensation awards under such circumstances are nominal only. Ex-ante, before the consensual easement of flight, the price reached out between the government and the landowner must be greater than the price of the land due to over flights. The just compensation amount is figured at the amount of market devaluation and not at hypothetical selling price. But this is a case of distribution and not the payment for the property the government received. This can also encourage the government to take the property by devaluing the property a priori.

After a thorough discussion of "physical invasion" as litmus, we come out with the following important shortcomings:

1) If the obligation for compensation is strictly concomitant with acquisition of title, then why compensation is provided in the flight nuisance cases and
2) Why claims for compensation will be so compelling for a government activity which causes no substantial economic harm.
3) Why flight nuisance cases are not given differential treatment.

In order to find solution to better litmus test, we move onto the diminution of value test.

Diminution of Value

In this case the compensability is dependent on the amount of harm inflicted on the claimant. This should not be misconstrued as large harms held compensable and small harms non-compensable. Rather the point is that amount/degree of harm is stated to be the discriminant of compensability. The magnitude of test does not hold sway in cases involving physical takeover or restriction on an activity due to nuisance. It can be used in the regulation against property uses and non-trespassory devaluation consequent on public development. A comparison of magnitude is intended in this test. It is expressed as the ratio of loss in the value of affected property and the pre-existing value of the affected property or income of the complainant. Thus in order to determine compensability one is expected to focus on the particular "thing" injuriously affected and to enquire what

proportion of its value is destroyed by the measure in question. If this proportion is so large as to approach totality, compensation is due, otherwise, not. But the difficulty with this approach is regarding the definition of the particular thing. Suppose person A owns a tract of unimproved land. Can we categorise land as one thing or is it several? Can we regard this piece of land geographically divided into more than one thing? Answer is yes, it can be. The government can't escape the obligation to compensate A on the ground that only a quarter of the value of thing has been destroyed. Thus even this rule is full of infirmities. Now let us move to the third rule:

Balancing social gains and private loss

In this rule, contemplated gain of the society and the harms to the individual or a class of individuals is calculated. A measure is deemed legitimate if individual losses are found to be outweighed by social gains. But the danger with principle is that it makes us believe that there are people in the society whose interests are not relevant while calculating society's interests. But this in contrast to the liberal, democratic ethos of the society. But then the question is that how can this test be made more intelligible?

To quote Michelman,

"This test can be rendered intelligible - on individualistic assumptions - only by supporting it to inquire whether, considering that some people will suffer losses from a proposed measure, the measure is yet efficient in the sense that other people's (not "society's") gains in some sense exceed or overshadow the admitted losses."

But implicit in the above mentioned line is the unstated ethical premise that th collective imposition of individual harm will be tolerated if they bring a net gain i aggregated welfare.

Balancing test can be restated by asking whether a distribution could be arrived a whereby,

$$[(\forall i \in N)(xR_i y) \wedge (\exists j \in N)(xP_j y)]$$

But this is nothing but Pareto Superiority concept. Clearly a collective action lackin such a potentiality is wrong because it is ethically unjust to make somebody better off a the cost of another. The problem with this measure is that although this measure tells u whether a measure is efficient or not but many a time it remains vague abou compensation. This can be elucidated with help of following example. Suppose there ar three individuals in the society namely A, B, and C. Now take the following tw possibilities:

Gains B + C > loss A [marginally]

And gains B + C > loss A [large amount]

Can somebody tell that in the first case, a measure can be justly enforced against A without compensating him? Thus even this rule does not give a proper answer to the compensability issue.

Private Fault and Public Benefit:

According to this rule, the compensation is due when the imposition of restrain on an activity from the government helps the public at large through the extraction of public good from private property. On the other hand the compensation is not required when the government asks a private party to restrain conduct which is harmful to others. Thus if somebody is asked by the government to stop making nuisance he is not paid compensation. But this method is not free from ambiguity because there is a difficulty involved in classifying a good which gives the benefit and a good which creates a nuisance. The good can sometimes be viewed as giving positive benefits and the same good can sometimes be viewed as a nuisance. This can be elucidated with the help of the following example. Suppose there is a regulation forbidding the erection of billboards along the highway. Now it can be viewed in two different ways. On one hand it can be perceived as one which prevents the harm of roadside blight and distraction. On the other hand it can be perceived as one securing benefits of safety and amenity. But if this is the case then there can be problems in deciding whether a regulation should be accompanied by compensation or not.

There seems to be another problem with this principle. The principle stipulates that if the imposition of restrain on an activity from the government prohibits a conduct which is harmful to others then compensation is not required. Now consider an interesting case. Person 'A' acquires an isolated tract of clay-rich land. When he acquires this piece of land, he believes that the piece of land will be profitably used for brick

work. Fortunately for A, after the acquisition of property, the value of his brick-making activity increases from time to time. In the meantime the city spreads and it is now seen that brick-maker's land is surrounded by residences and a serious incompatibility develops between the brick-maker and his neighbours. Now the government comes into picture and asks the brick-maker to stop brick-making. The pertinent question that arises is that why the government asks the brick-maker to stop his work for the betterment of the society. The brick-maker came at a time when nobody was around that tract of land. Now according to the rule private harm and public benefit, compensation cannot be provided since it is a prohibition against a nuisance case. But then the rule is not holistic. The uncompensated brick-maker is surely sacrificed in the interest of social amelioration. From the foregoing analysis we can say that the compensability can't depend upon a rule couched in terms of harms and benefits.

Till now we have surveyed four general "tests" and we have surely reached one conclusion i.e. none of the tests is adequately discriminating and reliable. Thus the hunt begins for a clear and convincing statement of purposes of the compensation practise. To begin the search for theory building we discuss the concept of property. After discussing the theories of property we will be able to develop more or less sound rules of decision. Another pertinent question that comes to our mind is that why out of blue we try to discuss the theory of property for settling compensation issues. This is so because the questions of compensation seem to presuppose the idea that an existing distribution should normally have a degree of permanence - an idea that seems bound up with the existence of "property". Thus we discuss the different theories of property namely:

1. "Desert" and "Personality" Theories
2. Social Functionary Theories
3. Utilitarian Theories

In the words of Michelman, a "desert" theory is one which justifies property by appeal to an ethical postulate about individual merit, asserting that property is desirable because under its regime individuals are able to keep what is due them.

Locke's celebrated theorem[2] of "labour theory" can be interpreted as a theory of desert. Locke's axiom, on such an interpretation, would be that whenever one mingles his effort with the raw stuff of the world, any resulting product ought - to - simply ought - to be his. Thus according to this, a producer's special claims on his product must have played some role in the development of our property institutions. This Lockean desert theory is of no value if compensation not paid every time property is devalued.

Personality theories assert that production and not consumption should be regarded as an end in itself. They regard property as an indispensable arrangement to meet this end.

After giving a brief description of desert and personality one must be interested to know what answers these theories provide to the compensability issues. Basically these theories don't provide any special key to the compensation problem. But these theories do tell us that if encroachment without compensation becomes the order of the day then

[2] J. Locke (Peardon ed. 1952),The Second Treatise Of Government, Chapter 5

the ideas of permanence, predictability and security will not evolve within individual minds. But this will in turn offend the values prized by these theories. Thus takings without compensation will threaten the very assumption of permanency and security which are necessary for production; which in a way is regarded as an end in itself by desert and personality theories. Thus these theories provide some answers to the compensation problem that production will be affected if compensation is not provided after takings.

Social Functionary Theories

These property theories depend on chiefly on ultimate values associated with consumption. The production is recognised as instrumental for attainment of subsistence, comfort and leisure. Aristotle, one of the proponents of this theory, believed that only an owner - an identified person with a clear power and responsibility - will be moved, whether by obligation or pride to bestow on resources the attention they require in the interest of fruitful production. In view of Christian fathers and their scholastic followers, private property is seen as a device to curb eternal dissention. Thus both believe that ownership of property provides the conducive environment for production and consumption. Locke opined that production beyond subsistence required saving, capital formation, investment and management which could not occur without ownership.

The pertinent question that arises here is that why it is called Social Functionary Theory. This is because the owner is viewed as a social functionary. The justification for

his ownership is his functional, not his personal merit. If the owner gets profit then he must share either through charity or through payment of higher wages to his workers. But if any excess amount is apportioned then why an owner will take an onus to produce. The answer given by the social functionary theorist is that the owner does this because he feels that order, pride, responsibility and management are his objective functions.

Even after delineating social functionary theories in detail it is not clear how or why a refusal to make compensation payments might raise peculiar risks of dissention or of undermining pride or ownership. So I don't think that this theory can be of much help in sorting out compensation issues.

Utilitarian Theories

David Hume was one of the greatest proponents of this school of thought. Hume posits men initially in an atomistic, non social situation. Gradually sexual attraction and natural affections among family members lead men into a first perception of the advantages of association. The wish to associate gradually transcends the family group. In the process of association, each person carries with himself a certain accumulation of possessions. But this does not imply any security of possessions since men associate due to selfishness. But if people trespass against one another's property, the tendency to associate will not last long. So people try to respect the boundaries drawn by one another which come out into an established set of rules. Thus property, according to Hume, is a conventionally recognised stability of possessions. Gradually the rules extend to other

resources. The brief description of Hume's approach does tell us why the concept of property emerges but it does not tell us why private property emerges. Why collectivisation of property does not become the order? The answer is that private property emerges because, starting with the assumption of atomism, the natural move will be towards simply stabilising the possessions of men entering into association. Collectivisation is a more complicated and less obvious solution. So Hume's theory does not certainly explain why collectivisation should be resisted. But one thing is clear from Hume's explanation that as long as individual possession continues to be the norm, there is serious disvalue in the spectacle of any encroachment on possession by public authority which is suggestive of exploitation.

Bentham was another proponent of this theory. Property, according to Bentham, is collection of rules which are presently accepted as governing the exploitation and enjoyment of resources. These rules, according to Bentham, are needed for minimum acceptable level of productivity. Bentham brings to fore the fact that human beings will not produce in the absence of secure expectations about future enjoyment of product. A new distribution is a disappointment to expectations. Once redistribution has been affected it becomes clear that people will not protest against future redistribution. Therefore in future, redistribution will also take place. People concerned about the insecurity of expectation decide not to produce. Thus productivity gets affected. Therefore we can see that collective decision making is deemed objectionable according to Utilitarian property theorists. It is due to this fact that we may be encouraged to derive from the theory some criteria for determining which collective allocation decisions

should be held impermissible unless those impacts are offset by compensation payments. Thus we can see that this theory has got direct relevance to the general compensation problem. However critiques allege that it can't be discriminatory among capricious redistribution cases i.e. it can't tell us in which cases to compensate and in which cases not to compensate. Though criticism has been levelled against these theorists, nevertheless the Utilitarian Theory does have a direct and obvious relevance to the general compensation problem.

Another important proponent of the utilitarian theory has been Frank Michelman. The utilitarian approach that Frank Michelman developed 40 years ago consisted of a hybrid of the Pareto and Kaldor-Hicks criteria. Michelman argued that a judge whose objective is to maximise welfare should resolve a takings issue by estimating and comparing the following economic impacts: namely - efficiency gains, settlement costs and demoralisation costs.

(i) Efficiency gains - excess of benefit produced by a measure over losses inflicted by it. Benefits are measured by total number of dollars which prospective gainers would be willing to pay to secure adoption, and losses are measured by the total number of dollars which prospective losers will insist on as the price for agreeing to adopt.

(ii) Settlement Cost - measured by the dollar value of time, effort and resources which will be required in order to reach compensation settlements adequate to avoid demoralisation costs.

(iii) Demoralisation cost - total of (a) dollar value necessary to offset disutilities which accrue to losers and their sympathisers specifically from the realisation that no compensation is offered and (b) the present capitalised dollar value of lost future production caused by demoralisation of uncompensated losers, their sympathisers and other observers disturbed by the thought that they themselves may be subjected to similar treatment on some other occasion.

After going through definitions of these three concepts it is quite obvious that efficiency gains do not take into consideration demoralisation costs or settlement costs. Demoralisation costs and settlement costs are concomitant without any capricious redistribution.

Once the judge has calculated these impacts, Michelman and Ackerman contended that her job is straightforward. If (i) is the smallest, the action should be enjoined. If (ii) is the smallest figure then she should not enjoin the action but should require that the parties hurt by it be compensated. If (iii) is the smallest figure, she should allow the government to proceed without compensating the victim.

Society will have to avoid not only those capricious redistributions which a compensation payment could easily offset but also those practically non-compensable ones which can't plausibly be said to be necessitated by the pursuit of efficiency. It must be remembered that as the collective allocation measure approaches the limit of doubtful efficiency the claim for compensation will become more compelling.

Till now we have dealt with Utilitarian stance towards efficiency, property and security. All these are needed for the critical study of actual compensation practices. But from this one should not conclude that the question of compensability is intelligible only when compensation is regarded as an instrument of utilitarian maximising. Compensability can also be viewed as question of justice. It becomes imperative to discuss whether a person might not claim compensation (or claim compensation) in the name of justice regardless of the consequences for efficiency. John Rawls' account of "justice as fairness" is very pertinent in this case. Rawls mentions the two fundamental principles in this regard. The first principle is a general presumption that social arrangements should accord no preferences to anyone, but should assure to each participant the maximum liberty consistent with a like liberty on the part of every other participant. The second principle defines a justification for departures from the first: an arrangement entailing differences in treatment is just, so long as (a) everyone has a chance to attain the positions to which differential treatments attach, and (b) the arrangement can reasonably be supposed to work out to the advantage of every participant, and especially the one to whom accrues the least advantageous treatment provided for by the arrangement in question.

Rawls' two principles can be applied by analogy to test the justice of a compensation practise. Analogous to the equal liberty principle one can concoct a rule which forbids all efficiency motivated social undertakings, which have the prima facie effect of impairing liberties unequally unless compensation payments are employed to equalise impacts.

Rawls' second principle though more complex than the first one can let us know whether a decision not to compensate is fair. This can be done by asking the following to the disappointed claimant:

(a) To appraise his treatment and calculate his advantage over a span of time and

(b) To view the particular decision in question as a specific manifestation of a general practise which will be applied consistently to situations involving other people.

The claimant's inability to extend his answers to either of these questions makes us believe that the treatment will be unacceptable to him even though it is fair. A fair arrangement is one which is best for whoever turns out to be worst off.

After a thorough elucidation of property rules in general and utilitarian concept in particular, it is apt to revisit our rules of decision which were previously inconclusive and which did not give any solution to the compensability problem.

Thus from the foregoing discussion we can say that the function of a compensation practise is to fulfil a strongly felt need to justify the general expectations of long-run evenness. If somebody feels that the need for compensation is a social interest in maximising production, then this is nothing but the utilitarian approach to compensation. If however the need for compensation is simply rooted in the condition of being a human person then justice or fairness is key to compensation.

Physical invasion

The factor of physical invasion had few problems, namely,

(I) Private losses otherwise indistinct from one another maybe classified for compensability purposes according to whether they are accompanied by physical invasion.

(II) This principle does not take into consideration a critically important variable - size of the private loss. This is so because in many instances purely nominal harms are automatically deemed compensable if accompanied by governmental occupation of private property.

Thus, both of these problems are now easier to understand. When a private property is taken by the government, it seems likely that the owner is sustaining a disproportionate share of cost of some social undertaking. There becomes no need to trace remote consequences in order to arrive at owner's loss. So if physical invasion is used as a discriminant of compensability then the settlement cost is brought down. This means that one does not need to measure dollar value of time, effort and resources to reach compensation amount in order to offset the demoralisation cost.

The pertinent question that arises now is that simply because physical invasion criterion brings down settlement cost, will it be right to say that it should satisfy the test of fairness. If somebody says so then the justification is really weak. Though physical invasion test brings down settlement costs, its capacity to distinguish between significant

and insignificant losses is too small. The Utilitarians will say that to use physical invasion as an index can bring arbitrariness. Due to this, this criterion is rejected, judged by the standards of absolute fairness.

Diminution of value

Diminution of value is nothing else but the ratio of the size of claimant's loss with the pre-existing value of that spatially defined piece of property to which loss in value seems to be specifically attached. It can now be suggested that judicial reliance on such comparisons reflects a utilitarian approach to compensability. The analysis in a utilitarian compensation program depends on a number of assumptions which, while not void of plausibility are surely debatable. The assumptions are:

1) That one thinks of himself not just as owning a total amount of wealth or income, but also as owning several discrete "things" whose destinies he controls;
2) That deprivation of one of these mentally circumscribed things is an event attended by pain of a specially acute or demoralizing kind, as compared with what one experiences in response to the different kinds of events consisting of a general decline in one's net worth; and
3) Those events of the especially painful kind can usually be identified by compensation tribunals with relative ease.

Of the three propositions, one can surely suspect the second proposition. The first and third seem true. Now once these propositions are accepted one can explain many cases of compensability or non-compensability with lucidness. But before this we need to consider few important cases.

a) Pennsylvania Coal Case: Justice Holmes who wrote for the court held that a restriction on the extraction of coal which effectively prevented the petitioner from exercising certain mining rights was a taking of property and so could be enforced only upon the payment of compensation. Holmes intimated that separation in ownership of the mining rights from the balance of the fee, prior to enactment of the restriction, was critically important to petitioner's victory.

b) United States vs. Twin City Power Company: Twin city decision held that, when riparian lands are taken by United States in connection with a river development project, just compensation does not include any element of value derived from the expropriated owner's actual or prospective exploitation of the flow of navigable waters. The reason given by the court was that because the "navigation servitude" of the United States gives it a paramount right at any time to divert or obstruct the flow of such waters, no one could form any valid expectation of the flow, and such an expectation, therefore could not give rise to any compensable value.

c) United States vs. Virginia Power Company: United States acquired a flowage easement over riparian lands which were already subservient to a flowage

easement acquired in the past by the respondent. The United States contended that no compensation was due to anyone. But the court held that the owner of the easement must be compensated for the value of the easement which was an amount the easement should have cost it.

After describing few important cases, it will be easy to explain why in some cases compensation was provided while in others it was not. The claimant in Pennsylvania Coal, which supposed itself to own mining interest before the incidence of regulation owned nothing of a consequence afterward. The claimant in Virginia Electric had owned a flowage right and now holds nothing, whereas the claimant in Twin City still had the valuable riparian land it began with.

Balancing

While discussing this topic in the earlier section we argued that even if the process of striking a balance between a claimant's losses and "society's" net gains would reveal the efficiency of the measure responsible for those losses and gains, it would be inconclusive as to compensability. After discussing the concept of fairness at great length and viewing compensation as a response to the demands of fairness we can now see that the balancing approach though certainly inconclusive is not entirely irrelevant to the compensability issue. The fairness demands that some persons should not be sacrificed for the society unless such action is unavoidable. Now take a situation where the society pursues a doubtfully efficient course and simultaneously refuses to pay compensation. Such a measure is clearly unfair. The balancing test does the same. The test is not aimed at

discovering whether a measure is efficient or not but whether the society takes into cognisance the sacrifices of few at the hands of many by compensating them whenever the measure taken is of doubtful efficiency.

Harm and Benefit

We concluded earlier that the harm-benefit distinction was illusory as long as efficiency was to be taken as the justifying purpose of collective measure. But now we have been treating the compensation problem as one growing out of a need to reconcile efficiency with fairness. In this scheme of things, harm-benefit distinction does have a relative use.

It should be noted that it is difficult to draw a sharp line of distinction between the two types of measures. This can be elucidated with the help of brick-making example. Suppose the brick-making is established at an isolated place where other activities are non-existent, visitors are seldom. The brick-maker does not do harm to anybody. Moreover brick-making is a worthy occupation. Gradually the city expands and engulfs the yard. Certainly brick-making activity is incompatible with the people residing nearby the brick-making yard. Now, the brick-maker is creating a nuisance or harming the neighbour. The rule says that the brick-maker should stop his activity and he should not be paid compensation. But this is clearly erratic. The implicit argument is that the brick-maker should have realised that one day city will expand and engulf the brick making activity.

The general notion has been that the nuisance curbing regulations don't generate claim for compensation. The compensation is dismissed by assuming that owner's claim is no more than a thief's or gambler's. But the fact is that one can't dismiss a claim for compensation in nuisance curbing regulations in some cases. Similarly the rule stipulates that compensation is due whenever the restrain on an activity from government helps public at large through the extraction of public good from the private property. Therefore if the government stops me from erecting any structure on my piece of land, it can't do without fully compensating me. But does it hold good for every case? Consider a case where a person buys a scenic piece of land along the highway during the height of public discussion about the possibility of forbidding all development of such land, and the market clearly reflects the awareness that the future restrictions are a significant possibility. Now if restrictions are ultimately adopted then does that person have a claim for compensation? Clearly the court will decree against the person's claim for compensation as it will be a weak claim. Thus from these two cases we are able to say it for a moment that the reconciliation of efficiency and fairness concept in harm and benefit principle can help us solve some illusory cases.

Before we complete this chapter, two things remain important. First is that if there is prior warning that the collective action may be taken on a piece of land then compensation is not needed if the piece of land has been acquired after prior warning. This is also not inconsistent with the Utilitarian regard for security. Second, is it manageable to distinguish cases in which prior warning is or is not present? Let us deal briefly about the first thing. Utilitarian Property theory, for all its emphasis on security of

expectations, easily allows that compensation need not be paid in respect of investments which, when they are made either (a) interrupt someone else's enjoyment of an economic good or (b) are of a sort which society had adequately had made known should not become the object of expectations of continuing enjoyment.

The second problem is the difficulty of deciding whether such a warning, if implicit, was or was not given. Regarding this an idea is that there is no need to compensate when social action interrupts or frustrates some mode of enjoyment of property which was always in conflict with the other people's expectation since the beginning. One can elucidate this point by taking an example. If the brick-maker purchases enough of surrounding land to buffer adjacent holdings from the impact of his brickwork then he is able to "internalise" the benefits and costs of his operation. Also any consequent devaluation of land will show up in the brick-maker's own profit-and-loss ledger. Since this reasonable course was open to the enterpriser at the time he committed himself to brick-making, his failure to follow it fairly exposes him to the risk of restrictive legislation later on.

The buffer zone argument can easily be challenged. In the previous paragraph only, we should have asked how much of the surrounding land the brick-maker can buy. Clearly as a precautionary measure, the brick-maker has to assume the worst - that the owners of adjacent land will prefer to use their land for residences. But moment it is done, the rule is not efficient. It will cost more to the brick-maker by buying extra pieces of land. Moreover it is nothing but the infringement of liberty.

The buffer zone argument can be countered in another way. Suppose the rule is that a certain area is to be used for brick-making. A person builds his home there. Then the question can easily be asked that's why it is not incumbent on the homebuilder to acquire a buffer zone - enough surrounding land to insulate him from the effects of any brickwork which the owner of the adjacent land may choose to build thereby internalising all consequences? It can be argued that one can't know whether one's neighbour has brickwork in mind. But this is true for the brick-maker also. So it is difficult to tell which if the activity is a nuisance. If somebody says that the brick-maker should have realised it in the very beginning or he should have calculated that it might be injurious to somebody else's expectations then this statement is similar to an eccentric situation where I pick a piece of gold lying in my path and people say that I have foreclosed them from taking gold. Clearly the argument will be very weak.

We have not been able to resolve the second issue totally. Nevertheless after elucidation of properly rules the tests of compensability which somehow seemed *illusory, prior* to the discussion of property theories, have become more reliable a test of compensability.

Just Compensation for takings

Under this topic, we are going to discuss the right amount of compensation for taking. The offer/ask disparity, also known as endowment effect, has been used to urge

compensation exceeding market value for takings of property by eminent domain. It is pertinent to define the two terms before we move any further. Offer means nothing but the wiliness to pay. Ask means the willingness to accept. Our purpose here is to argue few things like whether offer/ask disparity is related to the takings issue and whether it is right/just on the part of the government to compensate with the market value. In other words, what constitutes the just compensation in case of takings? Is market value the appropriate measure of "just compensation" when it is acknowledged that taking has occurred? The takings issue involves the question of payment of just compensation for the taking of private property for public use. Just compensation is required by the concluding words of the Fifth Amendment of the US Constitution. Most other countries, have acknowledged the obligation to compensate when property is taken (Garner, 1975; Ogus 1990).

Regarding the question whether the market value constitutes the "just compensation" in case of takings, several have argued that the offer/ask disparity makes market value too low a standard for just compensation (Knetsch 1983, Ellickson, 1989; Knetsch and Borcherding, 1979). Offer/ask disparity is well established in experimental economics subjects. Subjects require significantly greater cash compensation to surrender a specific entitlement in their possession. For a student of economics willingness to accept is nothing but equivalent variation and willingness to pay is compensating variation. It has been found in experimental economics that equivalent variation seems to be much greater than compensating variation. The large size of the disparity was first empirically established in laboratory experiments by economists Jack Knetsch and J.A

Sinden (1984). Experiments of Boyce et al (1992) have confirmed this result. Smith (1991) conceded the existence of offer/ask and related anomalies in one and two shot situations, but he described experimental evidence that the disparities grow progressively narrower as subjects gain more experience. Smith's line of defence can't be pursued as eminent domain typically involves episodic events. The pertinent question then is why market value constitutes the compensation amount despite knowing that it is not the appropriate measure of just compensation? This is because if a public project is undertaken then it is both a taking from landowner and, if compensation is paid, and a taking from the taxpayers who have to finance the landowner's compensation. Thus overcompensation of the landowner amounts to an unjustified taking from the taxpayer. The government's taking ledger must be balanced on both sides. Moreover asking prices are so hard to determine, it might be acceptable to use market prices.

Institutional arrangements for securing just compensation and the significance of public perceptions of the takings doctrine

What can be the institutional arrangement for securing just compensation? The moment we think of fairness as a standard against which to test political action, we contemplate of a body which has the task of assuring the fairness of political action. This apex body happens to be none other than the courts which can impose an extrinsic constraint on the non-fair political process. The judiciary solves the problem by promulgation of sound rules of decision. One can nonetheless challenge the attribution of pre-eminent responsibility to judiciary. This objection stems from the fact that the courts may find it too difficult to grasp fairness as a standard for judging a political decision. Though severe criticisms have been levelled against judiciary as apex body nevertheless it inculcates values among the public against the unjust encroachment of private property by the government by citing the sound reason and logic for a particular decision. Thus the court affects public perception. Thus we analyse in detail how courts affect public opinion.

The significance of Public Perceptions of the taking doctrine

In this chapter our aim is to seek answers to two questions, namely

a) Have the court's decisions affected public opinion regarding the vulnerability of private property to regulation or devaluation by the government? And

b) To what extent do the rulings draw upon or affect popular views regarding the protections that private property should enjoy?

Both the questions deal about how the public apprehends and reacts to the Court's decisions. In order to explain things in detail, the four variants of the general approach that currently dominate the takings literature are studied. They are namely,

- Economic Analysis
- Epstein's Program
- Kantian Liberalism
- Theories of the Good

A) Economic Analysis: The version of utilitarianism originally developed by Michelman and Ackerman is the most influential of the four perspectives. Michelman argued that a judge whose objective is to maximise welfare should resolve a takings issue by estimating and comparing the following economic impacts: (i) efficiency gains (ii) settlement costs and (iii) demoralisation costs. Once the judge has calculated these impacts, Michelman and Ackerman contended that her job is straightforward. If (i) is the smallest, the action should be enjoined. If (ii) is the smallest figure then she should not enjoin the action but should require that the parties hurt by it be compensated. If (iii) is the smallest figure, she should allow the government to proceed without compensating the victim. Thus one can't ignore the impact of judicial decision on popular views regarding the circumstances in which compensation is appropriate.

Epstein's Program: Central to Epstein's argument is the proposition that judges ought not defer to contemporary public opinion regarding the legitimacy of governmental interferences with private property. However a review of the pertinent writings of James Madison suggests that Epstein would do well to consider one connection between the takings doctrine and public opinion. Unlike Madison, Epstein believes that the judiciary could and should assume the leading role in keeping legislatures within bounds. But Epstein's doctrine will suffer from problems because of the large majority of the regulatory laws which would be subject to challenge under Epstein's doctrine. This will put enormous burden on the judiciary. Therefore if the judges inculcate in public at large the fact that rent-seeking is wasteful and consequentially immoral rather than identifying and blocking those activities, his approach will serve a better purpose.

Kantian Liberalism: Central to Kantian vision is the notion that the individual rights don't depend for their content and should not depend for their security on the will of the majority. Kantian theorists don't consider very seriously the capacity of the judiciary deliberately to shape public opinion concerning the importance and sanctity of private property. Their major works contain little discussion of government speech. They need to develop a coherent and persuasive analysis of the takings doctrine.

Theories of the Good: Of late few legal scholars have begun proposing approaches to the doctrine founded on the proposition that social and political institutions should be arranged to facilitate one or another kind of human flourishing. Margaret Jane Radin, one

of the proponents of this theory argues in favour of increased protections against governmental interference with personal property (Radin, 1982). These scholars don't incorporate in their arguments an appreciation of the educative power of constitutional decisions. None supports authoritarianism but everybody advocates for some restrictions on the power of the government. They in a way believe that leaving people free to form opinions and make choices and mistakes is essential to the development of the sense of confidence and competence that must figure in any defensible theory of human flourishing.

Last but not the least we can say that public perceptions are germane to all four of the theories that dominate contemporary takings scholarship. For both classical liberals and Kantian theorists, the educative power of the judiciary provides opportunities for instituting the political and social regimes that they consider just. But it is very sad that neither classical liberals nor Kantian theorists confront some fundamental questions regarding opinion shaping by the government. These scholars who are critical of liberal traditions have even greater reason for taking into account judges' capacity to inculcate values. But it is very unfortunate that none of the adherents of the dominant approaches has thus far devoted significant attention to public perception.

Conclusion

For a long period of time the state has exercised the authority to deprive a citizen of the benefits of his/her private property. For instance it has a right of eminent domain which is the legal right to acquire property by force rather than voluntary exchange and put it to public use. When the buyer wanting to acquire a property has the power of ED, he does the following:

(a) He attempts to negotiate a voluntary sale and offers values

(b) If the highest offer is rejected, he obtains a forced sale at a price determined in the court of law.

Similarly the state has the right to regulate which means that the state is entitled to restrict what citizens do with their property. These actions have been termed as takings.

With the passage of time, a country follows a path of development. Construction of railway lines, roads, over bridges and many other things are needed for the development. For these developmental projects private properties are needed. Historically it has been seen that these private properties are taken from the people staying in the poor areas. Roads and other desirable public facilities are built in the poor areas because the value of property in these areas is lower and the govt. needs to compensate less for the takings in these areas.

The next pertinent question is that why the govt. intervenes at all? What is the rationale for collective action? Why it can't be the case that the gainers and losers interact

directly or indirectly through the third party enterprisers. If an activity benefits gainers more than losers then gainers can make offers to losers which will be sufficient to induce losers to quit their objections. Conversely if an activity costs losers more than the gainers, the losers can make an offer to the gainers which will induce the gainer to quit their proposal. But these voluntary arrangements don't materialize because of the difficulties associated with arranging human affairs and inability of a person to take account of all the costs or all missed opportunities for mutual benefit. Moreover, certain investments e.g. construction of dams, airports, highways are in the nature of public investment. The private players can't undertake such projects because of the difficulty of people paying for the benefits received from the project.

Concomitant with the power of takings is the obligation on the part of the government to pay compensation. This is against the backdrop of ethical justification, since it is unjust to make somebody better off at the cost of another. People who cite ethical uneasiness as a basis for compensation are one group of people. There are others who believe that over the long run, benefits and gains will cancel out and thus there is no need for compensation. If ethical uneasiness is taken as a criterion for compensation then one needs to calculate all impacts and valuation of all burdens. But it may be quite impracticable to identify all the losses or to predict all the values which a compensation settlement would assign to people. Further the tedious calculation will deter the govt. to undertake even the efficient projects which are necessary for development. Thus there begins a search for a powerful tool which ends our quest for a rule that tests whether compensation is due or not.

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Historically few factors have been used by the judiciary to decide whether an occasion is compensable or not namely: (a) Physical invasion, (b) Diminution of value, (c) Balancing social gains against private loss and (d) private fault and public benefit. Discussion of all these four tests shows that none of the four tests yields a sound and self sufficient rule of decision. None of the tests is adequately discriminating and reliable. Therefore, one begins the search for theory building by discussing the concepts of property, namely: (a) Desert and Personality theories (b) Social functionary theories and (c) Utilitarian theories.

Personality theories assert that production and not consumption should be regarded as an end in itself and property is an indispensable arrangement to meet this end. Social functionary theories depend chiefly on ultimate values associated with consumption. They believed that ownership of property provides the conducive environment for production and consumption. They further believed that the owner is a social functionary and he undertakes production activities because of the feeling of order, pride, responsibility and management. Another very important theory for analysis is the utilitarian approach. The utilitarian approach in general and the utilitarian approach of Frank Michelman in particular are very important for analysis. The utilitarian approach that Frank Michelman developed 40 years ago consisted of a hybrid of the Pareto and Kaldor-Hicks criteria. This involved balancing settlement costs, the transaction costs of making the compensation, with demoralizing costs; the anxieties of landowners and production losses occasioned by not compensating. Drawing on the insights of David

Hume, Michelman argued that a judge whose objective is to maximize welfare should resolve a takings case by estimating and comparing the following economic impacts:

i) The net "efficiency gains" secured by the governmental action in question (excess of benefits produced by a measure over the losses inflicted by it).

ii) The cost of measuring injuries sustained by adversely affected parties and of providing them monetary compensation and

iii) The "demoralization costs" incurred by not indemnifying them.

Once the judge has calculated these impacts, Michelman contended that her job is straightforward.

If (i) is the smallest figure, then she should contrive some way to enjoin the action. If (ii) is the smallest figure, she should not enjoin the action but should require that that parties hurt by it be compensated. If (iii) is the smallest figure, she should allow the government to proceed without indemnifying the victim.

Thorough elucidation of property theories enables us to reach a direct and reliable test of compensability. Then comes the issue of just amount of compensation for takings. The debate centres on the fact that whether market value of compensation constitutes the just compensation in case of takings. The offer ask disparity well established in experimental economics, also known as the endowment effect has been used to urge compensation exceeding market value for takings of property by eminent domain. But few reservations have been directed against this proposition. Those who oppose any move to compensate beyond the market value state that whenever a public project is

undertaken, then it is both a taking from the landowners and, if compensation is paid, and a taking from taxpayers who have to finance the landowner's compensation. The overcompensation of the landowner amounts to an unjustified taking from the taxpayer. Difficulty associated with determinacy of asking price is another legitimate reason why it might be acceptable to use market price.

Last but not the least is the issue of institutional arrangements for securing just compensation. Judiciary can assume the responsibility of an apex body which can impose an extrinsic constraint on the non fair political process and can solve problems by promulgation of sound rules of decision. Though it can have some limitations in the form of difficulty to grasp fairness as a standard for judging a political action. Nevertheless, it is far superior to any other institution which can assure the fairness of political action.

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