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Book Review: Takings. by Richard A. Epstein.

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the most scurrilous political diatribes in newspapers would be unlikely to harm the republic. From his mid-nineteenth century vantage point, he relished the clashes of partisan newspapers as healthy and inevitably leading to social and political stability.

Protecting the Best Men is not as strong in its discussion of the twentieth century. Libel cases of the last decade or two are discussed almost perfunctorily. Further, Rosenberg may not be critical enough of the legal establishment to suit some observers. He suggests that the proliferation of libel suits has stemmed from more journalists producing more column inches about events of greater public interest. Now there are also more lawyers in the U.S.—about 650,000, or two-thirds of the world's supply. Separate courses in media law are offered in many law schools—adding mightily to the several lectures that used to be devoted to defamation and invasion of privacy in torts courses roughly twenty years ago—so that the frequency of lawsuits against the media in the 1980s is not surprising. (The old saying goes, put one lawyer in a town; that lawyer will starve. Put two in a town, they will both get rich.)

Beyond Professor Rosenberg's splendid beginning, there is much work to be done, much reinterpretation. As he observes:

Indeed, the prominent libel battles of the mid-1980's—General Ariel Sharon versus Time, Inc., William Tavoulaareas versus Washington Post Co., and General William Westmoreland versus CBS—assumed the character of trench warfare involving elite members of the modern corporate-military order. If, as some observers insist, late twentieth-century politics revolve around a new kind of "feudalism," might not many modern liberal trials be seen as contemporary versions of baronial conflict among the self-styled best men?

TAKINGS. By Richard A. Epstein.¹ Cambridge, Ma.: Harvard University Press. 1985. Pp. xi, 362.

*Edward Foster*²

Public law, argues Professor Richard Epstein, should be a coherent and consistent extension of the individual rights that are secured by private law. Although public law covers relationships between groups, these must be translatable into statements about individuals; public law should not deny rights that the government is pledged to protect in private law. *Takings* argues that the origi-

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nal constitutional design did make public law consistent with private law, and that the massive expansion of government power in this century (zoning, rent control, workers' compensation laws, transfer payments, progressive taxation) is largely inconsistent with the Constitution. It follows that the Supreme Court's decisions upholding these violations of individual rights were mistaken.

Professor Epstein's claim rests mainly on the eminent domain clause ("nor shall private property be taken for public use, without just compensation"). But his argument is not narrowly legalistic. His reasoning draws heavily on economics, and he asks the economists' question: When do private markets fail, so that regulation is justifiable?

A theory of public law must derive from a theory of the state. Epstein joins the framers of the Constitution in starting from Locke's contractarian theory: the purpose of government is to exert the police power which protects each from the aggression of others who might threaten life, liberty, or property. With social order established, industry will flourish because it is then reliably rewarded; the institution of government causes total output to increase, so that all may benefit. The central challenge for constitutional law is to make certain that all do benefit, and that the government claims only those resources needed to perform its functions.

Unanimous consent to each government action would offer one way to keep government in check, but sheer numbers of persons, and the threat of strategic behavior, rule out that standard. Locke was willing to settle for tacit consent by the governed coupled with exhortation to the governors. Epstein rejects Locke's solution, for fear that it may permit a voracious government to take more than the governed wish to provide, for purposes that they do not approve. Rather, he proposes that relations between the government and the governed be based on "an explicit and rigorous theory of forced exchanges" in which the owner must receive as compensation for any taking of property by the state, and as part of the same transaction, an equivalent or greater value. He goes further and argues that "just compensation" requires that *any net gains from government activity should be distributed in the same proportion as the initial distribution of wealth.*³ Moreover, the purpose of government should be sharply circumscribed:

[T]he entire system of governance presupposes that in a state of nature there are two, and only two, failures of the system of private rights. The first is the inability

3. Epstein states both that gains from government should be distributed in accordance with the initial distribution of wealth and that they should be congruent with the distribution of taxes. The two may not be the same.

to control private aggression, to which the police power is the proper response. The second is that voluntary transactions cannot generate the centralized power needed to combat private aggression. . . . As these two problems are the only ones that call forth the state, so they define the limits to which the state may direct its monopoly of force. The theory that justifies the formation of the state also demarcates the proper ends it serves.

From these premises Epstein reaches the conclusion that many twentieth century government actions are inconsistent with the eighteenth century Constitution. Before evaluating this conclusion, I will describe his reasoning in greater detail.

I

Professor Epstein defines "taking" broadly, to include any action which diminishes the value of private property, as well as the actual transfer of physical ownership; his definition differs from the Supreme Court's in that it includes taking from large groups, though each individual loss is small, as well as from small groups, each member of which suffers substantial loss. Thus, neither regulations nor taxes nor modifications of liability rules for private contracts can be excluded from the effect of the eminent domain clause.

Next comes the analysis of the possible justifications for a government taking of private property. Epstein lists three: the police power, consent to the taking (or, in case of accidental taking, voluntary assumption of risk by the owner of the property taken), and just compensation given in exchange for property taken for a public purpose. Just as takings must be defined broadly, the possible justifications must be defined narrowly so as to protect the individual against government power.

Use of the police power justifies a taking only when it is intended to protect against a threat to life, liberty, or property; it is not justified when it is intended merely to provide a public benefit. Thus an environmental regulation designed to prevent pollution that harms others is a valid exercise of the police power, and requires no compensation; but a restriction on billboards designed simply to improve the view does require compensation.⁴

Even when the end is justified by the police power, the means employed must be appropriate and as unintrusive as possible: the evils of drink do not of themselves justify closing a brewery, and the risk of fire does not suffice to justify restrictive zoning ordinances.⁵

4. Epstein acknowledges, and rejects, arguments by Sax and Michelman suggesting that there is no analytic difference between the two. Insofar as the issue is economic and not legal I agree with Epstein's position, but it is not central to this discussion.

5. Indeed, Epstein's main complaint against zoning ordinances, one of his list of twentieth century innovations that lack solid constitutional basis, is not that they cannot be justi-

Epstein points out that the "public purpose" test for takings has become virtually inoperable, with any remote connection to the public welfare being adequate justification for taking property under eminent domain. He argues that the public purpose requirement should be revived and assigned a central place in eminent domain law. His basic reason is the one that preoccupied Locke: to protect against the government's use of its powers, in this case eminent domain, to reward its own supporters at the expense of others. The more widely benefits are dispersed among the populace, the less danger that a taking, even a compensated taking, will confer a benefit on a favored few at the expense of others. This consideration, I think, explains his proposal that "public purpose" should be interpreted to mean benefits distributed roughly in proportion to initial wealth or to the amount of tax paid.⁶ The use of such a test would give the courts a means to judge whether or not a particular taking was unfairly biased toward one group at the expense of others.

The final issue in Epstein's basic argument is the definition of "just compensation." He adopts definitions that seem obvious and sensible from the viewpoint of economics, but are not always accepted by the courts. First, compensation should be based on the market value of the property taken (not some lower "reasonable rate of return on original investment," as in rent control laws). Compensation may be implicit, and in kind rather than in cash: the landowner prohibited from putting up a large sign receives compensation in the fact that his neighbor is similarly prohibited. Owners of a common pool of petroleum or gas each benefit from regulations designed to maximize the total extracted; so do the creditors of a bankrupt benefit from regulations designed to maximize the total recovered from his estate. But in such cases of implicit in-kind compensation, individuals must be protected against bearing a share of the burden out of proportion to their share of the benefit.

What are the concrete implications of all these principles? Here are some of Epstein's illustrations:

fied under the police power, but that they have not been so justified; there has been inadequate exploration in landmark cases of whether less costly and less intrusive alternatives would have accomplished the important public ends being advanced and of whether particular ordinances were essentially discriminatory takings for the purpose of redistributing wealth from one group of landowners to another.

6. Epstein does provide an exception for cases of necessity, such as a mine, a railroad or a dam, in which the benefit may accrue to private persons; in such cases he is concerned with the likely difference between market value of the condemned property and the value in use to the owner: because the owner had not voluntarily sold at the market price it is manifest that the value in use exceeds the market price, though we cannot know by how much. Epstein argues that in such cases it is appropriate to insist on payment of a bonus over market price, plus any legal costs, to make a crude attempt to compensate for value in use rather than value in exchange.

1. When introduced in the first quarter of this century, workers' compensation statutes offered an exchange in which both employers and employees gave up something. To compensate workers for job-related injuries, employers gave coverage even when not negligent in exchange for lower levels of recovery and a simplified procedure. In light of lower administrative costs, it is possible that all could gain by substituting this system for common law litigation. However, this possible justification is made suspect by the fact that such statutes were defended, when introduced, as a way to redress the imbalance of bargaining power between employer and employee, a consideration that could be used to void virtually all private contracts, since bargaining power is rarely equal. Moreover, changes in the laws since their introduction may well have converted an originally fair bargain into one which is now lopsided. A provision in the original statutes to allow employer and employee to opt out of the system by contract might have provided adequate protection, but absent such a provision Epstein regards the statutes as unconstitutional.

2. Government regulation of railroads and public utilities is justifiable, because the grant of eminent domain to such firms for their distribution networks represents a taking from the public; to then prohibit their exploitation of a monopoly position is simply a way to assure that the public receives just compensation for the original taking. But other regulations of prices, wages, and interest rates have no similar defense and are unconstitutional. The National Labor Relations Act, with its restrictions on freedom of contract, also fails for lack of just compensation.

3. In the area of taxation, excess profits taxes are clearly a taking without compensation, as are state severance taxes on the extraction of minerals. And lacking any clear evidence that the benefits of government are distributed so as to increase more than proportionately with wealth or income, the progressive income tax is also a taking without just compensation: its impact on the rich is disproportionate to the benefit they receive.

4. Finally, transfer programs ranging from Social Security and Medicare to unemployment compensation and welfare programs all suffer from the same flaw as the progressive income tax: the affluent have a disproportionately low probability of benefiting from such programs and bear a disproportionately high share of the cost. The result is a taking without just compensation.

II

As an economist, I will not presume to evaluate possible juris-

prudential objections to Professor Epstein's thesis. Much of what he says will make sense to economists of various political inclinations. His main objective is to protect against "rent seeking"; that is, the practice of devoting resources to obtaining income by political means through transfer payments, tax exemptions, or favorable regulations. Economists (and Epstein) deplore rent-seeking, on the ground that it diverts energies from productive activity in the marketplace and leads to an overall diminution in prosperity, making us all worse off. Although I am an unreconstructed, bleeding-heart liberal, I agree that rent-seeking is a major problem. Rent-seeking activity benefits the poor so infrequently and so ineffectively, and others so often, that the poor might very well be better off if the Constitution were interpreted as Epstein wishes.

Nevertheless, I have some reservations about Epstein's argument. These reservations revolve primarily around the issue of transfer payments for welfare programs, and they arise from several points of view. Let us start by treating social welfare programs as an insurance plan. As Epstein points out, private insurance markets can fail for two reasons: adverse selection and moral hazard. Adverse selection occurs when the buyer of insurance knows the risk better than the insurer does, which tends to lead to high-risk people insuring, while low-risk people decide not to insure, creating a situation in which insurance rates rise until low-risk people who wish to insure cannot afford to do so if they are unable to prove that they belong in a low-risk category. Moral hazard is the phenomenon that those who are insured against an event lose some of their incentive to prevent it from happening. When either of those two problems is present, insurance will be unavailable or too expensive for some potential buyers. State provision of the insurance cannot solve the problem of moral hazard, but it can solve the problem of adverse selection, because compulsory insurance for all means that no insured person can take advantage of private information to opt in or out of the system.

Some of the misfortunes and choices that lead to poverty—catastrophic fires, for instance—can be insured against in the private market. But others—bad genes, a rotten environment, etc.—cannot. Compulsory government "poverty insurance" is therefore at least fairly plausible from an economic point of view.

On the other hand, compulsory insurance does involve the considerable social cost of involuntary participation by those who dislike the idea. Professor Epstein rejects the insurance rationale for transfer payments, on the ground that the insurance is not fair to all the parties. We do not all start out in identical circumstances, and

if some of us, endowed by fortune with better prospects, are required to buy insurance that is a bad bargain, there is a taking without just compensation.

Let's look at the problem from another angle. From the viewpoint of those affluent individuals who lose by participating, a poverty program amounts to a forced charitable contribution; to analyze this requires consideration of another form of market failure, one not discussed by Epstein. Like other "public goods," charitable contributions are plagued by the "free rider" problem.⁷ If, as a contributor to charity, my concern is with alleviating hunger rather than with the psychic reward that might come from basking in the public or private knowledge of my generosity, I will benefit more from having other people alleviate poverty than from doing so myself; if others share my concerns but also my selfishness, there will be less charity than we would each prefer to have unless we can arrange a social pact to jointly contribute.⁸ Persons who are so motivated will support some level of tax for such a charitable purpose and up to that level will receive just compensation through an implicit payment in kind. So some of those who at first sight appear to suffer from an involuntary welfare program are not in fact harmed by it.

At this point the argument for or against welfare programs looks much like the argument for or against military expenditures. In either case everyone receives the benefit whether or not he wants to receive it, because if it is to be provided it must be provided for all. In the case of national defense Epstein comes down on the side of provision, despite the fact that not all will approve:

When the United States government decides to commit troops in foreign combat, its actions will be supported by some and opposed by others. Nonetheless, the constitutional command for a single foreign policy [actually, physical constraints rather than any constitutional provision] . . . makes it impossible to simultaneously satisfy all points of view. To insist that classic public . . . goods provide equal subjective benefits, much less benefits that exceed tax payments, is entirely inconsistent with our (indeed any) system of organized government. Some measure of equality may be provided simply because the government makes an enormous number of collective decisions that are supported by different groups for their own reasons. For some persons the balance will not even out in the long run. The price of collective life is that disappointed citizens cannot obtain tax refunds for unwanted public actions, either case by case or on an aggregated basis.

7. A free rider enjoys the benefit of a good (such as an open-air concert, unscrambled radio signals, or national defense) without paying for it. The phenomenon does not arise with ordinary private goods, consumption of which is limited to the person in possession.

8. Put another way, if 10,000 people each pledge to contribute \$100 on the condition that everyone else does the same, each individual knows that his \$100 contribution will guarantee that \$1 million goes to the charity. Without the pact, a \$100 contribution delivers only \$100 to the charity. Standard fundraising techniques exploit this fact.

In the case of transfer payments Epstein comes down on the other side of the argument. Why so? Once we consider the public good aspect of involuntary charitable contributions, I do not see that the logic is any different. In either case one must decide whether the general good justifies coercion of those who do not approve.

Even if we remove the public good aspect of private charity by postulating that every donor's satisfaction comes only from public admiration for his generosity, society might still agree that a safety net, to help people in desperate cases, would be a legitimate joint responsibility best undertaken by government. Whether or not constitutional scholars would unanimously support the notion that protection of life, liberty and property includes an obligation for public support in cases when children and incompetents cannot obtain food, shelter, and clothing, economic thought would certainly accept that as a legitimate cause for government action.

The same arguments may also justify some degree of progressivity in the income tax. At least for the very lowest levels of income they justify collecting no taxes at all. Such an exemption imposes a primitive progressivity on the tax schedule, in that the total tax paid as a fraction of income then increases with income, even though each dollar of extra income incurs the same tax burden for those who pay taxes.

Another issue is suggested by unemployment insurance. Perhaps the government policies that would be permissible under Epstein's reading of the Constitution could never lead to inflation or to government actions designed to reduce aggregate demand in order to stop inflation. I am skeptical that this outcome could be assured; and failing it, we should address the fact that anti-inflationary policy can put people out of work, creating a taking for which they deserve just compensation: "landing nets for the front-line troops in the battle against inflation," in Walter Heller's ringing phrase. Following Epstein's reasoning, there is no particular justification for funding these payments by a tax on employers (and employees); in exchange for the general benefits provided by effective inflation control, they should be funded from the general revenue.

So much for my first set of reservations about the book's economic analysis. It is difficult to tell whether or not to place any great weight on my remaining reservation because, while Epstein enunciates the principle clearly, he does not appear to follow it strictly. The principle is that net gains from government activity should be distributed in the same proportion as the initial distribution of wealth. My difficulty with this principle is in part practical: because most government activities affect the general equilibrium of

the economy, shifting prices and income flows in complex ways, it would not be possible to control the net effect except with an intrusive system of individualized taxes and transfers; moreover, in most cases it is impossible to predict the precise consequences of any specific government action, so it would not be possible to do what Epstein suggests.

More than that, Epstein's proposal sets a standard for government programs that is extraordinarily rigid compared to the standard suggested by the private market mechanism: a private bargain can be struck with any distribution of the gain. We presume that a trade entered into voluntarily by two competent individuals will make both better off. Epstein proposes a much more rigid standard for trades undertaken through the medium of the government: a specific distribution of the gains. I think that the Epstein standard is not workable (as suggested by the fact that he is willing to settle for other criteria in specific cases that he analyzes in his book). But the purpose of the standard, as I interpret it, is simply to give us a tidy criterion for judging whether or not any particular government program is designed to funnel benefits to a favored few. It is possible that judges could address that question without the rigid distribution requirement that Epstein imposes.

* * *

I have discussed only the bare bones of *Takings*. It is a much richer book than one might infer from my review, and wise in discussing how to accommodate the principles Epstein advances to the world as it is, which includes many settled programs and consequent expectations that violate those principles. As a layman, I find Professor Epstein's thesis both stimulating and attractive. As an economist, I find his reasoning consistent with modern economic thought. It is only in some particulars that I disagree with his conclusions. For the most part those conclusions are consistent with economic theory and with the policy prescriptions that most economists—liberal or conservative in politics—would support. I am pleased to recommend the book both to constitutional scholars and to economists concerned with public policy issues.