Eminent Domain:

Should Private Property Be Taken for Public Use

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The U.S. Supreme Court has long recognized the federal government's power to acquire private property for public use. This is true even though "eminent domain" does not appear in the Constitution. The power of eminent domain is limited, however, by two restrictions. First, as with any federal action, the use of eminent domain must be "necessary and proper" in accordance with the congressional powers enumerated in Article 1, Section 8, of the Constitution. Second, the use of eminent domain must obey the final clause of the Fifth Amendment, which states, "Nor shall private property be taken for public use, without just compensation." The states' use of eminent domain must be consistent with federal interpretations of public use and just compensation.

The U.S. Supreme Court's 2005 decision in *Kelo vs. New London* resulted in public outrage, although the ruling didn't overturn any earlier decisions; it merely affirmed an earlier decision by the Connecticut Supreme Court. That decision allowed the city of New London, which was officially designated as "distressed," to use eminent domain to acquire 15 properties, one of which belonged to homeowner Susette Kelo. Neither Kelo's house nor any of the other properties was in poor condition despite being located in a "distressed" city. The city acted under a state statute declaring that the taking of land for purposes of economic development was a taking for public use. The city's economic development plan designated the parcels for office space, parking and retail services. This scenario highlights the central issues of the Kelo case: What is a "public use"?

In its 5-4 majority opinion, the U.S. Supreme Court stated in *Kelo* that the government can never take property from one private party for the sole purpose of giving it to another, even if just compensation is paid. On the other hand, the government can always do so if the general public acquires some actual use of the property. The court has been defining the ground between these extremes since the late 1800s. From the start, "it embraced the broader and more natural interpretation of public use as 'public purpose,'" the court said in *Kelo*, and deferred to legislative declarations about public use and purpose.

The Public Good vs. Public Goods

Economists recognize a difference between "private goods" and "public goods." Private goods are both "rival in consumption" and excludable. Rival in consumption means that one person's consumption of a private good denies others the opportunity to enjoy the good. The price of a private good is essentially a result of the good's scarcity, and some individuals will be excluded from consuming the good because they are not willing to pay the price of the good. Unlike a private good, a public good is both non-rival in consumption and non-excludable. The textbook example of a pure public good is national defense because if one U.S. citizen receives the protection of national defense, then others will necessarily benefit from that protection. One person's consumption of a public good does not deny others from consuming the good, and people can use the public good without paying for it. Because the additional cost of providing the good to another person is essentially zero (since all people can use the good once it is provided to one person) the market price for additional users would be zero, which would not be practical for profit-making firms, and the good would tend to be undersupplied in the market.

Who Wins? Who Loses?

Transferring property from private to public use, however, requires government intervention in private markets. Anecdotal information and formal academic research show that, in general, countries with less government involvement in private markets experience more economic growth than countries with more government involvement in private markets. Of course, certain groups do benefit from the taking of private property, such as developers, property managers and local politicians. Developers and property managers gain income from developing the property. Many local politicians favor targeted economic development because of what they see as the immediate benefits from development, such as increased employment and tax revenue.

However, the greater economic costs of government intervention in private markets outweigh presumed immediate and tangible benefits from taking private property for economic development. The use of eminent domain for economic development complements already existing economic development tools such as TIFs (tax increment financing), tax breaks, local development grants, etc. These tools, however, probably won't lead to more societal welfare because each tool simply involves a transfer of income from one group to another, often resulting in a zero-sum gain. Justice Sandra Day O'Connor stated in her dissent to *Kelo*, "The beneficiaries (of eminent domain) are likely to be those citizens with disproportionate influence and power in the political process, including large corporations and development firms."

Private Property Rights

How can governments promote economic development that yields economic growth? Rather than using eminent domain or other tools to target individual economic development projects, local governments can examine why particular areas need significant economic development incentives to spur economic growth. For example, are taxes too high, thus making it less likely for business to move to the local area? Do current regulations stifle business creation and expansion? Local governments should focus on creating a business environment conducive to risk-taking, entry and expansion rather than attempting targeted economic development through eminent domain. One requirement for a strong private market is secure property rights. Research shows that without property rights, individuals may not make the best economic use of their property and economic growth will be limited.

Classroom Discussion

1. Identify the two restrictions under which the government must operate when exercising eminent domain authority. Why are these restrictions important?
2. Define the term "public good" and give some examples besides those stated in the article.
3. Why are private property rights important?

This article was adapted from The Taking of Prosperity? Kelo vs. New London and the Economics of Eminent Domain, *which was written by Thomas A. Garrett, assistant vice president and economist at the Federal Reserve Bank of St. Louis, and Paul Rothstein, associate professor of economics and associate director of the Weidenbaum Center on the Economy, Government, and Public Policy at Washington University in St. Louis, and was published in the January 2007 issue of* The Regional Economist, *a St. Louis Fed publication.*