RICHARD A. EPSTEIN

PROPERTY RIGHTS AND THE RULE OF LAW: CLASSICAL LIBERALISM CONFRONTS THE MODERN ADMINISTRATIVE STATE

The rule of law sets out a set of general prescriptions of generality, neutrality, consistency, prospectivity and simplicity that are thought to be appropriate for all sound legal systems. Formally, there is no necessary connection between the belief in the rule of law and a system of limited government with strong rights of property and contract. It is often claimed therefore that the modern administrative states can introduce extensive forms of social control and redistribution in ways that do not offend rule of law principles. This essay takes issue with that content and argues that the high levels of discretion that are routinely involved in the administrative state force it to abandon these rule of law constraints. The modern synthesis thus leads to lower levels of both freedom and prosperity than the classical liberal synthesis in which the rule of law and private property work together in a harmonious fashion.

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PROPERTY RIGHTS AND THE RULE OF LAW: CLASSICAL LIBERALISM CONFRONTS THE MODERN ADMINISTRATIVE STATE

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INTRODUCTION: TWO VISIONS OF GOVERNMENT

Much of modern political theory literature examines with great fervor, but little understanding, the twin principles of property rights and the rule of law. It is therefore critical to explore exactly what these two phrases mean, and how they interact. The purpose of this essay is to explain in nontechnical terms why these twin ideals should be regarded not as benign truisms, but as the key pillars of the classical liberal system that generates a system of government that possesses both the means and the ends to create a free and open society. In order to see what is at stake in this classical liberal system, it is necessary to contrast it to a different form of social organization that subordinates these principles in favor of an overarching vision of the modern administrative state. That vision of government puts its faith in a legal regime that insures the *participation* of all interest groups in an open administrative process fueled by professional government expertise, which is in turn given wide leeway by courts who give little protection to property rights.

My thesis is that this modern mode of administrative governance is inferior to the classical liberal system that it displaces. For engineering this substitution, chiefly through the adoption of the progressive policies of Franklin Roosevelt's New Deal, the people in the United States and overseas have paid dearly with a loss of both liberty

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and prosperity. In order to defend this thesis, I shall first set out the traditional understandings of the interrelationship between the rule of law and private property. Thereafter I shall discuss the modern version in order to explain how that breakdown of the old restraints has led to serious dysfunction in modern government, especially in connection with questions of land use.

THE TRADITIONAL CONCEPTION OF THE RULE OF LAW

At the outset, it is useful to note that the strongest social commitments to the rule of law and private property long antedate the rise of the democratic institutions that eventually gave birth to the administrative state. At its inception, the rule of law was a device that was intended to negate the arbitrary power of the monarch, which was often encapsulated in the Roman maxim, *quod principi placuit legis vigorem habet* –that which is pleasing unto the prince has the force of law. The rival conception that we live in a nation of laws, not men, was the effort to impose some constraint on the exercise of royal power. One of the key weapons in this struggle against arbitrary power was the oftmaligned conception of natural law, which frequently was assigned divine origins. This appeal to higher authority was intended to, and did, exert additional moral pressure on the monarch as a substitute for both electoral oversight or vested individual rights. No one could truly insist that these classical rhetorical flourishes, even when deeply held, worked perfectly. Indeed there are notable failures in governance that no set of exhortations, maxims or institutions can forestall. That said, be thankful for small favors. The insistent and fervid repetition of the natural law theme surely did no harm. In many close situations, these principles have tipped the scales against abuses of state power.

Isolating the requirements of the rule of law within this context, however, takes some hard intellectual work. In particular, this program can only be carried out if we reject the common forms of linguistic skepticism that so often permeate the modern philosophical analysis of the key building blocks of any classical liberal order, based on this venerable conception of property rights. One telltale sign that this is being done is the subversive use of quotation marks around such terms as “coercion,” “nuisance,” “causation,” “good faith,” and “intention of the parties.” It becomes all too easy to knock down the view that societies can follow the rule of law if language is so malleable that words prove incapable of carrying some reasonably precise meanings. To assert this claim of linguistic transparency is not of course to deny the existence of hard cases. But these populate any and all legal regimes no matter what their commitments. Thus we could ask the same skeptical questions about terms like “equality,” “habitat,” “social justice,” “privilege,” “basic rights,” “marginalization,” and “environmental impacts,” that are the building blocks of the modern regulatory state. The key point therefore is that some ambiguity besets every conception of the law. Pointing that out, without more, is hardly a decisive argument against any substantive position, be it liberal or conservative, classical or modern[1]. As the old sage once said, “we know of the existence of twilight, but do not therefore deny the distinction between night and day.”

[1] Here is one example from tort law. There is often a question of whether the standard of care that one person owes to his neighbors should be framed in terms of “good faith” or “reasonable care

The "rule of law" principle contains *no* explicit substantive component. Historically, the principles of natural law arise in efforts to escape the chaos and uncertainty that all individuals face in living in a state of nature. On this point, the Lockean instincts have proved largely sound in basic outline, even if wanting on matters of detail. Most people do have a strong sense of self-interest, but one which is tempered by an awareness of the rights of others, and a strong perception of how a small number of dangerous individuals could destabilize a fragile peace to the ruination of all concerned. So why then take the risk of forming governments whose monopoly over the use of force can also be productive of abuse? Only because the alternatives are worse. As Locke insisted, in the state of nature "There wants an *establish'd,* settled and known *Law,* received and allowed by common consent to decide all controversies between them."[2] The needed rules are meant to be (as they are often not today) "plain and intelligible."[3] State power also remedies the want of a "*known and indifferent Judge,* with authority to determine all differences according to the established law."[4] It is easy to be dismissive of these guarantees in wellfunctioning legal societies. They seem familiar, therefore elementary, and even banal. So why should anyone bother to discuss them. But think again. Any society plagued by massive civil disorder will be one in which these principles have been systematically disregarded. It was no accident that the libertarians who worked to restore the respect for law in South Africa were so insistent on these minimum procedural requirements that had previously been honored in the breach. It is always a dangerous intellectual course to take for granted the most important building blocks of a sound social order.

As these brief remarks indicate, the word "rule" in the phrase "rule of law" suggests at its core a strong prohibition on the *ad hoc* application of state power in individual cases against individuals or groups singled out for special treatment in either the criminal or civil justice system. Of course, this principle does not deny that prosecutors have to look at the facts of each individual case to see whether enforcement action is justified. But they must always undertake this investigation by reference to a substantive norm of general application. This simple *nondiscrimination* principle helps prevent public officials for singling out their enemies for retribution under rules that they would never apply to their friends. *Selective* prosecutions may be narrower in scope than general ones, but they create a degree of discretion that paves the way for exacting retribution.

The rule of law, however, is too thin if it only requires the use of general rules. The second formal element requires that these laws be published in advance and in clear

under the circumstances." One cannot decide that question by noting the vagueness inherent in the rival conception. The point is especially true given that *both* of these standards have their place in the law, and that each of them is subject to a reasonably rigorous interpretation. Good faith means that an actor should in principle weight the interest of another as equal with his own in making decisions under conditions of uncertainty, but absolves the decision maker of the consequences of innocent error. Reasonable care refers to the condition where a party is asked to take precautions up to the point where their expected costs at the margin equal their expected benefits. The meanings here are clear enough. Their application is often fraught with difficulty.

[2] John Locke, *Second Treatise* § 125.

[3] Id.

[4] Id. § 126.

form for all to see. so that everyone can steer clear of brushes with the law. Here again the sovereign still keeps complete control over the content of the rules, which could be harsh, unwise or counterproductive. But all else being equal, public and known laws are better than secret and variable ones that have the same objections. The general prohibition against *retroactive* laws flows nicely from this requirement. People are judged by the rules in place when they acted, not by rules brought to bear later on.

But what of the legal proceedings themselves? Now we come to the last of the core principles of the rule of law. Each person is entitled to have notice of the charges and to present his or her case before the neutral public official vested with power to decide the case. No general principle is self-enforcing, and the right to be heard on matters of both law and fact is yet another condition of a free and prosperous society. Ex parte, or one-sided procedures, may be appropriate to initiate some public action, but they are never appropriate to resolve conclusively any dispute that removes or infringes the rights and liberties of others.

The structural component of the rule of law also has something to say about the structure of our legislative institutions. By recognizing the need to discipline the use of coercive power, defenders of the use of law are drawn in modern political settings to divisions of legal authority that slow down the process of law making. It is no accident that the drafters of the American Constitution were drawn to a complex system with two major features: separation of powers at the federal level, and a federalist system that featured a division of authority between the national and state governments.[5] For these purposes, the precise details of these systems, and the enormous complexity that they generate, matter far less than the philosophical orientation that drives their adoption: the presumption against legislation out of the fear that it is likely to do more harm than good, given the diverse and selfish motives of political actors. Under this regime, moreover, a strong presumption exists against the delegation of large policy decisions to administrative bureaucrats that operate outside the glare of public restraint. As with the rule of law particularly, this presumption is free of any substantive commitments. Thus far the organization of the legal order is incomplete.

PROPERTY RIGHTS IN THE GRAND SCHEME

■ *What We Mean by Private Property*. The gains that are obtained from following the procedural safeguards of the rule of law are magnified when married to a substantive vision that affords strong protection of individual liberty and private property. For most purposes, these two notions should be treated as one, as they were in Locke's famous formulation of property that spoke of "lives, liberties, and estates,"[6] which has its pro-

[5] See, for the classical articulation, *The Federalist Papers* (Clinton Rossiter edition, 1961). Note that the Constitution separates federal powers when it vests the legislative power in Congress (Article I), the executive power in the President (Article II) and the judicial power in the Supreme Court (Article III). Elsewhere the Constitution protects federalism and states' rights. The Tenth Amendment, which modern cases have reduced to a truism, provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

[6] John Locke, *Second Treatise*, ch. 9, § 123.

found echo in the Due Process Clauses of the Fifth and Fourteenth Amendments, that protect against the state deprivation of "life, liberty or property, without Due Process of Law." For these purposes, I shall concentrate on the issue relating to economic growth and prosperity, and thus shall not address such well-known conflicts as that between individual liberty on the one side, and social order and national security on the other, except to say that the rule of law values outlined above require the same known and regular procedures for those suspected of treasonous and hostile acts that are needed to preserve prosperity in the economic realm. There is, quite simply, no area of human activity to which the principles of liberty and property are inapplicable.

With the focus on private property (and labor used for productive purposes), it is important to disabuse ourselves at once of the notion that these rights must be absolute in form and content just because they are critical. Unfortunately, that description of absolute property rights substitutes for the more nuanced account of its defenders in the ill-intentioned caricature created by the opponent of property rights. It is therefore important to see why the absolutist conception of private property goes astray in order to set up a more measured defense of a system of strong property rights.

The first objection to the absolutist notion starts with the simple observation that all societies from ancient times to the present must make room for common property. From the earliest times rivers and oceans and beaches were there for all to use and none to appropriate. That one simple rule made it possible to develop transportation and communication across complex social networks that could otherwise be blocked by one or more private property owners. Every modern society has the preservation and financing of these common elements as one of its core missions. The key question is to make sure that the governing rules are not tilted in a fashion that favors, for example, early comers to late arrivals in determining access to the network. To do otherwise, is to encourage people to stake out excessive claims early on solely to preserve their preferences over others'.

Yet most productive property is not embodied in networks, but in objects that are capable of being reduced to private ownership. It is at this point that the Roman and common law conceptions of private property come into their own. The first element of property rights in particular things is that they are rights that are good *against the world*, wholly without the consent of any other individuals. Unless that condition were satisfied, it would not be possible to create any secure entitlements in land, structures, equipment or indeed any form of personal property. No individual could claim to be owner of him or herself, so that no one would be in a position to bargain with everyone else to secure their own bodily protection or the ownership of external things that they acquire in all legal systems by taking first possession of otherwise unowned objects. The human population is in constant flux, so that the use of agreements to create initial entitlements could not survive the constant birth and death of other individuals. The initial creation of private property is therefore *social* at its core.

But that said, just what bundle of rights does private property give to its owner. The key insight here is that the rights themselves have to be defined in ways that allow them, consistent with rule of law principles, to be known and observed by all other individuals with whom no personal communication is possible. The choice of a sound property "baseline" is not random. Quite the opposite, the *only* set of rules that achieves

that goal is one that requires of all persons that they *forbear* from interfering with the property rights of any other person. Why forbearance? First, that right is *scalable.* The same configuration of rights can work with a society of 100 strangers or with one of a one billion people or anywhere in between. No matter who comes and goes, "keep your hands to yourself" remains the maxim of right conduct with which all can comply. More concretely, the acts of compliance are attainable in all societies, whether rich or poor. Thus traditional property rights differ strongly from modern positive rights to jobs or housing or health care in that these positive rights can never assume constant form, but are always dependent on the resource base of society, and political decisions on how those resources are to be divided. But the operative principles of the older system of property rights works equally well with ancient and modern societies. It is no accident that the Roman Law solutions to basic legal problems of property have survived without a hitch in modern times because of the deep structural unity found within the conception.

■ *The Bundle of Rights*. Yet just what does this property right give its owner against the rest of the world? One element of course is the right to *exclude* all other individuals from the ability to enter the property of another. Clearly if others can enter and take that property for their own use, the rights of an owner are gone. But what about lesser infringements of property that involve only its use, or its sale or other disposition to others? On the slightest reflection, it is clear that any robust conception of property rights has to imitate the classic liberal legal bundle that gives all persons the exclusive rights to *occupy*, *use* and *dispose* of their property. In addition (and this is an important detail) ownership of land carries with it the right to gain access to the communication and transportation networks that link private owners together and permit them to enjoy the gains from trade.

Putting the rights in this form is meant to dispel the notion that any one of the elements in this indissoluble bundle enjoys some *logical priority* over any other element of the bundle. And that deep and uniform conception of the property bundle is indispensable for wringing out the full value of all property rights. To see why, just think of a world in which the property rights in question contained only one or two of these three elements. Thus assume that the right to exclude others only gave the owner in question exclusive occupation of some designated land. How could the "owner" of that stripped down bundle decide to clear or cultivate the land or build improvements on it? Occupation, after all, only means the right to sit on the property, not to use or develop it. At this point, however, the rejoinder comes, just how are these use and development rights unlocked, if indeed they are to be unlocked at all? One wholly unsatisfactory solution is to say that the approval of everyone else is needed to unleash these rights, at which point we face the transactional obstacles that called for a creation of property rights in the first place. Alternatively, the right to use and develop property could be conditional upon the approval of the state, which can grant or withhold it at will. Yet by that account, the veto power of the public (whose legitimate position is by no means established) could easily block needed use and development.

It follows therefore that use rights must be part of the original bundle of rights protected by the legal system under the rule of law. Yet just what do these "use rights"

consist of? The vulgar conception is to claim that the right to use property permits one individual to use his gun to kill his neighbor or use his land to pollute his neighbor. No legal system to my knowledge has ever adopted so odd and indefensible a position.[7] A property owner must have exclusive use of his property, but it hardly follows that he should have unlimited use of that property. In all cases the key challenge posed to the legal system is to identify that set of consistent property uses that maximize the value of the holdings of all individuals within the group. The common law of tort and nuisance makes it improper to invade the space of another with bullets or pollution. The exact boundaries of these prohibitions take a good deal to explicate because of the complex cases that can arise at the margin. But as a first approximation it is enough to say that the law favors the *like* liberty of all to the use of their land that on average maximizes the value of all parcels of land subject to the common legal regime. To give one simple illustration of how the principle works, it has never been accepted under the private law that one person cannot build on his land because it will block the views of another. If that rule were rigorously pursued, the first occupant could not build while the neighbor's lay vacant, lest improperly he block his neighbor's right to build. The prior-in-time rule has no application between neighbors. The only choice is to allow both parties to build in their own time, or neither. That choice is easy if tested against the value of both parcels under the alternative rules. Better two houses with imperfect views than no development at all.

■ *Rights and Remedies*. The law that governs land use, moreover, does not only deal with the rights between the parties. It also has to govern remedies. On this question, it is easy to award damages for harms already caused or to enjoin by legal order those which are now taking place. The hardest question, however, deals with *threatened* harm. At this point, it becomes necessary to respond to two different forms of error. The first is to allow the harm that ensues when the underlying activity is not halted. The second is to halt the underlying activity even though it turns out with the benefit of hindsight that it would have caused no harm. Getting the right balance between these two errors is critical, and on this matter the traditional property rights approach held back from issuing injunctions until the threat of harm was *imminent*, so that any further delay would be reckless. At that moment, the legal system became unrelenting, so that the activity had to be stopped regardless of the cost and inconvenience that it imposed on the wrongdoer.

This approach got it exactly right. The late application of the clear, but tough, standard influences all that takes place before it. Every landowner who faces a potential threat of damages and shut down will respond prior to the event by altering his or her activities so as to steer clear of that danger zone. The number of actual invocations of the law will be small, as will the interference with ordinary land use decisions, since virtually all private decisions will generate no public oversight or review. The balance of error is about right. And, as we shall see, one key feature of this approach is that it dis-

[7] See, e.g., James Harris, *Property and Justice* 32 (1996): "If deliberate homicide is prohibited, it would never be even a prima facie defence that the murderer was using his own dagger."

penses with the need for any permitting process for virtually all land uses, and thus inhibits the luxuriant growth of the modern administrative state.

■ *Disposition*. And so we come to the third key element of the system of property rights: the right to dispose of property, be it by sale, lease, mortgage, gift, or bequest. Some of these transactions are commercial, often with strangers, and others are gratuitous, often with family members. Both elements have a key place in the overall scheme. A property system that had only rights of occupation and use could not take advantage of gains from trade through voluntary exchange. The entire system of contract depends on the same clear delineation of property rights noted above. Otherwise no one knows who is entitled to sell what. The law of contract then allows each individual to pick out those particular persons with whom he or she wishes to deal. The most important protection in contract law is the right to *select* one's trading partners for their wisdom, wealth, integrity, expertise and the like. At that point it is possible to enter into detailed transactions that take into account all the nuances rightly ignored in the basic delineation of property rights, which facilitates the division of rights in particular assets among various holders. These detailed and fine-grained arrangements could never form the basis of the initial delineation of property rights. In the simplest terms, to remove or limit the right to dispose of property, either in whole or in part, is to remove or limit the prospect of gains from trade. Yet to condition this right on the blessing of the state is again to create a system of divided authority which slows down commerce for no discernible gain.

■ *The Synthesis*. Let us take stock for a moment of where we stand. The formal system of the rule of law maps well into the system of property rights that I referred to above. The known and clear boundary conditions means that it is possible to meet the formal requirements of the rule of law in any property dispute between strangers or neighbors. The specifics of particular contracts mean that judges have a clear roadmap of how private transactions should be decided. Their job is to follow the jointly expressed intentions of the parties, not to impose restrictions on them that they have not agreed to themselves.

■ *Common Property and the Power of Eminent Domain*. We have thus far shown how substance and procedure work together toward a common end. But does it follow that we have done all the work we need to create a coherent system of the state. The answer is no. The nub of the problem lies in a point mentioned earlier on –that most legal systems must rely a mix of common and private property to create an efficient use of all natural and human resources. Those divisions may be marked out by nature in connection with rivers and oceans, but often times the creation of roads and other forms of social infrastructure requires the use of state power. Quite simply, the effort to purchase lands in a voluntary market from thousands of separate owners to create a highway ends in frustration when the clashing interests block the creation of the unified road. The single holdout can disrupt the network.

At this point, the high transaction costs of real estate assembly explain why government frequently resorts to the practice of eminent domain, even though this historic use

of state power always poses a threat to rule of law conceptions. The words *eminent domain* suggest the dominance of public ownership over private right. Eminent domain confers on the state the power to displace forcibly private owners from their property for public use, so long as it pays them for the value they lose when the property is taken. At this point, the central inquiry is how to discipline this takings power so that it does not run roughshod over the institution of private property that it is designed to buttress. The correct approach involves several key components that must be briefly set out.

The first of these involves the ultimate criterion for invoking that eminent domain power: just compensation. State coercion should be applied to overcome the difficulties of high transaction costs by seeking, to the extent humanly possible, to leave those persons subjected to its coercive power *better off* after its imposition that they were before. In some cases this test cashes out quite simply. In most cases in which property is taken, this test requires payment of a sum of money to restore the *equivalence* between the pre- and the post-taking state of affairs. In this situation, moreover, the correct measure of compensation should cover not only the fair market value of the property, but the full subjective value of the land that has been taken, which exceeds market value for those people who have not posted “for sale” signs. In addition, the various “consequential” losses associated with forced dislocation need to be offset as well. These include legal and appraisal fees, loss of good will tied to businesses at particular locations, the various moving expenses incurred in relocation, and any taxable gain triggered by the forced sale of appreciated property.

On the other side of the ledger, the government should receive a *credit* for any enhancement of value that arises as part of the overall program of which a particular taking is a part. In some cases, these offsets may be negligible, but in others they could be quite dramatic. The location of a government highway or railroad in some isolated region may often require *no* compensation for the land taken. All that need happen to justify this result is that the increase in value from the retained portion of land means that the present value of the smaller plot is greater than the market value of the original, larger plot before the highway or railroad is constructed. These offsets indicate that the full economic accounting should include what I have termed the *implicitinkind* compensation associated with any real property.

The uses of these offsets become absolutely critical, moreover, to understand larger social institutions such as taxation and comprehensive forms of regulation, where in some cases *no* cash is required so long as the overall operation of the program meets our basic test of returning benefits to the individuals who are so regulated or taxed in excess of their tax or regulatory burdens. Out of this argument comes, I think, a strong case for the now unfashionable flat tax that has appealed to classical liberal thinkers from Adam Smith to Friedrich Hayek.[8] It is a system that allows the government to determine its own revenue requirements, free of all *ad hoc* restraints. Yet it makes sure that each person in the polity bears some fraction of the social costs of government, which places an insistent financial check on the willingness of dominant social factions to overtax their populations for partisan gains. Understanding the public choice com-

[8] See Richard A. Epstein, “Can Anyone Beat the Flat Tax?”, *Social Philosophy and Policy*, 19, 2002, no. 1, pp. 140-171.

ponent –which relates to how individual self-interest can subvert collective political choices– is critical to implementing any systematic program of governance that addresses the rule of law and private property rights. A taxation regime that systematically insulates any fraction of the population from any of the shared burdens of citizens creates the modern version of a *rentier* class that lives off expanding government programs to which it contributes nothing. Accordingly, the new device of refundable tax credits for those who pay no taxes at all –an essential part of the Obama tax program– should be strongly resisted for its deleterious effect on political deliberation.

Taxation and regulation, then, should be limited to those objects that cannot be organized through voluntary contributions, of which infrastructure, social order and defense are dominant. The flat tax represents two judgments. First the form of the tax reduces the level of political discretion without limiting the power of government to meet its revenue needs, large or small. Second, hard as it is to trace the pattern of benefits derived from government programs, the simplest working hypothesis is that those benefits are on balance proportionate to income. Indeed, if anything, the flat tax favors those individuals located at the *bottom* of the income distribution. They presumably attach a large value to their personal security which exceeds their wealth in tangible assets. They are taxed only on the later and not on the former. Keeping them in the taxation system therefore helps achieve a central tenet of limited government: confining government to programs where its efforts are needed.

The just compensation prong may be the first element of a sensible analysis of the government's taking power, but the complete analysis joins to it two other elements. The first of these involves the so called *public use* requirement that generated so much controversy in connection with the recent Supreme Court decision in *Kelo v. New London*.[9] The need for some such restriction seems evident, for no one thinks that the eminent domain power should be invoked by rich and powerful individuals who covet their neighbor's property but are unwilling to pay what the owner demands for it. But how deeply does this prohibition against government use of the eminent domain power cut? No one thinks that it applies when the government takes property for roads, parks or official buildings, even those like the Pentagon, which are off limits to the public at large. It is difficult to imagine any account of public use that does not permit these takings.

The harder cases arise when transactional obstacles block sensible resource use. The most common examples include the nineteenth century cases where riparians were allowed to flood farmland in order to create a sufficient head water to power their mills.[10] The transactional obstacles that stood in the path of large social gains could not be overcome by voluntary transactions. Similar situations included allowing individuals to run trams over vacant scrubland in order to transport their ore to a nearby railroad from, as it were, a self-made spur line. Beyond this point, traditional courts were not prepared to go.

[9] *Kelo v. City of New London*, 545 U.S. 469 (2005) (holding that "economic development" was a "public use" that allowed the city to buy land from unwilling homeowners through eminent domain in order to build new retail spaces, apartment complexes and parks).

[10] See, e.g., *Head v. Amoskeag*, 113 U.S. 9 (1885).

Beyond *public use*, a second element to add to just compensation analysis is the government *police power*, which allows the restriction of certain activities *without* any compensation at all. The traditional formulation of the police power –the ability of the state to impose limitations on the liberty and property of those subject to its control in the name of "safety, health, good morals and the general welfare"– leaves much to be desired, especially in its last two components. But the good sense of this conception is derived from the high transaction costs situations that drive the creation of the system of private property in the first place. Revert back to the core cases of nuisance that arise when one person pollutes the land or water of the neighbor. That pollution comes in all sizes and shapes. Emissions from millions of tailpipes could pollute the air that millions of people breathe, including those who were responsible for emitting these pollutants in the first place.

In this situation, the mind-boggling complexity of countless private lawsuits, even those brought as class actions, is enough to scare away the hardiest defender of private ordering. So the proper use of the police power should meet this test: the state is entitled to fine, limit or ban by legislation those activities for which its citizens could collect damages for an injunction, if they could afford the expense of a private lawsuit. This *agency* theory of government is *not* intended to give the state new worlds to conquer through legislation, but instead to allow its intervention to pick up the enforcement shortfall of private lawsuits. What counts as a nuisance remains unchanged, as does the insistence that its injunctive relief is obtained only for actual or imminent harms. The basic objective here is to prevent political arbitrage whereby people hope to get in the political arena gains that are not obtainable through private litigation.

This classical liberal position is of course subject to some important exceptions, as is the case of nuclear power, where no warning signs of failure may be apparent before a catastrophic failure. Hence for cases of that "imperative necessity" antecedent inspections and constant government oversight are well within the pale. But even here the exposure of firms to extensive tort liability should remain in place as an additional incentive against dangerous behavior. As such, the operative questions are how to best design that system so that it does not elevate delay in the deployment of nuclear power to the political art form that it has assumed since the serious incident at Three Mile Island now 30 years ago. That same logic does *not*, however, apply to the construction of roads and bridges or to the shipment or drilling for oil, when done by responsible parties. All these activities could be subject to massive government shut downs and fines in the event of actual or imminent harms, obviating the need for a complex network of advance controls.

■ *Regulatory takings*. The scope of the takings arguments is not, moreover, confined to the cases that have thus far been discussed, namely those of dispossession from property. As noted earlier, the key conception of property is of the uniform bundle of rights that contains at least the exclusive possession, use and disposition of any particular piece of property. To be sure, if the land is occupied by the government, compensation follows under a virtual automatic rule for physical takings.[11] But what about

[11] *Loretto v. TelePrompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

regulatory takings that arise, for example, in common cases of zoning, where owners are allowed to remain on the land but are restricted in ways that go beyond the common law with respect to the use, development or alienation of the land in question. These restrictions are not small beer, for in zoning cases their cumulative weight can easily suck 80 percent or more out of the value of the land. But are those losses in value subject to compensation? Note that no private party could demand these land use restrictions unless they were prepared to purchase a covenant (to restrain the uses on nearby lands) or an easement (to allow limited use of nearby lands).

Why is the state any different when it acts as an agent of the people it benefits? Applying this theory, state land use restrictions should be compensable, subject to two key qualifications. First, some zoning restrictions may well pass muster as antinuisance ordinances, such as those needed to prevent unguarded sandblasting or fumigation in residential areas. But cases that raise those issues today are few and far between. Second, sometimes the cumulative and reciprocal restrictions on all owners within a neighborhood may well produce offsetting advantages that negate any loss of market value. No loss, no compensation, because now the zoning system works usefully to overcome coordination problems for private owners.

Taken as a whole, the constitutional law inquiry into takings can be restated in nice game-theoretical terms. A sound takings regime protects *positive-sum* government programs from invalidation while striking down (given that compensation could never be provided) *negative-sum* projects that use regulation as a disguised system of wealth transfer. So understood both private property and its eminent domain limitation are part of a comprehensive system to advance social welfare.

■ *Redistribution*. This exegesis of the classical liberal position on the rule of law and property rights has thus far omitted one issue that has grown in importance in the modern welfare state: redistribution of wealth to offset disadvantages from birth, ill fortune or social position. The logic here is overtly welfarist. It is widely (and correctly accepted) that individuals derive diminishing marginal utility from additional units of wealth. Some equalization of wealth therefore should, all else being equal, generate an increase in utility from the same amount of wealth. No one doubts that state power was used in part to achieve this end, but much of the work was done voluntarily.

In light of these efforts, it would be a mistake to think that those people who focus on the rule of law and property rights are indifferent to the questions of wealth imbalance. Historically that was never the case. Before the clear separation of the state from the family, redistribution within extended tribal units was a powerful and persistent norm. How else to explain such institutions as tithing, which work on voluntarist principles? But the limitations on the implementation of this principle need brief summarization. First, there were efforts to limit the scope of protection in order to preserve incentives for productive labor. A farmer might be asked to leave his gleanings for poor people to collect. But that method of assistance had three powerful consequences. First, it tended to focus redistribution on situations where survival was very much in issue, not in cases where all persons were well above the starvation level, albeit with different levels of comfort. That decision focuses the process where it is likely to do the most good. If the level of survival is at five units of resources, then a redistribution of two

units from someone who has nine to someone who has three could make a great difference. At seven units and five units, two people live instead of one. The parallel shift of 200 from someone who has 900 to someone who has 300 produces far less social gain when both are far above the survival level, if it produces any social gain at all. Second, the gleanings in question were limited in amount and proportionate, roughly speaking, to the levels of production. And third, the recipient had to collect the gleanings, and not rely on someone giving a cash payment that required no work. These de facto restrictions tamped down on the level of redistribution to preserve incentives for production. The modification of the basic system to include these social obligations was small and its net benefits substantial.

Second, there was a strong tradition of "imperfect obligations" to help the poor by contributions either directly to needy persons or to intermediate institutions that could regulate the flow of assistance. Once again the effort here is to find the right level of social support for the needy. The imperfect nature of the obligation kept the business of redistribution out of the legal system and left it in the hands of voluntary private organizations like churches, foundling homes and hospitals, who could usually better monitor the conduct of the recipients than any impartial or remote public agency. Often, the aid was limited to those with identifiable conditions like hunger, blindness, or deafness, which few if any individuals would fabricate in order to receive aid that offered only scant compensation for the harms given. The creation of public systems of support – e.g. public hospital wards– was meant to capitalize on these features so that the welfare system did not grow to unsustainable proportions. The solutions that were reached were often inelegant and capable of insensitive application. But they did make real inroads into the insistent problem of human subsistence at a time when the material resource base was far smaller than it is today.

THE MODERN SYNTHESIS

The task that remains is to identify how this classical liberal system broke down in both its rule of law and private property dimensions. The task is instructive, because on all the points that mattered in the older system, the newer approach relaxes the relevant systematic constraints on government action. In some instances public and private institutions have resisted these changes, and in other cases, the advances in technology, fueled in large measure by a strong intellectual property system that is now under attack from multiple quarters, have more than offset the risks in question. But the soundness of this modern system is now called into question quite dramatically by the concatenation of economic events during the fall of 2008. The recent events contain a fair measure of irony. One element of regulation that passes muster within the traditional system is that which requires some government support and regulation over the banking system. A fractional reserve system is needed so that banks can lend some of their deposits. Yet that system will fail if customers lose confidence in a particular bank. An instantaneous demand for the repayment of deposits will create a run on the bank. The bank could be solvent in the sense that its portfolio of assets exceeds its total liabilities. Yet that bank could be *insolvent* in a second sense if its lending strategies render it unable to pay off all depositors on demand. The bank run would shut down an other-

wise profitable bank simply because it was lending part of its deposits to entrepreneurs. The government guarantee helps to guard against this risk, but it in turn can be sensibly issued only if public bodies can impose some effective oversight on bank activities. The relaxation of these restrictions was, without question, part of the fall financial meltdown, so that a restoration of the traditional legal framework should not be regarded as a repudiation of either property rights or the rule of law. But other elements of the modern system must be subject to more critical scrutiny for the corrosive effect they have on the overall economic environment. Here is a rundown.

■ *The Rule of Law Diminished*. One striking feature about the modern administrative state is that it goes to great length to undo many of the procedural and structural features on the classical system.[12] Start with the proposition that all disputes should be decided before impartial judges under known and certain rules. Those conditions do not hold in the administrative state. One feature of the current system is how it empowers specialized agencies to make decisions on matters that fall within their respective domains of competence. The fragmentation of courts of general jurisdiction leads to the creation of special "quasi" judicial bodies that deal with labor relations, under the National Labor Relations Act of 1935, with the Civil Rights Laws, under the Equal Employment Opportunity Commission, with securities, under the Securities and Exchange Commission, and with the raft of decisions that are made inside such huge departments as the Department of Education and the Department of Housing and Urban Development. The members of each of these bodies are appointed for their supposed expertise in a given area. But since there is only one sort of issue before the tribunal, it is easy to type-cast all office-holders as liberal or conservative with a high degree of predictability. The knowledge that this risk could occur leads to statutory requirements that X members of a particular agency be appointed by Democrats and Y by Republicans. The National Labor Relations Board as of the Fall of 2008 was down to two members because of the partisan struggles as to who should be appointed to each Democratic or Republican seat. Efforts to game the system come from all sides. The spectacle should shake our confidence in the competence of these bodies.

The creation of these administrative agencies contains yet further difficulties because the courts, jealous of the size of their own dockets, often give a free pass to many of the decisions that these bodies make in determining their own governing law. The modern tendency set in early when the Longshoreman and Harborworkers Act, the Supreme Court held that it was proper to allow this agency to determine the scope of its own jurisdiction.[13] The manifest risk that an imperial agency would expand (or unduly contract) its own powers for selfish reasons was not regarded then, nor is it regarded today, as a sufficient reason for a neutral judicial review of the basic statutory framework. The risk of bias that is so evident in the rule of law tradition was systematically downplayed.

[12] For my more systematic account of these issues, see Richard A. Epstein, "Why the Modern Administrative State is Inconsistent with the Rule of Law", *NYU Journal of Law & Liberty*, 3, 2008, pp. 491-515.

[13] *Crowell v. Benson*, 285 U.S. 22 (1932).

The level of judicial abnegation has gone still further under what has become known in administrative law as the doctrine of *Chevron* deference, named after the seminal (if misguided) Supreme Court decision in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc*.[14] The *Chevron* test purports to organize the level of judicial review over the decisions of administrative agencies under the Administrative Procedure Act of 1946. That Act was a commendable effort to rationalize the relationship between courts and agencies in the wake of the New Deal expansion of administrative law. One of its stated provisions requires that questions of law should normally be reviewed *de novo* by appellate courts. By that test the courts need not pay any special attention to the agency's reasoning on questions of law that involve, typically, standard issues of statutory construction.

In an enormous concession to administrative power, however, the Supreme Court decided to *defer* extensively to agency decisions even on these purely legal questions of interpretation. Its famous two-step test required courts to reverse an agency decision when the applicable statute was clear –though it is often unclear when that is– and the agency's decision deviated from that statute. But in those cases where the statute was ambiguous, deference to agency expertise was preferred.

This decision represents a regrettable truncation of the rule of law principle. Of course, it is correct for appellate courts to defer to agencies on questions of fact in the record. They do the same for common law juries that decide these matters of fact. And there is some reason to respect the determination of an agency on the way in which facts are assembled to answer some particular legal question, such as whether all the evidence in question indicated that the level of threat for pollution reached or exceeded some threshold level. Once again courts exhibit the same level of cautious deference that they show to a jury entrusted with the same question of fact. But on matters of textual interpretation, no agency has any greater expertise than a court; with interpretive authority, an agency may self-interestedly bring certain matters into its orbit or exclude them at its pleasure. That form of deference occurs in cases in which agency expertise is at a low level, and the risk of political bias is far higher. Yet the modern position does not look with suspicion on delegation of these key questions to administrative agencies but loudly applauds it.[15]

The problem here becomes most acute because of the huge degree of agency "flip-flop" that is inherent in such decisions, which undercut the role of democratic institutions and enshrine the power of administrative agencies so that they often act like the potentates in days of old. My favorite example of this switch involves the interpretation of the "navigable waters of the United States" in the Clean Water Act, which started with the narrow interpretation of waters sufficient to support navigation only to transform itself so that it covers all "intrastate state lakes, rivers, streams (including intermittent streams), mudflats, sandflats, wetlands, sloughs, prairie potholes, wet meadows,

[14] 467 U.S. 837 (1984).

[15] "[A]n agency's construction of its own regulations is entitled to substantial deference." *Martin v. Occupational Safety and Health Review Comm'n*, 499 U.S. 144, 150 (1991). Why? "Because applying an agency's regulation to complex or changing circumstances calls upon the agency's unique expertise and policymaking prerogatives, we presume that the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers." *Id*.

playa lakes or national ponds, the use, degradation or destruction of which could affect interstate or foreign commerce.[16] The choice between these two definitions does not involve some fine recalibration of the initial standard. Rather it speaks of a revolution in understanding that takes a definition that covers a few defined water courses and makes it a major empirical challenge to find any land or water anywhere within the state that does not fall within the scope of this definition. No principle of interpretation that malleable can be regarded as consistent with the rule of law. The justices of the Supreme Court can read legislative text just as well as anyone else, and they should do just that to stop this kind of overreaching that invites nonstop lobbying especially with changes in the political party in charge of the executive branch. The delegation to the administrative state necessarily distorts the balance of power in any constitutional system.

The challenges to the rule of law also extend to the lifting or softening of the prohibition against retroactive legislation. These moves were routinely denounced under classical liberal theories. Not any more. Now the new fondness for administrative discretion has swallowed up this useful formal constraint. The constitutional prohibition against ex post facto laws is applied only to criminal sanctions, which is fair enough. Unfortunately, the traditional notions that no person should be deprived of life, liberty or property without due process of law has been uniformly held insufficient to block any change in law that carries only civil penalties or liability. The modern cases that mark the change are those which allow the government to impose additional liability to compensate persons for personal injuries for actions that were regarded as legal when performed.[17] And the same principle has been applied to allow the United States to force individual firms to participate in its Pension Guaranty Fund notwithstanding the explicit earlier promise that they could withdraw without penalty at any time if they so chose.[18] The supposed reason for this modern position is that all persons are on notice that the government could always change its mind. Of course, they were, which is why the rule of law guarantees were so important. Alas, under the modern system what was once the reason for limiting government discretion now serves as the justification for exercising that power. Yet in the long run the lack of confidence in public institutions will reduce the number of persons who will deal voluntarily with the government, which in turn will only expand the coercive power of the administrative state. We are fortunate indeed that the standard rule of law guarantees still apply to criminal prosecutions. But we are much the weaker by the rise of discretion in the conduct of an administrative state.

PROPERTY RIGHTS

The difficulties with the modern approach to the rule of law are only aggravated by the light regard paid to traditional property rights in the new legal order. The basic architecture of the common law was meant to reduce the level of discretion in political actors,

[16] For discussion, see *Rapanos v. United States*, 547 U.S. 715 (2006).

[17] *Turner Elkhorn v. Usery*, 428 U.S. 1 (1976). That principle has been limited modestly in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998*).*

[18] *Pension Benefit Guaranty Corp. v. R.A. Gray Corp.*, 467 U.S. 717 (1984).

by forcing them to face a world in which all rights in tangible and intangible assets were well-defined. On that view, *all* the incidents of ownership were accounted for in the private law setting. Any government that respected these equally could only strip *any* of those rights away for some definable reason that involved either the prevention of nuisances or the provision, in cash or kind, of compensation, and then only for public uses or limited policing. The power to force the surrender of property was there, but always closely regulated.

In contrast, today's misguided interpretation of property under the Constitution preserves only a fraction of the original constraints and removes the rest. The point becomes clear when we look at all the questions about the use of the state power of eminent domain under the newer conception. The first question in that system asks about the definition of private property. No longer does constitutional law follow the traditional trinity of possession, use and disposition. Instead it is now said that the "essence" of private property is only the right to exclude others. On this view, the per se rules for compensation apply *only* to efforts of the government to dislodge someone from possession of the land, or even set itself up as a coowner. The issues of use and disposition are often up for grabs. So it is useful to consider both types of cases separately.

■ *Dispossession for Public Use*. In the cases of outright dispossession, the sole obstacle against government action is the public use requirement, which has become largely toothless in recent years. In contrast to the traditional cases that allowed takings to acquire land for public use *or* to limit serious holdout problems for private parties, the modern view imposes only the narrowest limitation on takings for one designated individual in order to give land to other –a naked taking, as it were, from A to B. But astute public officials can today easily circumvent this restriction.

In particular, the three important Supreme Court cases of the last 50 plus years have all extended the condemnation power out of a consummate faith in the power of government land use planning. Thus in the 1954 case of *Berman v. Parker*[19], the court gave an expansive reading to the police power to authorize the taking of property that itself was in usable condition because it was located in a blighted area: health and safety were joined by a respect for aesthetic considerations.

Next in *Hawaii Housing Authority v. Midkiff*,[20] the public use requirement was read still more broadly to allow the state to condemn the landlord's interest in leased property at the request of the individual tenant who desired to own the property outright: "where the exercise of the eminent domain power is rationally related to a conceivable public purpose, the Court has never held a compensated taking to be proscribed by the Public Use Clause."[21] It is important to decode this sentence for general readers. The words "rationally related" mean the exact opposite of what is commonly understood. Far from suggesting that there is a cogent connection between the public ends and the means chosen to achieve it, the phrase suggests that exact opposite: any tenuous connection will do. For its part the words "conceivable public purpose" contemplates a set of ends that is far broader than those suggested by the initial constitutional phrase

[19] 348 U.S. 26 (1954).
[20] 467 U.S. 229 (1984).
[21] Id. at 241.

"public use." The use of this elastic test thus validated a statute where the state would only condemn the landlord's interest if the tenant first placed the needed sums in an escrow account in ways that removed all financial risk from the Hawaiian government. And why? To break up a supposed land oligarchy that had existed in Hawaii for many years –at a time when the landlord was trying to sell these properties in order to diversify the sovereign risk of direct regulation.

The culmination of this movement came in the *Kelo* decision of 2005, where private homes were condemned ostensibly for private developers whose redevelopment efforts were claimed to spur an expansion of the tax base. But again the Supreme Court never bothered to confirm whether this assertion could be true –the condemned land still lies vacant over three years after condemnation. Nor did the original city plan specify the purpose for which the land was to be used. *Kelo* thus survived only because of the generous standard announced in *Midkiff*. The public indignation it generated was borne of the populist sense that the sacrifice of property rights was done through an unholy alliance of developers and local governments.

Why this response, when *Midkiff* was met with relative public silence? *Midkiff* allowed sitting tenants to displace their landlords. *Kelo* allowed outsiders to throw sitting owners out of their homes. The wrench of possession explained the indignation, but the large source of anguish with this discretion lies in the general insecurity that it creates in all land titles, which in turn could act as a disincentive to private investment in properties that could be snatched away for a fraction of what they are worth. And the situation is in many cases even worse. There have been repeated claims that local governments cut back on their maintenance of public facilities in areas in order to reduce the value of the property subject to condemnation. The question of moral hazard exists in all areas of human activity. The lax standards for public use multiply the risk of its occurrence.

■ *Use and Disposition*. The legal issues change when the government action does not dispossess an owner from his property but restricts his ability to use or dispose of that property within the framework of the traditional common law rules. In connection with these modern "regulatory" takings, everything is now up for grabs. Clearly, no one supports the view that the state can routinely block all use and all sale of property. Indeed, under current law, the older conception of property rights still controls until the regulators move in. But governments will always act to fill an economic void. The bottom line therefore is that legislative or administrative actions can, and routinely do, subject these rights of use and development to government veto –all in the name of the public interest. Anyone who wants a sense of how elaborate the processes can become need only look at the complex multilayer process the Uniform Land Use Review Process (ULURP), which routinely strangles real estate development in New York City. It takes immense expertise to master the regulatory procedures involved: at a minimum they require an initial certification, followed by a Community Board Review, a Borough President Review, a City Planning Commission Review, a City Council Review, and a Mayoral Review.[22] Each of these steps reflects a different constellation of political in-

[22] See Uniform Land Use Review Process, http://www.nyc.gov/html/dcp/html/luproc/ulpro.shtml. It takes immense expertise to master procedures that at a minimum requires an initial certification,

terests, so that winding the way through the process is akin to threading six needles at a single time. Clearly no one is prepared to let go of the process, so that paralysis often replaces development. Laws like ULURP generate, through a torrent of legislation, the complex holdout situations that the common law definition of property rights helped avoid. Only the owners can build or use; but only if they can remove the omnipresent array of government vetoes.

The pattern of judicial deference thus ushers in a new era in which the use of state power is no longer tied to a narrow set of ends served by a well chosen set of means. The same relaxation on both means and ends that was announced in *Midkiff* carries over to the distinct question of regulatory takings. It is not only the process that becomes interminable. It is also the wide range of purposes, often dubious, to which it can be put. No longer is the state limited in its power to enjoin only that conduct that poses an imminent threat of harm to others. Today the imminence requirement is completely scrapped. In its place the state at a minimum can condition its permit on a landowner's showing that under no conceivable circumstances will his actions cause traditional forms of nuisance. This new balance radically increases the expense of running a public land use system. Now every case is brought into a political maze no matter how tiny the risk of harm. Most of these reviews are useless, and easily coopted to slowing construction by neighbors who crave the peace and quiet for which they are not prepared to pay. No one could deny that this system produces some benefits to the winners: otherwise we would not witness the political machinations. But the relevant social question is not whether those benefits are positive, but whether they are larger than the harms that regulation inflicts on the losers. Here is one rule of thumb that suggests it is not. The people who loudly insist on restricting the activities of their neighbors would *never pay* what it costs to buy out the easements and covenants that are needed to put those restrictions in place. Who would pay $1,000 to cover the loss to a neighbor if he only got $100 in return?

Yet the system is even worse than this. It does more than relax the imminence requirement with regard to means/ends connections. It also vastly expands the class of "legitimate" ends that justify, under an elastic account of the "police power," regulation without compensation. Any desirable social improvement may do the job. It is thus commonly held that local governments can use zoning restrictions to preserve the "character" of the neighborhood by forbidding new construction that some committee deems to be "incompatible" with the neighborhood. Often times these restrictions prevent owners in designated landmarks protection districts from improving their property, unless they hew to some original architectural scheme fashioned decades before –no matter how inappropriate to the modern setting. And there is little doubt today that it is legitimate for the state to devise rules that mandate high population densities in some regions and low densities in others. The broad swathe of public powers also allows local governments to impose large lot, set back, and height restrictions limitations on

followed by a Community Board Review, a Borough President Review, a City Planning Commission Review, a City Council Review, and a Mayoral Review. Clearly no political figure will let go of the process. Since each

the construction of new homes, even those that provide small benefits to neighbors at great costs to owners.

The new legal system also reverses the common law view that the first to build has no right to stop construction by late arrivals that block their views. And the artificial division of development into different zones for commerce and residential use, which prevents the coherent development of neighborhoods, is routinely sustained as well. Nor are these regulations confined to the external features of new development. In New York City the regulations go so deep as to require all renovations of private homes and apartments to meet disability standards dealing with wheelchair accessibility to all portions of the apartment. Elsewhere, relaxing the common law rules on nuisance makes any environmental issue a trump over private property rights. Filling in wetlands, developing real estate that is used by wild animals for foraging, cutting down timber that houses endangered species are all legitimate government activities.[23] Yet the absence of any compensation obligation, overreaching is again the order of the day, for nothing whatsoever limits the cause of environmental protection to those harms that fall in the public domain or the private property of other individuals. It is as though the instinct that landowners have for the preservation of their own properties counts for little in the social calculus.

The rise of this permit culture is the most salient feature of modern land use regulation. Its full impact cannot be gauged simply by looking at a single permit in isolation. Multiple government agencies are concerned with safety, population density, esthetics, environmental protection, disability, and traffic; each has its own veto power over any new project or the modification of any existing one. The right measure of social welfare in this case asks whether the *combined* weight of this new luxuriant permit system exceeds its costs. The answer to that question has to be a rousing no. Quite simply the permitting process today for most new projects takes longer than the construction process and could be every bit as costly.[24] The new norm is for the formation of seductive "public/private" partnerships, which stifle initiative by encouraging developers to seek cozy deals with planners whose legitimacy they implicitly shore up with each successful personal appeal. These permit costs mount further if we add back in the futile expenditures of seeking permits for projects that never get completed. Yet no one on the government side takes into account the time value of money. Indeed the United States Supreme Court takes the position that the cost of delay by a "normal" –read ever longer– permit process imposes only noncompensable losses on landowners.[25] That risk is then compounded by the further rule that no one is allowed to challenge a restriction in court, until all administrative remedies are "exhausted," which of course gives local governments ever greater incentives to draw out their administrative processes to protect dominant local interests.[26] Nor is the ballot box an effective remedy for the nonvoters who would like to move into a community where the permit barriers are

[23] See, e.g., *Smith v. Town of Mendon*, 822 N.E.2d 1214, 1215 (N.Y. 2004).

[24] For a vivid first person account of how this happens, see Doug Kaplan, "The Allure of Public/Private Development", *The Insider*, 11 (Fall 2008).

[25] See *First English Evangelical Church of Glendale v. County of Los Angeles*, 482 U.S. 304, (1986); *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 535 U.S. 302 (2002).

[26] *Williamson County Regional Planning Commission v. Hamilton Ban*, 473 U.S. 172 (1985).

kept high. And to make matters worse, all sorts of procedural obstacles make it almost impossible to bring these cases in federal court, out of the reach of locallyelected judges.[27]

The cumulative effect of these restrictions is ample, often running up to 80 percent of the value of the land. Nor is there any expectation of systematic gains to neighbors or other nonowners that exceed these losses. The majoritarian politics that drives administrative control cannot be defended on the blithe assumption that all neighbors lose from new development. The development can be stopped by the majority even when important neighborhood groups stand to gain as well. In most cases, the indirect gains and indirect losses to neighbors are likely to cancel out. In all cases, however, the direct losses in land values remain. The process repeats itself countless times, usually with the same result. All the adverse publicity in the land use area is focused on cases like *Kelo*, where the government forces people off their own lands. However, most of the social losses come from the endless rounds of regulation which swap (at best) small external gains for large immediate losses. Developers may play one municipal government off against another. But landowners receive no compensation for the loss of the capital value in their lands.

■ *Exactions*. The downward cycle created by weak protection of rights of use and development has spawned yet another practice: land use *exactions* that are used by local governments and private owners to unlock the value in real estate that is tied up in the permit system. Under the current rules, each new permit creates the opportunity for local and state governments *to sell back* to landowners their common law rights of use and development. If you want to develop a "wetland" in the middle of town, "mitigate" the losses by purchasing some land for the government elsewhere in the county or municipality. If you want to add an additional story to a new residence, by all means enter into a deal whereby some fraction of the space will be devoted to affordable housing at below market rates, or agree to pay a special assessment to build a new school, fix a train station, or start an art museum.[28]

The key point here is that these improvements are demanded in order to reduce the tax burdens that are otherwise charged to current residents who often find themselves in a no-lose situation. If the conditions are accepted, they receive free goods paid for by new entrants. If they are denied, the low densities of the neighborhood are preserved. Today this exaction game goes on largely without judicial supervision. To be sure, two Supreme Court cases instructed that some limits should be placed on the power of local governments to issue permits in exchange for favors.[29] But those cases have lost all their pop because of the conscious and consistent efforts of lower federal and state court judges to find some legitimate purpose to every condition that is attached to a particular permit.[30]

[27] See, e.g., *San Remo Hotel, L.P. v. City & County of San Francisco*, 545 U.S. 323 (2005).

[28] See, e.g., *Ehrlich v. City of Culver City*, 911 P.2d 429 (Cal. 1996).

[29] See *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987); *Dolan v. City of Tigard*, 512 U.S. 374 (1994).

[30] See, e.g., *Rogers Machinery, Inc. v. Washington County*, 45 P.3d 996 (Or. Ct. App. 2002).

■ *Disposition*. The inefficiencies that exist with the restrictions on use have some parallels with those on disposition. The issues in question should be grouped around three standard types of transaction: sales, leases, and mortgages, each of which has its own peculiarities. Once again the simple logic of public choice economics explains the observed patterns. Local governments will never impose restrictions on the prices that local owners can sell their property at. Tenants have fewer inhibitions against setting maximum rental prices. Fortunately, the long-term destructive effects of rent control on communities seems clear, so that the tendency today is to back away from these restrictions, not to advance them. There is too much evidence available about the orderly operation of rental markets in unregulated communities for most localities to want to develop the peculiar dysfunctional rent control cultures of New York City, Cambridge Massachusetts or Santa Monica California.

In those localities that do adopt some rent control statute, these statutes tend to be upheld, even though they allow tenants to disregard the terms of their leases. Nonetheless, the weak conception of property rights treats private landlords as though they operate public utilities. Under the modern rent stabilization laws, they are entitled to recover, roughly speaking, the current costs of their operation plus a fair return on their invested capital.[31] They cannot be required to accept annual percentage increases below the level of inflation.[32]

This convenient formula sounds plausible until due notice is taken of what it omits from the equation. All increases in the underlying value of the property inure to the tenant, and not to the owner. All reductions in land values fall on the landlord, as tenants are free to leave unless the landlord lowers the rent. This heads-I-win-tails-you-lose system of accounting transfers a key component of the ownership bundle to tenants without just compensation. The upshot is a real deterrent on new construction, which in turn forces up the prices of existing units that are outside the rent stabilization laws. Systematic application of rent control regimes often leads to an erosion of the tax base, which makes it harder for cities to provide the social services that they might otherwise wish to provide.

The rules governing mortgages may follow the same pattern. Left free of government intervention, the initial terms of mortgage –interest, duration, security, foreclosure– should be decided by voluntary agreement. Nonetheless, legislative intervention to forestall foreclosure received its constitutional blessing from the Supreme Court in the 1930s, even for mortgage moratoria that delayed loan repayment, which in turn reduced the worth of the lender's lien. This inability to foreclose at the end necessarily compounds the willingness to lend at the outset.[33] Yet the legislative effort to forestall one kind of tragedy in fact spurred on a second, for those banks that could not foreclose on loans failed when they were unable to repay their depositors. The deep problem in the 1930s was that a persistent *deflation* required loan repayments with more expensive dollars than those that had been borrowed. That defect, however, can

[31] *Fisher v. City of Berkeley*, 693 P.2d 261.294□295 (Cal. 1984) (requiring reasonable economic return on investment).

[32] *Helmsley v. Borough of Fort Lee*, 394 A.2d 65 (1978) (invalidating ordinance that limited rent increases to 2.5 percent for want of administrative relief in hardship cases).

[33] See, e.g. *Home Building & Loan Association v. Blaisdell*, 290 U.S. 398 (1934).

only be countered with another portion of the classical liberal playbook –the preservation of a stable unit of public currency, which can serve as a reliable ruler for *all* private transactions. Unfortunately, *no* adjustment of the risk of default between lender and borrower can neutralize this deflationary mistake. To be sure, the current spate of mortgage defaults, often by borrowers –who put little or no money into the property– is not tied to deflation. In this heated legal environment, the insistent legislative calls to renegotiate loans downward has put additional pressure on the home mortgages, which makes it more difficult for the holders of securitized interests to value or rationalize their frayed portfolios. A solid system of property rights in mortgages, coupled with the elimination of subsidized loans, would have gone a long way to limit this difficulty.

■ *Redistribution*. The last point of comparison touches the thorny question of income or wealth redistribution. Within the modern administrative state the combination of broad administrative protection and weak property rights leaves the amounts and objectives of redistribution to untrammeled legislative and agency discretion. The careful efforts to limit redistribution to cases where it is likely to do the most good are displaced by the confident assertion that people have all sorts of positive rights to jobs, to health, to education, and a living wage. The correlative duties on other persons are systematically suppressed by assertions that these duties fall on the state, rather than on the individuals who are taxed to fund these obligations. The allocative losses from redistribution are usually ignored, often by the implicit assumption that the dollar taken from one results in a dollar given to another. That implicit assumption overlooks the decline in overall wealth attributable to factional struggles and administrative costs. Even harsher words are due to the perverse patterns of redistribution brought on, for example, by an endless array of farm subsidies that provide government support to our unembarrassed financial elites. The total amount of these unfunded obligations continues to grow in our most popular welfare program. Today's only serious debate over Social Security, Medicare (with its new Part D on prescription drugs) and Medicaid is not whether they will become insolvent, but when that will happen, and what horrific dislocations will follow.

We are now at a critical juncture in the United States as we are caught between two sets of social forces that could aggravate the current dislocation. On the one hand there are enormous pressures to expand the amount of transfer payments to certain individuals. The current catch-phrase speaks of refundable tax credits, which are disguised welfare payments to individuals who have already been insulated from all obligations under the income tax. Yet on the other side there are proposal now afoot, especially with unions and health issues, to shrink the national resource base by placing new burdens on voluntary exchange. The simple math indicates that any nation that tries to increase redistribution while reducing productivity is heading for a crash of major proportions. There are of course sensible voices that counsel against these reckless programs. Political prudence, however, may not be sufficient to forestall the political pressures that move so strongly in the opposite direction. Yet it is worth noting that this potential economic meltdown could never happen within a classical liberal framework that rests on the twin pillars of limited administrative discretion and strong property rights. The right attitude on redistribution is not to rule it out of bounds on first prin-

ciples, when in fact there is always some (but not unlimited) considerable public support for these programs. But the better approach is to adopt what I have termed elsewhere a philosophy of "redistribution last."[34]

The overall strategy is this. First make sure that the productive side of the economy is in good shape, which should work through open competition and vibrant markets to raise the level of overall wealth, including that acquired by the least fortunate in society. Once that base is preserved the scope of redistributive policies can be accordingly reduced, given that a large resource base is coupled with a lower level of need. In this environment, the reduced burden allows voluntary contributions to pick up more of the slack, which further reduces the need for public funding. In stark contrast, the current entitlement cycle drives the relationship between production and redistribution in the wrong direction, as fewer resources must meet ever larger political demands. The feared, but more likely, result of this vicious circle is that the bubble that has burst in the real estate markets will burst elsewhere as entitlement programs consume a disproportionate fraction of national wealth. The price of our rejection of the rule of law and strong property rights is steep indeed.

CONCLUSION

The point of this systematic point-by-point comparison of the classical liberal and modern positions should now be clear. We are in a position to understand the negative synergies that inevitably emerge whenever governments abandon a legal system that rests on the twin pillars of the rule of law and strong property rights. Of necessity, the complex modern procedures needed to deal with the new, fluid system of property rights confer huge gobs of discretion on government officials at every level. That discretion in turn generates new political claims that consciously block the productive use of scarce resources. The case for classical liberalism does not rest on some mysterious alchemy or atavistic yearning. It rests upon a clear appreciation that limited government and definite property rights are the only reliable barriers against the corrosive force of unregulated selfinterest. Discretion is the sine qua non of political life, but only in that important set of issues that require collective decisions in the organization of the government work force and in the direction of key polices on matters that go to war and peace and foreign relations. I am aware of no serious political thinker who believes that any sensible set of institutional arrangements can avoid the necessity for collective political choice on matters that can often go to national survival. But all decisions are not of that sort, for it is possible to discipline key government activities of taxation, regulation and eminent domain so that government actors do not swallow up the liberty and property of ordinary people in the belly of an ever larger and more undisciplined administrative state. The current fuzzy border between public and private function has allowed government to encroach too frequently on matters of economic and social choice that are best left to private development and cooperation.

[34] "Decentralized Responses to Good Fortune and Bad Luck", *Theoretical Inquiries in Law 309 (Article 11)*, 9, 2008, http://www.bepress.com/cgi/viewcontent.cgi?article=1179&context=til.

Think of the problem in terms of a simple model in which the quantity of regulation demanded increases as the cost of obtaining that regulation decreases. In a world without definite property rights enforced by clear procedures, the cost of acquiring property rights through regulation or taxation approaches zero, at which point the demand for regulation or taxation skyrockets. In effect we see a veritable explosion to acquire private assets for public uses at bargain prices, which is in turn met by the fierce resistance of those whose wealth is placed at risk by political forces. The critical role of a robust just compensation requirement is that it introduces a conscious price mechanism to discipline the public appetites for private assets. No one can say that this set of property protections is perfect. No system ever is. But in the long run the best that any system of governance can do is to play the odds. The old wisdom in favor of the rule of law and private property needs to be restored today, more perhaps than ever before in this nation's history.