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Property Rights and the Social Contract: the constitutional challenge in the U.S.A.

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IN A MANNER reminiscent of Socrates, the proponents of land value taxation strive to convince people of the validity of ideas that lie on the edge of their consciousness, not yet acknowledged. Because no one made the land, a person can have a respectable claim to the use of more than a proportionate share of land only if he or she compensates those who thereby have less than proportionate shares. Thus the rent of land must be collected socially. But when people begin to entertain this idea, and realize that it implies that the sale price of unimproved land would fall to practically nothing, they often are brought to a halt by the thought that this would constitute a 'confiscation of the property of landowners,' and therefore could never be acceptable.

My purpose is to analyze in detail the concern that land value taxation would be confiscation. I will begin by discussing the theory of confiscation, and then consider how this theory applies to land value taxation. I will argue that by using a constitutional amendment it is possible to implement 100% land value taxation, without compensation for the virtual disappearance of the sale value of land titles, while still being faithful to the values that lie behind the concern for confiscation.

There is a good side to the concern about confiscation. This concern reveals an understanding that there is potential for governments to intrude upon what properly belongs to individuals, and that such intrusions ought not to be allowed. Such an understanding is one of the requirements for successful democracy.

But why does the prospect of land value taxation trigger the concern for confiscation? Why is it *not* generally seen to be confiscation when a government appropriates to itself a substantial fraction of what individuals earn from their labor and capital? To persuade the people who talk of 'confiscation' that land value taxation ought not be regarded as confiscation, we must understand what they mean by this term.

The fifth amendment to the U.S. Constitution ends with the words, 'nor shall private property be taken for public use, without just compensation.' This clause reflects the understanding that governments are capable of taking what belongs to individuals, and the desire to prevent this abuse of power. But a constitution can only express principles in the broadest terms. The detailed meaning of a constitution emerges over time, as its principles are interpreted in legislation and legal cases. And the 'takings clause' has been at the center of a great deal of debate and numerous legal challenges to government action.

One of the most widely respected analyses of the body of law that has emerged from cases involving the takings clause is a 1967 paper by Frank Michelman in the *Harvard Law Review*.[1] One of Michelman's principal conclusions was that if one wished to state rules that would distinguish the cases where courts had decided that a government action constituted a taking of property, for which compensation was required, from cases that courts had decided did not constitute takings, and therefore did not require compensation, then the following rule was central:

If a government action reduces the value of something that a person owns to nothing or nearly nothing, then that action is a taking of the person's property, and the government must provide compensation. On the other hand, if a government action reduces the value of something a person owns only partially, leaving a significant fraction of the original value in the hands of the owner, then that action is not a taking of property, and no compensation is required.

In a more recent review of the law of takings, Michelman summarized the apparent current position of the Supreme Court as follows: For activities that are nuisances there is no issue of takings. For other activities, a government action is a taking if it involves

permanent physical occupation of property or if it eliminates all economic value of the affected property.[2] There is one further test to which the court may have given the same authority.[3] A government action may be a taking if it represents a reversal of an earlier government position on which an aggrieved person relied in making an investment.

This summary of the existing rules is consistent with regarding a tax that collects all the rent of land as confiscation, while not regarding as confiscation a tax that collects half the return to capital. When all the rent of land is collected by a tax, the sale value of unimproved land can be expected to fall virtually to nothing, so by the stated rules the tax is a taking that requires compensation. On the other hand, a 50% tax on the return to capital is not a taking by this rule, because capital still retains a significant fraction of its original sale value.

But why, it might be asked, do we tolerate government actions that eliminate substantial fractions of the value of property when we do not tolerate government actions that take all the value of property? To answer this question I shall first address the question of why it is that government actions that eliminate all the value of things are unacceptable.

The reason, I believe, is that we understand that one of the ways in which democratic decision-making can go awry is that a 'tyranny of the majority' may develop. That is, a faction that constitutes more than half of the legislature may take over and make all decisions in whatever way suits themselves, without taking any account of consequences for those outside the faction. Our expectation that legislative bodies will operate through political parties reflects an acceptance of factions, although the rarity of straight party votes is an indication that the legislative process generally involves more than a simple imposition of the will of a majority faction on the whole group.

If a majority faction were to take over a legislative process completely, then one of the things that they might do, in the absence of a constitutional constraint, would be to pass laws by which the property of people who were not supporters of the faction was appropriated for their purposes. We know that this would involve unnecessarily unfair discrimination against those whose property

was appropriated, because if the property in question actually were needed for public purposes, then it would be possible to call on everyone to contribute to a fund from which those whose property was to be taken could be compensated. And so to prevent unnecessarily unfair appropriations by a majority faction we forbid the taking of property for public purposes without compensation.

Why, though, is the same analysis not applicable to actions that take part of the value of things? Indeed, there are some legal scholars, notably Richard Epstein of the University of Chicago Law School, who assert that the requirement of compensation for takings *should* be understood to apply to all diminutions of value from public actions.[4]

I believe that there are two reasons why Epstein's view has not generally prevailed. First there are the 'transactions costs' of implementing universal compensation. If anyone who had property that was adversely affected in any noticeable way by government actions was eligible for compensation, there would be substantial additional administrative costs of processing all the claims. The possibility of receiving compensation could be expected to give rise to artificial claims and to exaggerated statements of the magnitude of valid claims. If the administrative costs of dealing with claims of compensation for partial losses of value are large relative to the magnitude of the claims, and if partial losses of value of property are a commonly recurring phenomenon, then the uncompensated losses will be sufficiently equally distributed for nearly everyone to benefit more from not having to contribute to the compensation of others than he would lose from not being compensated himself, and none of those with net losses would lose all that much.

A second reason for not compensating for partial losses is that these losses may reflect coherent decisions about who should bear which costs. For example, we are now in the process of limiting the use of chlorofluorocarbons (known as CFCs), to avoid further damage that CFCs do to the ozone layer of the atmosphere. This development is likely to reduce the value of equipment that has been created for the sole purpose of manufacturing CFCs. If we do not compensate the owners of such equipment for the losses they incur as a result of the phasing out of CFCs, then the producers of other substances will be motivated to be more concerned about the

potential harmful consequences of their own products. It is as if we were saying that the past existence of a particular state of affairs does not create an entitlement to the perpetuation of that state. What people are entitled to is an evolving best guess as to what is in the general interest. If people develop expectations that go unfulfilled because of an evolution in our understanding, we can classify those expectations as ones that should not have been developed in the first place.

Thus it is that a distinction is made between a government action that eliminates all the value of something, which is regarded as a 'taking,' and would be regarded as confiscation if compensation were not provided, and an action that reduces the value of something, which is not considered a taking, and for which no compensation is required.

This distinction between actions that take all the value of things and actions that take only part of the value of things has been challenged recently by the introduction of the concept of 'conceptual severance.' This idea is best explained with an example. Suppose that a local government passes a regulation stating that no buildings taller than 100 feet may be built. From what has been said so far, it would appear that this is not a taking of property. The new regulation may diminish the sale value of some land, but there will still be many ways in which it can be used. Suppose however that some people, concerned about shadows, have been purchasing from others easements specifying that no building taller than 100 feet will be built on specific sites. Occasionally someone who has a site for which such an easement has been sold buys it back again so that he will be able to construct a building taller than 100 feet. At the time when the new regulation is passed, there is someone who has just repurchased such an easement and is about to begin construction. The regulation can properly be said to take 100% of the value of the easement that he has just purchased. This would appear to mean that the regulation constitutes a taking, at least as far as he is concerned, and that he is therefore entitled to compensation. More generally, for any regulation that restricts the use of property, there is a possibility of a contract in which the right to precisely that action is exchanged. Therefore, we can 'conceptually sever' the right at issue from the remainder of the property, and the regulation will properly be

described as taking all the value of what has been conceptually severed. And if such contracts *could* exist, what difference should it make whether they *actually* exist for the issue of whether compensation must be paid?

An example of conceptual severance becoming actual severance, and threatening to intrude upon the issue of compensation, arose in the recent case of Keystone Bituminous Coal Association versus DeBenedictus.[5] This case arose from a Pennsylvania law that requires coal companies to leave in the ground enough pillars of coal to insure that the ground will not collapse. This seems like an eminently reasonable regulation, which would diminish the value of coal holdings by little enough not to qualify as a taking. But there is more to the story. Many years earlier, the coal companies had purchased, along with mineral rights, what in Pennsylvania is known as the 'support estate,' by which is meant the right to be assured that the surface will not cave in. Somewhat remarkably, people built extensively even though they knew that coal companies held the support estates. Such building is not necessarily financially irrational. If it was reasonable to expect that any mining that did occur would be far enough in the future that the investments in improvements could be recouped before the mining started, then it was not irrational to improve the land without owning the support estates. But as the years passed, the holders of the surface rights came to rely on an indefinite postponement of the mining that had earlier been contemplated.

While permitting limited mining, the Pennsylvania law had the same effect as a law prescribing that every coal company that held support estates without the corresponding surface estates was required to turn the support estates over to the holders of the surface estates. If the law had been written in that fashion, the court would almost certainly have declared that it served private rather than public purposes and was therefore a deprivation of property without due process of law. With the law written as it was, however, the Supreme Court said that the law could be justified by a State's power to regulate nuisances, and even if the caving in of the surface had not been a nuisance, it would not have been a taking in any case since the coal involved consituted only about 2% of the companies' total holdings. The Court thus rejected the notion that the severability of

the support estate might transform a permissible regulation into a taking. The distinction between government actions that take some of the value of things people own and those that take all their value was maintained by the courts, though at some cost of apparent obtuseness. The court was saying, in effect, 'We all know what a "thing" is, so we all know what it means to take all the value of a thing.'

Michelman has an explanation of why the courts would refuse to deal with conceptual severance. According to Michelman, the protection of property against confiscation is the manifestation of a desire by our constitutional founders to provide 'a private sphere of individual self-determination securely bounded off from politics by law.'[6] The concept of property, existing apart from law, seemed entirely natural and unproblematic to our constitutional founders. For modern legal thinkers, on the other hand, property is made murky not only by conceptual severance, but also by the possibility of treating as property any advantage that accrues to individuals by virtue of legislation (tobacco acreage allotments, import quotas, broadcasting licenses, etc.).

An intractable problem is created, Michelman says, by the fact that we want both popular sovereignty — rule by the people— and limited government, and these two ideals must inevitably conflict. We use the idea of property to manage the conflict between popular sovereignty and limited government to specify the boundary between a region of activity that can be controlled by legislation and a region where individuals are free from legislative intrusions. Because of the great importance of this rôle of the idea of property, courts resist such notions as conceptual severance that would tend to undermine the coherence of the concept. To preserve the boundary-identifying rôle of property, courts search for formal tests like 'permanent physical occupation' and 'elimination of all economic value' that connect with common understandings of what property is all about.

To show how 100% land value taxation can be acceptable despite its virtual elimination of the sale value of titles to unimproved land, I must explain how the function of preserving the boundary between where individual rights prevail and where democratic process prevails can be sustained, even though the ban on actions that eliminate

all the values of things is apparently violated. For this purpose it is useful to examine in more detail the limitations of democratic decisions.

A well-functioning government is understood to be a device through which people pursue the common good. In an ideal world, everyone would have the same perception of the common good, and all government actions would be approved unanimously. In our less-than-ideal world, on the other hand, we are rarely able to achieve unanimity, for two distinctly different reasons. First, people may have the best of intentions but still have differing perceptions of the common good. Second, people may pursue their selfish individual ends rather than the common good in their democratic participation. Whichever reason is the cause of departures from unanimity, there are things to be said in favor of democratic process. If the departures from unanimity are caused by differing perceptions of the common good, by people who have no selfish intentions, then democratic process is a useful way of settling on the view that is most likely to be right. On the other hand, if departures from unanimity are caused by the pursuit of divergent selfish purposes, it can still be said that, if the average advantage to those who favor a measure is the same as the average disadvantage to those who oppose it, then a democratic decision among the affected persons will reveal whether the measure is in the overall net advantage of the group.

These arguments in favor of democratic process do not prove that if a proposal is adopted by a democratic process, then it is necessarily the best thing to do. Sometimes the option favored by the minority will be better, either because the majority, though unselfish, happen not to be such good judges, or because the majority are selfishly intruding on the minority in ways that harm the minority much more than the majority would benefit if they were to prevail. The selected course of action expresses what the group has decided it *shall* do, and the possibility that the group actually *should* do something else cannot be precluded. There is no infallibility in democratic process. Rules like the prohibition of takings without compensation are intended to identify classes of cases where the likelihood of the action being an inappropriate pursuit of selfish advantage is so high that better results can be expected on the whole if these actions are precluded.

What makes the institution of 100% land value taxation an appropriate democratic action despite its apparent violation of the proscription of uncompensated takings is that it is pursued for reasons that have nothing to do with selfish advantage. Land value taxation is concerned with insuring that all receive their shares of our common heritage, and that all are able to decide for themselves how the wages of their labor and the interest from their capital shall be used.

Nevertheless, for those who do not yet see the merit of land value taxation, the claim that its advocates are not pursuing selfish advantage is easily doubted. The political landscape is full of proposals that cloak selfish advantage with claims of high purpose. How are the advocates of land value taxation to demonstrate their *bona fides* and distinguish their proposal from all these others?

The answer to this question, I believe, lies in the writing of another modern legal scholar, Bruce Ackerman. In a series of lectures titled 'Discovering the Constitution,' Ackerman elucidated the argument that James Madison used to defend the Constitution against charges that it could not be valid because the body that drew it up was not authorized to do so.[7] What Madison said was that the validity of the foundation of a nation came not from its adherence to a pre-established protocol, but rather from ability of a proposal to gain the respect of people despite its lack of proper antecedents.

As Ackerman explains, Madison was expounding a theory of political participation that dovetails with the distinction between legislation and constitutional provisions. The consideration of legislation is an activity that is so unending that it would be unreasonable to expect citizens to devote enough time to it to be able to participate in all issues on a truly informed basis. Politics is an occupation for some, a hobby for others, and for most of us an activity with which we have only a passing acquaintance. As a result, the legislative process becomes dominated by political specialists and special interests. Because it would be unreasonable to expect voters to devote enough time to political questions to prevent this, it is not something that can be corrected; it must simply be accepted.

On rare occasions, however, a political question comes to be so prominent in public discussion that nearly everyone comes to have a reasonably well informed opinion on the subject. It is only on these

occasions that The People of a nation can be said to have spoken. The constitution of a nation, on this view, is a device for limiting the range of action of those who tend to politics between the times when The People speak.

What this means for land value taxation is that its introduction would not be barred by the constitutional prohibition of uncompensated takings if it were introduced as a constitutional matter rather than a legislative matter. There are several perspectives from which this makes sense.

First, as a matter of logic, constitutional amendments are on the same footing. One constitutional amendment cannot preclude another. Second, there is precedent. It is embarrassing to admit that the original American constitution provided for the perpetuation of slavery. When slavery was renounced at the end of the Civil War, the Fourteenth amendment provided that, '... neither the United States nor any State shall assume or pay ... any claim for the loss or emancipation of any slave.' Not only did it happen that no compensation was paid, but the possibility was explicitly ruled out. In adopting this provision we were as much as saying that those who held slaves should have known that it is not possible for one human being to own another. Any 'losses' arising from the social recognition that all humans are free cannot be the basis of valid claims for compensation. As Henry George pointed out, the introduction of land value taxation has much in common with the freeing of slaves.[8] Both involve the restoration to individuals of their birthrights — to the disposition of their time and talents, and to their shares of the heritage that Nature provides to sustain us. For the same reason that slave holders did not have a respectable claim to compensation, neither do landholders. It should be obvious that no one can have a claim to own land, because no one made the land. The fact that land titles happen to have permitted individuals to use excessive shares of our common heritage, without compensating those who thereby have less than their shares, cannot oblige us to perpetuate this unjust arrangement indefinitely.

Another way of putting this point is to say that a framework specifying the requirements of justice must provide for the possibility of moral evolution. To insist that a particular arrangement must be perpetuated because of its past existence, irrespective of the

moral understanding of the current generation, would be nothing but ancestor worship. If, upon examination of the way that rights are allocated, the current generation discovers an impropriety, they must rectify it. If the granting of their just deserts to those who were previously deprived requires that someone else receive less than he or she had previously expected, then there is no one more suited to bear this disappointment than those who claimed more than their shares in blind disregard for justice.

This does not mean that the poor widow whose life savings were used to buy land titles (if there really is such a person) must starve. We have an obligation to provide for all who cannot provide for themselves, for whatever reason, and in any case the poor widow would be entitled at least to her share of the rent of land.

This defense of 100% land value taxation, without compensation, has implications for the way that this idea ought to be pursued. It means, first, that it is inappropriate to suggest that any individual ought to favor 100% land value taxation because he or she will pay less in total taxes. Attention to such selfish considerations is inconsistent with the justification for not paying compensation. Furthermore, while there are good arguments for land value taxation from the perspective of promoting the overall efficiency of an economy, it is out of order to dwell on these. If 100% land value taxation is required by justice, then 100% land value taxation would be required even if it imposed an economic burden on an economy. Also, it would be inappropriate to pursue political stratagems that might make it possible to achieve 100% land value taxation as the program of a narrow coalition of political activists. It is only the change in society's consensus regarding the requirements of justice that makes it just to institute the change without compensation. The primary task of the advocates of 100% land value taxation must be to spread the understanding that the earth is the heritage of all humanity. We must seek the grand coalition of all rather than a narrow majority.

These remarks on the ethics of advocating 100% land value taxation, it is to be noted, do not apply to the proposal to reform the property tax in urban areas by shifting taxes from improvements to land. The reason for this is that if the property tax were replaced entirely by a tax on land that yielded the same revenue, there would be little if any fall in land prices. In fact, the shifting of taxes from

improvements to land probably causes land prices to rise on average. This is because the average piece of land pays the same tax as before, but now land is more valuable because it can be improved without creating additional tax liability. Any losses in property values would be inconsequential. It is this absence of anything like a taking that makes the proposal for property tax reform fair game for ordinary politics, where it is permissible to suggest that people vote in terms of their self interests and to seek victory through a coalition of activists.

Returning to the issue of 100% land value taxation, the idea that the earth is our common heritage leads to a different understanding of the boundary between what is politically permissible and what is an impermissible intrusion upon individuals. The idea of not taking property without compensation is fundamentally linked to preserving the property arrangements of the status quo. The alternative perspective, consistent with 100% land value taxation, is that no individual can have a just claim to any special advantage. The only claims that individuals can make are upon the products of their labor and capital, and upon equal shares of what nature provides. What must be shared equally is not only the advantage from using land, but also the advantages from using such things as radio and TV broadcasting opportunities, zoning exceptions, taxicab licenses if they are limited, fishing permits, and so on. Justice is then maintained not by preserving the distribution of advantages described by the status quo, but by preserving equality in the distribution of returns from government grants of rights.

NOTES

1. F. Michelman, 'Property, Utility and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law,' *Harvard Law Review* 80 (1967) 1165-1258.
2. F. Michelman, 'Takings 1987,' *Columbia Law Review* 88 (Dec. 1988) 1602-04, 1622.
3. *Ibid.*, 1604, footnote 21.
4. R. Epstein, *Takings, Private Property and the Power of Eminent Domain* (Chicago, University of Chicago Press), 1985, p. 349.
5. *Supreme Court 107* (1987), 1232.

6. F. Michelman, 'Takings 1987,' *Columbia Law Review* **88** (Dec. 1988) 1626.
7. B. Ackerman, 'Discovering the Constitution,' *Yale Law Journal* **92** (1984), 1013, 1039-43.
8. H. George, *Progress and Poverty* (New York, Robert Schalkenbach Foundation), 1979, p. 362-63.