The Fifth Amendment to the U.S. Constitution proscribes government takings of private property without just compensation. Legal and economic scholars have long debated the conditions under which the takings clause should apply, and hence, conditions under which compensation needs to be paid to private agents for damages that they sustain from government actions. Recently, this debate has become of paramount concern to environmentalists who fear that the U.S. Supreme Court's increasingly wide application of the takings clause will make environmental regulation and preservation so expensive to the government that lawmakers will respond by providing too little environmental protection. Wiebe and Heimlich echo this concern in the context of wetlands policy, writing: "The likely effect of greater requirements for landowner compensation is decreased wetland protection as a host of other public demands compete in an era of concern over federal budget deficits."

It is hard to understate the breadth of potential application for takings law. In the environmental arena alone, endangered species protection, local development planning and building restrictions, and coastal zone management are just a few examples of government measures that are potential objects of takings challenges.

In this article, I discuss the economic arguments about the application of the takings clause and relate these arguments to two recent and controversial Supreme Court decisions, Lucas v. South Carolina Coastal Council (1992) and Dolan v. City of Tigard (1994). I should caution the reader that the arguments presented here concern long-run economic effects of legal doctrines on takings. Crucial among these effects are incentives for private land development and investment that, in the case of wetlands for example, have already taken place. Nevertheless, the legal application of the takings clause, to wetlands and other cases, needs to consider these incentive effects in order to provide correct economic signals to current and future landowners.

The legal landscape

The takings clause has been interpreted by the U.S. Supreme Court as requiring landowner compensation whenever a government action either denies the owner all economically viable use of the property (e.g., Agins v. Tiburon 1980) or physically invades the property, however minor the invasion (e.g., Loretto v. Teleprompter Manhattan CATV Corp. 1982). Since Pennsylvania Coal Co. v. Mahon (1922), "taking" of property has also been recognized to occur when the government infringes upon property rights in less overt ways. In Pennsylvania Coal, the Court established vague criteria for distinguishing between a "taking" and the legitimate exercise of the state's police powers, exercise which is exempt from the takings clause. These criteria, namely that regulation not go "too far" in diminishing property value, have been the object of debate ever since.

Although government regulations do not constitute a taking when they are for the purpose of nuisance prevention or, equivalently, for the protection of public or private resources (Mugler v. Kansas 1887), it is not entirely clear that regulations must be motivated by nuisance prevention in order to survive a takings challenge. The Court's majority opinion in Lucas v. South Carolina Coastal Council (1992) has been interpreted by some as imposing such a requirement (e.g., Searchinger 1992). However, in his concurring opinion in Lucas, Justice Kennedy maintains that "the common law of nuisance is too narrow a confine for the exercise of regulatory power." That is, nuisance is not the only criterion that should be applied when considering whether a government action "against" a person's property is exempt from the takings clause.
Kennedy argues, rather, that a duty to compensate exists when regulations violate a property owner’s “reasonable expectations” concerning uses to which the property may be put.

In *Lucas*, the Supreme Court ruled that the takings clause applied when a local authority sought to comply with the South Carolina Beachfront Management Act by prohibiting the plaintiff, David Lucas, from developing two beachfront lots. The Court ordered the defendant to pay Lucas compensation for losses that he sustained as a result of the development ban. A feature of this case that is emphasized throughout the Court’s decision is that Lucas held undeveloped property on which the government now prohibited building, while owners of developed beachfront property were not prevented from enjoying the fruits of their development. This unequal treatment of Lucas permitted the Court to rule in Lucas’ favor and, at the same time, reaffirm its ruling in *Penn Central Transportation Co. v. New York City* (1978). In *Penn Central*, the Court sustained New York City’s landmarks preservation program against a takings challenge, writing that exemption of a government regulation from the compensation requirement of the takings clause can rest “not on any supposed ‘noxious’ quality of the prohibited uses but rather on the grounds that the restrictions were reasonably related to the implementation of a policy—not unlike historic preservation—expected to produce a widespread public benefit and applicable to all similarly situated property [italics added].” This last clause reflects a requirement for equal protection of property owners that is important both in understanding the Lucas case and, as will be seen below, in economic arguments for application of the takings clause.

Beyond *Lucas*, the Court recently strengthened the takings clause in two ways. First, in *Nollan v. California Coastal Commission* (1987), the Court ruled that a taking occurs—and hence, compensation is required—whenever there is not “essential nexus” (or clear connection) between a proposed land-use and the government regulations or exactions imposed on the landowner in return for land-use approval. “Essential nexus” exists when government exactions can be motivated by a legitimate state interest that would be impaired by the proposed development. For example, in the Nollan case, the California Coastal Commission (CCC) argued that, if Nollan were allowed to build a bigger house on his coastal property, the public would be harmed because its view of the shoreline would be impaired. However, when issuing Nollan a building permit, the CCC did not restrict Nollan in a way that would mitigate the damage to the public’s view of the beach. Rather, it required that Nollan provide the public with access to the beach across his property. The Court ruled that this requirement (or exaction) was not motivated by the state interest that was impaired by the development and, hence, did not pass the “essential nexus” test; as a result, the Court ordered the permit requirement to be either voided or paid for by the State of California.

In *Dolan v. City of Tigard*, “essential nexus” was not at issue and the Court went a step further in...
strengthening takings claims. In this case, the City of Tigard confronted the plaintiff, Florence Dolan, with a “price” for the city’s permission to build a paved parking area and roughly double the size of her plumbing supply store. This price took the form of partial land setasides for a public bicycle path and flood control easements, both of which were related to public costs of the proposed development in increased traffic congestion and flood control. Dolan sued the City of Tigard, arguing that its permit requirements constituted a taking. In ruling for Dolan, the Court went beyond Nollan by arguing that a regulation’s exemption from the takings clause requires both “essential nexus,” which was satisfied in the Dolan case, and “rough proportionality” between the private costs of exactions and the external costs of the development. “Rough proportionality” requires that the degree of exaction implicit in government-imposed permit conditions bear a reasonable relationship to the impact of the proposed development; although the Court asserted that “no precise mathematical calculation is required” to establish rough proportionality, it clearly envisions some loose calculation of private costs of permit requirements and public costs of development. In the Dolan case, the Court ruled that the City of Tigard did not make an effort to quantify these costs and, hence, did not establish “rough proportionality.” In what follows, I argue that this new Court doctrine of takings may promote inefficient government behavior and, as a result, may not be in the public interest.

**Economic arguments**
Economists have studied the relationship between compensation for government “takings” and the economic efficiency of private and public decision making. Economic efficiency requires that net economic benefits, the difference between benefits and costs across all people in an economy, be at the highest possible level. Net benefits include benefits to the general public from government-provided goods, such as national defense and park land; costs of activities to persons other than those engaging in the activities, such as the costs of chemical plants’ toxic waste to neighboring residents; and all private benefits of activities and uses.

In thinking about takings law, it is important to distinguish between issues of efficiency and issues of distribution or “fairness.” Compensation for government actions—vis-à-vis no compensation—affects the distribution of economic welfare between citizens by providing a benefit to the compensated party at the expense of the taxpaying public. Such a benefit may be motivated by concerns for fairness. For example, if a property owner has developed land in ways that were fully legal at the time of the development, but is subsequently directed by the government to restore the land to its pristine state, fairness may argue for full compensation of the property owner. However, the question posed here is not whether and when compensation would be fair, but rather, whether and when it would be efficient.

In addressing this question, it is useful to begin by considering two classes of cases. In the first type of case, a government regulation is designed to prevent a property owner from harming other landowners, the general public, or public resources (such as public waters). For example, a government regulation may ban the disposal of toxic pollutants on neighboring lands or waters, or restrict the discharge of fill into waterways that would worsen flooding of downstream properties, or limit the type of buildings and land uses that are allowed in residential neighborhoods in order to protect local residents from noise, traffic, and danger. In the second type of case, a government action is designed to provide a public good. For example, if the government wishes to build a road, a defense facility, a park, or a dam, it is not preventing harm per se, but is instead providing a new good or service to the general public.

While compensation is typically required for the second type of government action, the Supreme Court has defended the government against takings challenges for regulations that prevent harm. However, recent legislative proposals threaten to require government compensation for such regulations. For example, the Republican Contract proposes that any federal action which diminishes the value of a property by 10 percent or more be subject to a compensation requirement.
Requiring the government to compensate for harm-preventing regulations can impede economic efficiency in at least two ways. First, compensation for those who would otherwise create harm can elicit efforts to generate potential harm in order to obtain compensation. Second, if the owners of some property or resources must compensate those that wish to harm their resources, but the owners of other property or resources are not required to compensate potential harmers, then those resources requiring the payment of harm-prevention compensation will be undersupplied. An analogy helps to illustrate these points. Suppose that any landowner who uses his or her property to operate a restaurant must either pay compensation to anyone who wishes to dump garbage on the property, or accept the garbage. Such a requirement would lead to a shortage of restaurants and invite efforts to dump garbage on restaurant sites in pursuit of compensation. Although this example would seem to be far-fetched, it has a direct analog in the government's protection of environmental resources. If environmental resources must be protected by paying those who could benefit from damaging them, environmental protection will be undersupplied and landowners will be invited to seek compensation by proposing environmentally damaging projects least in the public interest.

Of course, the distinction between harm-preventing and public-good-providing government actions is not always clear in practice. Is endangered wildlife a public resource that is harmed by habitat-impairing land development? Or is wildlife habitat a public good? In view of this difficulty, economists have sought to think more generically about efficiency effects of compensation for takings. The most famous economic model of takings involves a plot of land which can be used by its owner in a variety of ways, some of which entail more investment than others. After an initial investment is undertaken, the government may decide that the land is needed for a public purpose, in which case the land will be "taken" for this purpose and the original investment will be lost. Three issues arise. First, what is an efficient private investment level and how can this efficient level be elicited from the landowner? Second, when is it efficient for the government to "take" the property and how can this efficient choice be elicited from lawmakers? And third, since the possibility of a taking confronts a landowner with some risk (unless he or she is fully compensated for the taking), how can efficient risk-bearing be achieved?

In a classic paper, Blume, Rubinfeld, and Shapiro (1984) argue that payment of compensation will prevent landowners from considering the prospective loss of their investment in the event of a taking, thus leading them to invest too much in their property. Without any compensation, the landowner confronts the true social returns on his or her investment, returns which are zero when the government diverts the land to public use; as a result, the landowner will make efficient investment decisions, holding back some investment in view of the possibility that private use of the land may later be found to be inefficient.

Two counterpoints to this argument have been invoked to restore economic motivations for compensation. The first is what economists call a "market failure." Specifically, if private markets do not offer affordable insurance for the risk of a taking, compensation can implicitly provide insurance to property owners and thereby enhance welfare (Blume and Rubinfeld 1984). One possible reason for insurance markets to fail in this way is that potential buyers of insurance may have better information about the likelihood of a taking than do insurance companies, thus making companies reluctant to provide "takings" insurance. However, Kaplow (1986) has argued that insurance markets are unlikely to fail in this way, so that if property owners desire insurance, private insurance markets will emerge for takings risks and compensation will not be needed to achieve efficient risk-sharing.

The second argument for compensation embodies the view that the takings clause is designed to curb the excesses of government and protect individual liberties, a view that is prevalent in the legal community (e.g., Epstein 1985). In economics parlance, the takings clause combats a government failure called "fiscal illusion." When it is subject to fiscal illusion, the government places less weight on the private costs of its actions than it does upon (continued on page 42)
As a result, it has been argued that the government should not appropriate private property too often if it is not compelled to pay the private costs of such takings. Compensation adds these private costs to the government's budget and thereby elicits more efficient government behavior. For example, in a government that operates by majority rule, lawmakers may place zero weight on the cost of their actions to politically impotent minorities and may, as a result, "take" too much minority land for public use. Fischel and Shapiro (1989) argue that the U.S. Constitution is designed to prevent precisely this sort of government exploitation; before anyone knows whether he or she will be in the majority or the minority, all will agree on a constitutional rule that requires some compensation and thereby forces the "majoritarian" government to consider the private costs of its actions. However, full compensation will lead landowners to overinvest in their property for the reasons described above; as a result, partial (rather than full) compensation will be called for unless the compensation can be decoupled from the landowner's investment choice.

These arguments are limited to some extent by both the nature of the development process envisioned in the primitive models, and assumed restrictions on the government's tax capabilities. In many development situations, the extent of development—or land "investment"—is better measured by the number of land parcels that are developed by their respective owners, rather than the level of investment on a given piece of property by a given landowner. That is, some landowners develop their property early on and others hold on to their property with the plan of development later; the number of "early developers" thus measures the level of land "investment." Moreover, when the government decides upon which and how much land to appropriate for public use, it confronts many owners of property on which heterogeneous development choices have been made. In the South Carolina case, for example, David Lucas held two undeveloped waterfront lots, while other landowners held waterfront lots that were similarly situated in all respects except that they were developed. Indeed, as economies grow, such heterogeneous development choices are efficient, with development proceeding in response to growing demand for the services that such new development can provide. However, this heterogeneity is crucial to the economic implications of takings jurisprudence.

When land development proceeds in this way, government takings do not—and should not—treat developed and undeveloped property symmetrically. Other things equal, the least valuable undeveloped land should be taken first, which implies that, if takings are not compensated, landowners have an incentive to develop their land early in order to reduce their risk of government appropriation. Since this landowner benefit of development does not reflect any true economic benefit, an absence of compensation will lead to more development than is efficient. That is, landowners will tend to develop too much land simply to avoid having undeveloped land that is more likely to be regulated or condemned by the government. However, if undeveloped landowners are compensated for government takings, then landowners will have less of an incentive to develop early on and efficiency can be restored. Rather than compensation leading to overinvestment in land improvements, as in the Blume, Rubinfeld, and Shapiro model discussed above, compensation now prevents strategic overdevelopment.

More generally, incentives to develop early are generated by differences between profits—or other benefits—that are available to owners of developed and undeveloped land. By appropriately protecting the relative value of undeveloped and developed land—rather than allowing this relative value to fall with takings of undeveloped land—efficient development incentives can be provided. Hence, it is not compensation per se that is necessary for the achievement of efficient development incentives, but rather the equal protection of developed and undeveloped property owners. In essence, an equal protection rule requires that government policy confront each and every landowner with an equal share of the total private costs of any takings, regardless of whether or not his or her particular land is taken. Undeveloped land then does not bear a greater share of the cost of takings than does developed land, and the incentive to develop early, in order to reduce the prospective cost of takings, is thereby eliminated.

Equal protection can be implemented by compensating all landowners who have their land taken. However, it can also be implemented by taxing developed landowners whose property is not taken, and providing correspondingly less compensation to landowners whose property is taken. For example, to satisfy equal protection, each and every landowner could be issued tradeable permits that entitle him or her to hold a fractional amount of developed land, where the fraction equals the overall proportion of land that the government wishes to have in private developed uses. In order to retain a land parcel in a developed state, an owner must buy up permits from other landowners, who then give up their development rights and agree to have their property placed in public use. Developed landholders are thus made to bear their share of the cost of tak-
ings. Of course, this tradeable development rights scheme may be considered unfair to developed property owners and challenged on these grounds. The purpose here is not to address such issues, but rather to illustrate principles needed for efficient takings jurisprudence. In this regard, the important point is that undeveloped property owners need to be protected in order to deter excessive development early on.

The implications of "fiscal illusion" for efficient takings jurisprudence also depend upon modeling assumptions. A number of scholars have argued that, when the government is subject to fiscal illusion and, hence, undervalues the private costs of its actions, it will "take" too much property and/or overregulate land use unless reignited in by a compensation requirement. These arguments, however, assume that the government cannot share in the benefits of private land uses. In fact, given its tax powers, the government can share in these benefits. Allowing for such taxation, it can be shown that a government that is not subject to the takings clause will choose its regulatory policies and takings decisions efficiently, even when it has fiscal illusion (Innes 1994). However, if the courts require that the government pay full compensation for private costs of its regulations, the government's regulatory choices will not be efficient. The problem with a compensation requirement is that it ties government budgetary expenditures to allowed development levels, with higher expenditures required when more land is regulated or taken. Hence, when the government is averse to budgetary outlays, a compensation requirement will lead it to curtail its expenditures by allowing more development than is efficient.

**Equal protection, environmental preservation, and two cases**

In the case of *Dolan v. City of Tigard*, the foregoing economic arguments suggest that the duty to compensate should be judged by a determination on whether Dolan was afforded equal protection and, hence, the same treatment and opportunities as were owners of similarly situated properties. Specifically, were there other property owners who had obtained development rights akin to those requested by Dolan and who were not confronted with a similar price for these rights?

If the answer is yes, then the anticipation of Tigard's regulatory policy, without compensation, would have provided an incentive for early development in order to reduce the risk of paying for a building permit later; court-imposed compensation would be justified to counter this incentive. However, Court records suggest that the answer is no, documenting that Dolan was only required to satisfy conditions of the city's Community Development Code that would apply to any other comparable development application. Hence, Tigard's policy, without compensation, is unlikely to have created an incentive for inefficient development. Moreover, a duty to compensate is likely to distort the city's choice of regulatory policy in one of two ways. First, if Tigard were to pursue a policy of allowing some development, but not unbridled growth, then it would have an obligation to compensate those whose development privileges are limited, rather than charge a price to those who propose additional development. Per the arguments above, this obligation may lead the city to underregulate land use. Second, if the city were to deny all development requests akin to Dolan's, citing damages that additional development would impose upon neighboring residents and public resources, legal principles and precedent would almost certainly void a duty to compensate the developer petitioners (*Mugler v. Kansas* 1887). So long as the city faces any budgetary constraints or fiscal illusion, the compensation costs of a partial-development strategy will favor regulators' choice of the no-development alternative even when this alternative is economically inefficient.

In ruling for the plaintiff in *Dolan v. City of Tigard*, the Court threatens to promote such regulatory inefficiencies by failing to base its decision on a determination of unequal treatment and instead interpreting the Fifth Amendment to require compensation whenever there is not, in the Court's judgment, both "essential nexus" and "rough proportionality." In essence, the economic arguments above suggest that neither of these criteria should be applied in adjudicating takings claims. Rather, as Justice Stevens argues in *Dolan*, "if the government can demonstrate that the conditions it has imposed in a land-use permit are rational, impartial and conducive to fulfilling the aims of a valid land-use plan, a strong presumption of validity should attach to those plans." If landowners are afforded both equal protection (with rational and impartial regulation) and protection from egregious government exploitation (with land-use regulations that are not a pretext for excessive taxa-
It asks: “Must the public pay off landowners to preserve the basic ecological processes on which our environment depends?” In this article, I have suggested that the answer to this question should often be no. If environmental protection is harm-preventing, the case for exemption from the takings clause is on firm ground both in legal and economic realms. Moreover, if the line between harm-prevention and good-provision is blurry, this article suggests that, before invoking the takings clause, one should be very convinced indeed that “fairness” is served by compensation, because inefficient government behavior—the underprovision of environmental protection—may be the cost of resolving a blurry distinction in favor of compensation. The Lucas decision, however, need not be interpreted as tipping the balance of takings jurisprudence against environmental protection. Rather, it reaffirms the principle that, if the government fails to afford landowners with equal protection, it is neither reasonable nor efficient to expect the courts to accept a zero-government-cost outcome that, as Justice Kennedy puts it, throws “the whole burden of the regulation on the remaining (undeveloped) lots.”

For more information


Dolan v. City of Tigard (s. Ct. No. 93-518, June 24, 1994).


Loretto v. Teleprompter Manhattan CATV Corp. (458 U.S. 419, 1982).


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Findings Citations


Note: RAE is the Review of Agricultural Economics and AJAE is the American Journal of Agricultural Economics.