

ECONOMIC IMPLICATIONS OF WIDER COMPENSATION FOR "TAKINGS" OR, WHAT IF AGRICULTURAL POLICIES RULED THE WORLD?

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No matter how many times socialism fails in practice, a good socialist can always deduce a new vision of socialism that will result in a workers' utopia. Similarly, no matter how many federal farm programs fail, agricultural economists can always concoct proposals for new government farm programs that they promise will miraculously avoid becoming shameless boondoggles.¹

INTRODUCTION

Ever since the Just Compensation Clause² was first applied to compensate a property owner for the effects of regulation,³ courts have struggled to develop legal criteria that separate cases where compensation is justified from those where it is not.⁴ A concept central to these criteria is that of "reasonable, investment-backed expectations." This concept, as Professor Michelman noted, has its roots in Bentham:

Property, according to Bentham, is most aptly regarded as the collection of rules which are presently accepted as governing the exploitation and enjoyment of resources. So regarded, property becomes "a basis of expectations" founded on existing rules; that is to say, property is the institutionally established understanding that extant rules governing the relationships

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1. James Bovard, Book Review, WALL ST. J., Sept. 3, 1992, at A8.

2. "No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken . . . without just compensation." U.S. CONST. amend. V.

3. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922).

4. See Charles H. Montange, *Regulatory Takings, Property, and Stick Theory*, 3 FERAE NATURAE 9 (Vt. L. Sch. 1992) (providing a discussion of the difficulty courts and legal scholars have had in defining regulatory takings).

among men with respect to resources will continue in existence.⁵

If such expectations are upset by regulatory action, a basis may exist for a takings claim. Thus, the issue of expectations is of special relevance to decisions about compensation for the effects of regulation.

This article considers four aspects of these decisions. First, to the extent that the disappointment of reasonable investment-backed expectations is used to justify compensation, such a takings test will be frustrated continually because expectations (even if investment-backed) are unobservable and subject to strategic misrepresentation by self-interested agents. Second, this approach to takings seems to require an assumption of imperfect foresight by the person from whom property is taken, an assumption at odds with a considerable body of economic theory advanced by conservative critics of government intervention in the name of rational expectations. Third, some argue that if compensation for takings is paid more widely, it would help "internalize"⁶ the costs of regulation, leading regulators to regulate less, and thus more efficiently. This claim is inconsistent with the theory of rent seeking in regulation advanced by many economists. Fourth, the experiences of agricultural land use and policy provide a rich empirical foundation for examining these issues. Where compensation for regulatory incursions is the norm, as in agricultural policy, rational agents misrepresent their past expectations and maneuver to receive compensation. The historical experience and current practice of agricultural policy shows that in such circumstances, government regulation tends to expand rather than contract, and adverse impacts result for both efficiency and the distribution of benefits. If the experience of U.S. agricultural policy provides a foretaste of wider compensation for takings, it should give pause to conservative opponents of excessive regulation.

5. Frank I. Michelman, *Property, Utility and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1211-12 (1967) (footnote omitted).

6. See *infra* notes 53-63 and accompanying text.

I. REASONABLE INVESTMENT-BACKED EXPECTATIONS

Since the 1922 case of *Pennsylvania Coal Co. v. Mahon*,⁷ the Just Compensation Clause⁸ has been subjected to various interpretations. In *Pennsylvania Coal*, the Supreme Court for the first time extended the Just Compensation Clause of the Fifth Amendment to require compensation for reductions in property value in certain circumstances of government regulation. Justice Holmes wrote that the general test of whether compensation is due depends on what he called "average reciprocity of advantage,"⁹ a somewhat vague concept in which an individual's private property rights must be weighed against the effects of the use of that property on her neighbors.¹⁰ Some of these effects are direct, such as polluting a neighbor's land; others are less direct, such as real estate development that diminishes the use of property for recreation; and still others are based on the protection of public safety or natural resources, and the neighbors affected may be construed as society as a whole.¹¹

In the 1978 case of *Penn Central Transportation Co. v. New York City*, the Supreme Court sharpened the economic criteria applied to the balance between private and public rights.¹² The Court considered whether compensation was due after Penn Central's application to build a fifty-story office building on top of Penn Station was denied by the zoning authority of the New York Landmark Preservation Commission. The Court considered three factors relevant to the determination: (1) whether the economic impact of the restriction on Penn Central was sufficient to require compensation; (2) whether denying the permit interfered with Penn Central's reasonable, investment-backed expectations; and (3) whether the character of the restriction of zoning was substantially related to the promotion of the general welfare in preserving

7. *Pennsylvania Coal*, 260 U.S. 393.

8. U.S. CONST. amend. V.

9. *Pennsylvania Coal*, 260 U.S. at 415.

10. *Id.* at 416; see also Kenneth Berlin, *Just Compensation Doctrine and the Workings of Government: The Threat from the Supreme Court and Possible Responses*, 17 HARV. ENVTL. L. REV. 97, 105 (1993).

11. Berlin, *supra* note 10, at 105-09.

12. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978).

historic landmarks.¹³ In brief, the Court's answer was no, no, and yes.¹⁴

The second criterion, of reasonable, investment-backed expectations, is the focus here, and enters significantly into the much-discussed 1992 case of *Lucas v. South Carolina Coastal Council*.¹⁵ A 1988 South Carolina statute¹⁶ prevented Lucas, who had invested in beachfront property in 1986, from building on it because of the property's proximity to the seashore. Lucas argued that the property had lost all of its economic value, and that the statute interfered with his reasonable, investment-backed expectations, thereby entitling him to compensation. Weighed against Lucas' private claims were the public interests protected by the Beachfront Management Act,¹⁷ and represented by the South Carolina Coastal Council. These public interests included the role of undeveloped beachfront as a storm barrier, as habitat for plants and animals, and as protection from erosion and harm to property.¹⁸

On appeal from the Supreme Court of South Carolina, which had denied Lucas' claim for compensation,¹⁹ the U.S. Supreme Court wrote five separate opinions in the case. The majority opinion, written by Justice Scalia and joined by Justices White, O'Connor, Thomas, and Chief Justice Rehnquist, remanded the case to the South Carolina Supreme Court.²⁰ Justice Kennedy

13. *Id.* at 124-38; see also Berlin, *supra* note 10, at 110.

14. *Penn Central*, 438 U.S. at 124-38. With respect to (1), it was determined that the economic impact of the restriction was insufficient because Penn Central could still profit from the railroad terminal and its airspace up to 50 stories high. With respect to (2), it was determined that the restriction did not interfere with reasonable, investment-backed expectations because Penn Central could still use the terminal for its railroad operations, its original intended purpose when built and purchased. With respect to (3), it was determined that the character of the restriction did not physically invade the property and was "substantially related to the promotion of the general welfare" because it preserved an historic landmark. *Id.* at 138.

15. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2892 (1992).

16. Beachfront Management Act, S.C. CODE ANN. §§ 48-39-250 to 48-39-360 (Law. Co-op. 1976 & Supp. 1992).

17. *Id.* § 48-39-260.

18. *Id.*; Berlin, *supra* note 10, at 118.

19. *Lucas v. South Carolina Coastal Council*, 404 S.E.2d 895 (S.C. 1991), *rev'd*, 112 S. Ct. 2886 (1992).

20. *Lucas*, 112 S. Ct. at 2889-902.

concurring in a separate opinion.²¹ Justices Blackmun and Stevens dissented vigorously,²² and Justice Souter dissented on the technical ground that the case was not yet ripe for decision.²³

Justice Kennedy's concurring opinion in *Lucas* was largely based on the argument that a taking occurs when a regulation "deprive[s] the property of all value . . . [where] the deprivation is contrary to reasonable, investment-backed expectations."²⁴ These expectations, Justice Kennedy claimed somewhat heroically, are "based on objective rules and customs that can be understood as reasonable by all parties involved," and that must be viewed "in light of the whole of our legal tradition."²⁵ By supporting regulatory actions "without a determination that they were in accord with the owner's reasonable expectations and therefore sufficient to support a severe restriction on specific parcels of property,"²⁶ Justice Kennedy argued that the Supreme Court of South Carolina had erred. In addition, the fact that other investors had been allowed to build prior to the regulation left *Lucas* to bear an undue burden.²⁷

Justice Scalia's approach involved a more oblique appeal to expectations: the state may regulate without compensation when an inquiry into the owner's estate shows that "the proscribed use interests were not part of his title to begin with."²⁸ In such circumstances, uncompensated regulation is justified because there are pre-existing expectations that the property may be restricted.²⁹ But this theory begs the fundamental question: *whose expectations are to count?*

In contrast to real property, Justice Scalia argued that the buyer of, say, a used car should anticipate and beware of unpleasant regulatory surprises: "[B]y reason of the state's traditionally

21. *Id.* at 2902-04 (Kennedy, J., concurring).

22. *Id.* at 2904-17 (Blackmun, J., dissenting); *id.* at 2917-25 (Stevens, J., dissenting).

23. *Id.* at 2925-26 (Souter, J., dissenting).

24. *Id.* at 2903 (Kennedy, J., concurring). See generally Berlin, *supra* note 10, at 120.

25. *Lucas*, 112 S. Ct. at 2903 (Kennedy, J., concurring).

26. *Id.* at 2904.

27. *Id.* at 2904; Berlin, *supra* note 10, at 120.

28. *Lucas*, 112 S. Ct. at 2899.

29. *Id.*

high degree of control over commercial dealings,' the owner . . . 'ought to be aware of the possibility that new regulation [will] render his property economically worthless (at least if the property's only economically productive use is sale or manufacture for sale).'³⁰

Why land is set apart from other commodities, according to Justice Scalia, is related to the fact that land is generally bought and sold with written *title* (although so are used cars). Justice Scalia argued that if restrictions on the property's use are not part of the title, or are not included in a more general nuisance regulation, then the restrictions can be regarded more readily as a surprise deserving of compensation. Justice Scalia even conceded that a landowner "necessarily expects" land use regulation, but that the "constitutional culture" of takings would be inconsistent with allowing the state to deprive the landowner of all economically valuable use.³¹

In this sense, Justice Scalia's oblique reasoning favors, even more strongly than Justice Kennedy's, the argument that unpleasant surprises resulting from regulation deserve compensation. The contents of the title, plus the general law of nuisance, provide the essential data that an investor-landowner such as Lucas should be expected to know. If a later regulation upsets this expectation, then a basis for a takings claim may exist. Justice Kennedy's argument suggests a larger amount of information that someone should be expected to know, and follows the precedent set in the *Penn Central* case more closely. But *both* arguments are ultimately about the disappointment of expectations, and what should constitute reasonable prior knowledge.³²

30. Berlin, *supra* note 10, at 124 (quoting *Lucas*, 112 S. Ct. at 2899) (footnotes omitted).

31. *Lucas*, 112 S. Ct. at 2899, 2900; see *infra* notes 44-52 and accompanying text (discussing the policy implications of the burden of proving expectations).

32. Berlin observes:

In today's highly regulated world, the expectation that future regulations would not restrict or prohibit the use of property in certain circumstances is unreasonable. Justice Scalia admits as much in the commercial personal property context. If title is rationalized as locking in the state of regulation at the time of transfer, just compensation analysis could only consider actual past restrictions, not expected future regulation. While the concept of title incorporates prohibitions in the law not written explicitly in the title, Justice Scalia apparently limits the cognizable prohibitions to those recognized in the

II. STRATEGIC MISREPRESENTATION OF EXPECTATIONS

Assume for the moment that investors in land cannot influence the market or regulatory environment; they are both "price takers" and "rule takers."³³ What a buyer of property expected at the time she bought it is of course not directly observable. In Justice Scalia's narrow test, what is written on a title, together with any liens, and the "proscribed use interests" that are not written in the title, such as nuisances under state law, constitute a minimum of what might be expected.³⁴ However, this is far less than an investor ought to know to purchase an interest in land. The broader scope of reasonable investment-backed expectations used by Justice Kennedy is still subject to the problem that these expectations are not observable, and are extremely subject to misrepresentation. If an appeal is made to what a reasonable observer might have known at the time about the likelihood of regulation, according to some "objective rules,"³⁵ the subjective essence of the market investment mechanism is lost. As leading economic theorists of risk have emphasized, "[i]t takes a difference of opinion to make a horse race."³⁶

One response to the argument that expectations are unobservable takes the form of what economists call "revealed preference." Insofar as an investor puts his money into a particular parcel of land, when he could have done something else with it, he is validating his belief in a particular expectation of both the market and the regulatory environment. However, the fact that an expectation is investment-backed may or may not be evidence in

relatively restrictive common law of nuisance. He rejects the notion that prohibitions in statutory law enacted after the passing of title limit the definition of property despite the fact that these laws reflect a community's judgment that an activity is socially harmful. Use of title rather than investment expectations is more favorable to sophisticated developers, who are treated less generously than the average person by the investment-backed expectations test, but would be treated equally well under the title test.

Berlin, *supra* note 10, at 127 (footnotes omitted).

33. See generally DENNIS C. MUELLER, *PUBLIC CHOICE* (1979).

34. *Lucas*, 112 S. Ct. at 2899.

35. *Id.* at 2903.

36. Michael Rothschild, Lectures for the Department of Economics at the University of Wisconsin (1977); see also Michael Rothschild & Joseph E. Stiglitz, *Increasing Risk I: A Definition*, 2 J. ECON. THEORY 225 (1973) (offering a formal treatment of the principle in practice).

favor of its reasonableness, and thus its candidacy for compensation. His preferences may be revealed, but they are not necessarily reasonable, and may reflect a penchant for high risks,³⁷ or what financial analysts call "plunging." Many investments, especially in natural resources such as land potentially rich in oil, gas, or minerals, are extremely risky. This risk arises from both natural and man-made sources, including regulatory ones.³⁸ In some cases, one could do as well by *random* exploration as by forming a reasonable expectation of which lands would yield profitable oil, gas, or minerals.³⁹ Similar points have been made concerning financial assets using darts thrown at stock market quotations in newspapers. Expectations, even when investment backed, are not objective, and may reflect the judgment of a gambler or a fool.

Even worse, to the extent that investors know compensation is available for potential losses, investors may favor riskier investments. As economists have shown, by truncating the downside risk of an investment, expectations shift in a way that actually draws money into higher risk ventures.⁴⁰ As in insurance markets, problems of moral hazard and adverse selection come into play when the terminally ill seek life insurance, the savings and loan industry's portfolio shifts to highly speculative land deals in response to government insurance, or gas and oil companies drill too many dry holes because of government depletion allowances.

Two notable cases of what might be called "investment-backed plunging behavior" motivated by the expectation of compensation are flood insurance and agricultural subsidies. As Daniel Farber notes in a recent critique of compensation for takings:

Suppose a landowner is considering a further investment in his property, but there is some chance that the property will be flooded by a proposed dam. We would like the owner to consider this possibility when deciding whether to make an

37. See generally Theodore Graham-Tomasi et al., *Foresight and Expectations in Models of Natural Resource Markets*, 62 LAND ECON. 234, 237-39 (1986).

38. *Id.* at 240.

39. See generally C. Ford Runge, *Energy Exploration on Wilderness: "Privatization" and Public Lands Management*, 60 LAND ECON. 56 (1984).

40. Graham-Tomasi et al., *supra* note 37, at 237-39.

investment, since the investment will be wasted if the dam is built. But if the owner can obtain full government compensation for the flooding, she has no reason to take the possibility of the dam into account. (If the dam is not built, the owner can expect a return from her additional investment, while she gets her money back from the government if the dam is built after all.) So the owner is indifferent to the possible construction of the dam and hence will tend to overinvest, with a consequential loss in economic efficiency.⁴¹

In the case of U.S. agricultural subsidies, by truncating the downside risk of losses due to declines in market prices, compensation encourages over-investment in certain subsidized crops, and discourages the development of private markets for crop insurance. Since crops are only partially "insured" by government subsidy schemes known as "deficiency payments," crop losses often lead to calls for "disaster relief."⁴²

In summary, the attempt to define "reasonable investment-backed expectations" as a basis for takings, either obliquely by reference to title and nuisance law as Justice Scalia suggested or directly as Justice Kennedy suggested, suffers from three critical problems. First, what someone expected or should have expected at the time is strongly subject to strategic misrepresentation. Second, whether an expectation is "investment-backed" is no guarantee of its reasonableness. Third, to the extent that potential compensation becomes a part of expectations and investment behavior, it encourages riskier investments and over-investment.⁴³

41. Daniel A. Farber, *Public Choice and Just Compensation*, 9 CONST. COMMENTARY 279, 285 (1992) (footnote omitted); see also Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1, 20 (1985); Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509 (1986); Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CAL. L. REV. 569 (1984).

42. See generally WILLARD W. COCHRANE & C. FORD RUNGE, REFORMING FARM POLICY: TOWARD A NATIONAL AGENDA (1992). On the truncation of risk due to government intervention in agricultural commodities markets, see Frederick I. Johnson, *Price Supports Under Uncertainty: The U.S. Oats Market*, 1 AM. ECON. 22, 36-44 (1989).

43. These problems will be demonstrated in part V by examples from agricultural policy.

III. WHITHER "RATIONAL EXPECTATIONS"?

A large part of the theoretical debate over macroeconomic policy in the 1970s and 1980s was driven by a group of Chicago School theorists, led by Robert Lucas (no apparent relation to the South Carolina investor), who asserted the inutility of government regulation in the face of "rational expectations."⁴⁴ In brief, these theorists argued that if the expectations of investors were "rational,"⁴⁵ that is, provided accurate forecasts, on average, given current information, then this foresight would disarm policymakers who sought to manipulate monetary aggregates, such as the money supply, and thus interest rates. By second-guessing regulators and regulations, rational investors could do them one better by positioning themselves to take financial advantage of regulations that they expect to become law. The "Lucas critique" led to the conclusion that economic policy was likely to be far less effective than generally supposed. Rational agents could second-guess regulators sufficiently often so that activist policy is jettisoned and policymakers retire to setting monetary aggregates as a form of stable background noise.⁴⁶

Naturally, this line of argument was congenial to conservatives, who placed a greater confidence in market forces than in bureaucrats or legislatures. Disregard for the comparative rationality of government is central to many arguments for wider compensation for takings. Regulatory judgments of efficiency, according to Michelman, "require insight (which legislators and planners possess in no greater quantity than the rest of us) into the idiosyncratic sources and capacities for well-being of the several members of society."⁴⁷ Justice Scalia, in *Lucas*, is especially critical of legislative findings as a basis for takings, arguing that "[s]ince such a justification can be formulated in

44. See Robert E. Lucas, *Some International Evidence on Output-Inflation Tradeoffs*, 63 AM. ECON. REV. 326 (1973); Robert E. Lucas, *Econometric Policy Evaluation: A Critique*, in THE PHILLIPS CURVE AND LABOUR MARKETS 19 (Karl Brunner & Allan H. Meltzer eds., 1976) (supplement to *Journal of Monetary Economics*).

45. See generally John F. Muth, *Rational Expectations and the Theory of Price Movements*, 29 ECONOMETRICA 315 (1961).

46. See Finn E. Kydland & Edward C. Prescott, *Rules Rather than Discretion: The Inconsistency of Optimal Plans*, 85 J. POL. ECON. 473 (1977).

47. Michelman, *supra* note 5, at 1180.

practically every case, this amounts to a test of whether the legislature has a stupid staff."⁴⁸

In response to the rational expectations critique of government policy, defenders of activist monetary and fiscal policy mounted counterattacks on rational expectations theory, showing how even with assumptions of nearly perfect foresight, government was needed to satisfy certain requirements for equating supply with demand, or "market-clearing."⁴⁹ In many markets, including the market for land, the rational expectations hypothesis ("REH") was unsupported by the data.⁵⁰

It is interesting that the REH, if taken seriously, has destructive implications for a theory of government takings. If private agents are presumed to have sufficient information to disarm the actions of government policy, including regulations affecting property, then they are incapable of reasonable, investment-backed expectations that are overturned by regulatory policy. In a game played by private investors against government regulators, if the investors can forecast the actions of the regulators, as well as the actions of others, then they are positioned not only to avoid takings, but actually to *profit* from them.⁵¹ If it is known which actions government is likely to take, investors can maneuver to advantage, whether the action is an open market operation of the Federal Reserve or the zoning of land. To the extent that investors' reasonable expectations are rational, regulation is unlikely to upset them, and the case for compensation is weakened, if not destroyed.

An alternative approach to expectations formation, more consistent with empirical studies of land markets, is that

48. Lucas, 112 S. Ct. at 2898 n.12.

49. See generally INDIVIDUAL FORECASTING AND AGGREGATE OUTCOMES: "RATIONAL EXPECTATIONS" EXAMINED (Roman Frydman & Edmund S. Phelps eds., 1983).

50. See generally KEVIN C. MOORE & WILLIAM H. MYERS, PREDICTIVE ECONOMETRIC MODELING OF THE U.S. FARMLAND MARKET: AN EMPIRICAL TEST OF THE RATIONAL EXPECTATIONS HYPOTHESIS (1986).

51. See Roman Frydman, et al., *Rational Expectations of Government Policy: An Application of Newcomb's Problem*, 49 S. J. ECON. 311 (1982).

investors form expectations "adaptively,"⁵² updating them as new information becomes available. This approach to expectations is entirely consistent with the argument for compensation. However, if potential compensation becomes a *part* of these adaptive expectations, it introduces much more serious threats to both efficiency and distribution. The most serious of these is "rent seeking."

IV. RENT SEEKING AND COMPENSATION

At the same time that the rational expectations arguments were being made by members of the Chicago School, a complementary group of "public choice theorists" developed political-economic arguments against regulation. These arguments were founded in the theory of rent seeking: that rational agents, acting as special interests, would seek to steer the actions of government to their own advantage.⁵³ Analogous to the price-making powers of a monopoly, if individuals could become "rule makers" rather than "rule takers," then by helping to write their own rules, they could extract "rents" from the rest of society.⁵⁴

There are at least two sources of inefficiency introduced by rent seeking if compensation for takings were to become widespread. First, self-interested agents will maneuver to receive compensation, actually *seeking to be regulated* in some cases. One such case is the Conservation Reserve Program ("CRP") of the U.S. Department of Agriculture. Second, pressure groups will attempt to affect regulations and the flow of compensation in ways that benefit them, spending resources on this manipulation rather than on directly productive activities. Again, the manipulation of agricultural subsidies provides an instructive example.

52. See generally MOORE & MYERS, *supra* note 50. See also MARC NERLOVE, *THE DYNAMICS OF SUPPLY: ESTIMATION OF FARMERS' RESPONSE TO PRICE* (1958) (providing the classic theoretical treatment of adaptive expectations).

53. See generally *THE POLITICAL ECONOMY OF RENT SEEKING* (Charles K. Rowley et al. eds., 1988). The phrase "rent seeking" is generally attributed to an article on the use of trade measures to extract rent through protection at the border. Anne O. Krueger, *The Political Economy of the Rent Seeking Society*, 64 *AM. ECON. REV.* 291 (1974).

54. See generally *THE POLITICAL ECONOMY OF RENT SEEKING*, *supra* note 53.

These possibilities do damage to the arguments of Fischel and Shapiro,⁵⁵ and of Richard Epstein⁵⁶ that more widespread compensation for takings will deter governments from excessive regulation. Fischel and Shapiro assert that majorities tyrannize minorities through regulation.⁵⁷ Without the check on tyranny represented by at least partial compensation for takings, politicians will pander to majorities and overregulation will result. Compensation thus acts for government regulators like tort law does for private firms, by creating disincentives to externalize costs. However, the analogy to the role of tort law internalizing externalities for a private firm is inapt, because government is anything but a profit-maximizing firm. As Farber observed in a recent commentary, public choice theory "gives us no reason to expect that the response of government officers will mirror the responses of the owners of a private firm. To determine whether compensation requirements will lead legislators to disapprove inefficient projects, we need to examine the political dynamics closely."⁵⁸

Political dynamics are driven largely by interest groups. Because those potentially involved in takings constitute a relatively *small* group vis-à-vis the public at large, their transaction costs of lobbying are relatively low, and they can act collectively with greater effect. This principle, revealed by actions of property inholders' lobbies and other anti-takings groups, is a basic tenet of modern public choice theory.⁵⁹ Politicians, according to public choice theory, are thus more likely to respond to small rent seeking groups, and to pass laws benefiting these minorities at the expense of the majority, rather than vice versa.

55. See generally William A. Fischel & Perry Shapiro, *A Constitutional Choice Model of Compensation for Takings*, 9 INT'L REV. L. & ECON. 115 (1989).

56. See generally Richard A. Epstein, *A Last Word on Eminent Domain*, 41 U. MIAMI L. REV. 253 (1986).

57. See generally Fischel & Shapiro, *supra* note 55.

58. Farber, *supra* note 41, at 289.

59. See generally MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965). Farber notes that "[i]f public choice has any one key finding, it is that small groups with high stakes have a disproportionately great influence on the political process." Farber, *supra* note 41, at 289 (footnote omitted).

It is therefore odd that Richard Epstein has argued that compensation for takings will actually *reduce* rent seeking.⁶⁰ Indeed, an *anticompensation* doctrine might be considerably more effective in reducing interest group pressures to engage in inefficient government spending. To paraphrase Farber, if you were a free-spending liberal contemplating land acquisition for public use, which interest group would you fear more: (1) taxpayers who are forced to bear an incremental increase in taxes because of the small cost of compensation to buy out landowners, or (2) property owners whose land is about to be seized without any compensation at all?⁶¹ Clearly, an *anticompensation* policy would generate more political heat against land use regulation by small affected groups than a general policy of compensation, which would be lost in the sea of general tax revenues.⁶²

What a general policy of compensation assuredly *will* do, if built into the expectations of the affected public—especially small, well-positioned special interests—is to cause them to maneuver to receive this compensation where possible, and to seek influence over regulations that provide such guarantees against losses. No better example of such behavior exists than American agricultural policy, or what one conservative critic has called the farm fiasco.⁶³

V. AGRICULTURAL POLICY AND COMPENSATION: THE EXPECTATION OF ENTITLEMENT

Reference has already been made to the role of agricultural subsidies and crop insurance in altering the investment-backed expectations of farmers.⁶⁴ In the case of agricultural price and income supports, farmers are induced to seek the shelter of these

60. See generally Epstein, *supra* note 56.

61. Farber, *supra* note 41, at 293.

62. In a classic theorem on public investment, Arrow and Lind show that where compensation for losses due to public investment are passed *directly* onto taxpayers, the risk to the average taxpayer of income reductions due to the project actually approaches zero as the number of taxpayers becomes large. See Kenneth J. Arrow & Robert C. Lind, *Uncertainty and the Evaluation of Public Investment Decisions*, 60 AM. ECON. REV. 364 (1970).

63. See generally JAMES BOVARD, *THE FARM FIASCO* (1989).

64. Federal Crop Insurance Act, 7 U.S.C. §§ 1501-1520 (1988); see also Laurie Erdman & C. Ford Runge, *Review: American Agricultural Policy and the 1990 Farm Bill*, 58 REV. MARKETING & AGRIC. ECON. 2 (1990).

subsidies, especially when prices are low. Because the subsidies are paid on specific crops (wheat, corn, oats, barley, cotton, sugar, rice, wool and mohair, and honey, among others), the choice of what to plant is guided as much by government programs of compensation as by market forces. Farmers call this "farming the government."

It bears emphasis that eligibility for these subsidies is tied directly to land in the form of a crop "base." This base entitlement is reflected in turn in farmland values. In principle, the payment of support on these base acres is compensation for the government's right to restrict a percentage of the base ("set-aside") from cropping, as well as for environmental requirements such as "sodbuster" and "swampbuster" regulations.⁶⁵

What do farmers do? First, they maneuver to receive this compensation by building base acres and buying them from others, leading to government payments that have recently run at ten to fifteen billion dollars a year, but which reached a high of twenty-six billion dollars in 1986.⁶⁶ Second, they organize commodity groups whose special interest is to garner the highest possible levels of compensation for their crop. The cornrowers' focus is thus the corn subsidy level, the wheatgrowers' wheat, and so on. In signing up for these subsidy programs, farmers protect themselves from downside market risks, leading to excessive investments in those crops that are most highly subsidized. This creates disincentives to purchase crop insurance in private markets, or even at subsidized rates from the government. In effect, insurance markets are crowded out by government compensation.

The overall effect of these subsidies is to create a system of entitlements in which it is expected, even demanded, that government continue to regulate the agricultural sector. That this compensation amounts to tens of billions of dollars each year, over eighty percent of which goes to fewer than twenty percent of the largest producers—those with the largest base acreage—has done almost nothing to deter the U.S. Department of Agriculture and

65. Food Security Act of 1985, Pub. L. No. 99-198, 99 Stat. 1504 (codified in scattered sections of 7, 16, 19, & 42 U.S.C.).

66. See generally Erdman & Runge, *supra* note 64.

Congress from renewing and enlarging many of the programs over time.⁶⁷ Given the rent seeking behavior of the powerful commodity groups, the only check on such spending in recent years has been general budget deficits.

Mandated compensation in agriculture, granted in return for intrusions on farmers' bundle of property rights, not only has failed to reduce regulation and "internalize" its costs, it has spawned farm-level behavior that actually *increases* the negative *external* effects of modern farming on the environment, and artificially inflates farmland values. By concentrating on relatively few crops rather than a risk-reducing diversification, environmental impacts such as erosion and excessive chemical and fertilizer applications have resulted.⁶⁸ If landowners are compensated for regulations that affect intensive development of land, it is reasonable to expect intensive development to continue.

In response to adverse environmental impacts, Congress in 1985 proposed an *additional* compensation measure for farmers willing to surrender the majority of their cropping rights on lands subject to erosion. The Conservation Reserve Program paid as much as twice the market price to retire this land from cropping for ten years. The CRP has been criticized by a variety of studies⁶⁹ for failing to target the compensation to the most erodible lands, and spending too much to do it.

To get land into the CRP, farmers have been led to misrepresent their intentions, claiming that they expected to keep cropping land even if they did not really expect it to be profitable, to qualify for the government buy-out of these cropping rights. Outside investors purchased farmland that was already enrolled in the CRP to receive the stream of benefits, even though they had no expectation of ever farming it. The federal government has now removed over thirty million acres of land from production

67. See generally COCHRANE & RUNGE, *supra* note 42.

68. NATIONAL RESEARCH COUNCIL, BOARD ON AGRICULTURE, ALTERNATIVE AGRICULTURE 97-130 (1989). See generally Barry K. Goodwin & Francois Ortalo-Magné, *The Capitalization of Wheat Subsidies into Agricultural Land Values*, 40 CAN. J. AGRIC. ECON. 37 (1992) (providing information on the inflation of farmland values).

69. See U.S. GEN. ACCT. OFF., FARM PROGRAMS: CONSERVATION RESERVE PROGRAM COULD BE LESS COSTLY AND MORE EFFECTIVE, GAO/RCED-90-13 (1989); Steven J. Taff & C. Ford Runge, *Wanted: A Leaner and Meaner CRP*, CHOICES 16 (1988).

for ten years, leading a new set of interest groups to dedicate themselves to continuing this compensation indefinitely to protect the land from future environmental damages.

Compensation programs like the CRP encourage farmers to say, whether true or not, that they expected to farm land now under conservation restrictions, so that they may collect compensation. Farm programs encourage investments in crops compensated by the government, such as corn, whether or not these crops are already in surplus. They further encourage the farm lobbies to manipulate these compensation schemes so as to extract even more rents from government programs. The result is to make the largest landholders even richer, and smaller landholders and farmers who do not participate in the compensation schemes are shunted aside.

CONCLUSION

The record of compensation in agriculture, although never justified in the name of "takings" per se, provides a sobering example of how such policies function in practice. These policies demonstrate all of the foibles of basing takings claims on the notion of upsetting "reasonable, investment-backed expectations." In general, they pay landowners to misrepresent their expectations; to direct investments toward, rather than away from, regulated schemes of compensation; to expand through special interests the scope of the regulation; and to increase benefits flowing to those who can capture the regulatory process. If this is not what advocates of wider compensation for takings have in mind, then agriculture provides a bitter foretaste of where such policies might lead.

