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Taking Law and Just Compensation from an Economic Perspective with Reference to German Law

Outline

This paper on taking and eminent domain has a focus on compensation for taking and on substantive law and gives examples from German constitutional and subconstitutional law. A public taking of private property requires being in the public interest. It is shown, why a full damage award for taking from the state cannot guarantee this. It is shown that full damage compensation for the affected is neither a necessary nor sufficient condition for guaranteeing that taking decisions are in the public interest or even lead to a higher valued use of resources. Tight legal norms and judicial controls are necessary to achieve the policy goals behind eminent domain power.

Unlike in civil liability full damage compensation for expropriation following the differential method might lead to unintended consequences. If compensation is very generous and if still many taking decisions are not in the public interest and therefore unconstitutional this incentivizes citizens not to fight for their rights and for restitution of the condemned land. A “suffer injustice and cash in” attitude might prevail among the affected. It is also shown that this rationale does not apply in states in which public “land grabbing” in the private interest is endemic and the legal system is too weak to check this. This might lead to underinvestment, which governments in such countries can avoid by generous compensation as a second best alternative.

Summary

This article analyzes the six pillars of taking law from an economic point of view with specific reference to German law. Many constitutions allow takings only in the interests of the public and against fair or just compensation. This implies that in countries with judicial review the Supreme Court or the Constitutional Court has the power to review sub-constitutional norms regulating taking decisions. The constitutional safeguards alone can however not protect owners sufficiently. Governments, parliaments and bureaucracies might take property for purely political purposes, for campaign sweeties,

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or to comfort powerful industries and lobby groups, or to maximize budgets and build bureaucratic empires. Yet they might still be in the position to hide their intentions under the veil of “common good”. In the USA the famous Kelo case has shown, how far practice can deviate from protecting private property as a fundamental right. It is therefore highly recommendable not to allow a public agency or bureaucracy to freehandedly specify the meaning of “common good”. German constitutional law requires that the precise specification of the public interest for any taking be stipulated in a federal or state statutory law. These specifications are subject to judicial review of the constitutional court and might be rejected for vagueness or for not per se pursuing the public interest. Thus “raising taxes” would violate the latter and “economic development” the former criterion. “Preserving energy safety” is however a constitutional rationale for taking. The numerous precise sub-constitutional laws describing a “severe public interest” can therefore only define a subset of the broad term “common good”. This subset shrinks further by the necessity requirement according to which the state must show that the taking is the mildest available form to realize the underlying project. These two restrictions lead to an effective protection of private property. They principally allow takings, yet they are submitted to a tight and far reaching judicial control. The rules effectively monitor the “grabbing hand” phenomenon, which can be observed in many countries.

From this it follows that there exist three subjects of power in German law. Parliaments must specify precisely the “severe public interest” under which a taking decision is constitutional. This guarantees that the specific rationale for takings is subject to a democratic decision in parliament. Bureaucracies take the decision without having much discretion with regard to the interpretation of the reasons given in the law and the decisions are subject to judicial control of administrative courts and constitutional review.

Takings in favor of private persons and profit seeking firms, poses no particular conceptual problems. A profit maximizing firm can promote public interests to the same extent as a bureaucracy, the latter directly, the former indirectly. However differences do exist. Unlike a public agency a profit maximizing firm acts within the realm of private autonomy. Whenever it seems to be advantageous, it might deviate the utilization of the land towards purposes other than the specific public interest legitimizing the taking. Safeguards should therefore guarantee that the expropriated property is used for its intended purpose in the long run. In Germany a taking in favor of a private person is
unlawful, provided the administration cannot show that the new investor has made a credible commitment to guarantee this. This problem does not arise for state agencies, whose policy targets are defined by the law.

In many legal orders including Germany compensation for taking has to be prompt, adequate, fair and effective. This is normally somewhat less than a damage award under civil liability which applies the much more precise differential method and which fully restores either the claimant’s wealth or even utility.

This can be justified by way of economic reasoning in rule of law states. The state cannot be incentivized and deterred by a damage award which is equal to the damage in the same way as a private actor. The economic analysis of state liability therefore differs from the analysis of civil liability. Unlike a private actor the state can spread the compensation payment among millions of tax payers regardless of whether the compensation is full or somewhat less. Full damage compensation can therefore not guarantee that a taking leads to the higher valued use of a resource unlike in the cases for involuntary transactions in civil liability. The question of an appropriate level of compensation must be answered not with regard to incentives for the state but with regard to incentives for property owners. Hence one would have to differentiate between two different legal and political environments.

-A government that continuously violates the constitution and engages in willful takings within a weak legal system with no judicial independence, a low level of compensation could seriously affect the level of private investment in the country. Investors would potentially fear the grabbing hand of the government knowing that they would not be able to rely on the judiciary when filing law suits for restitution of their property. If this pattern cannot be changed in the short run, a full and generous compensation could still maintain a high level of private investment such a country. However, this is only a second best solution.

-Provided courts abide by the law and constitution in a system with swift law enforcement, full compensation according to the differential method would have adverse effects. Full compensation would remove incentives from private investors to proceed against takings and file claims for restitution, since the latter would not be worth more than a damage award. Owners would then develop an attitude of “suffer injustice and cash in” rather than taking action against illegal or unconstitutional
government acts. It is however in the interests of the public that citizens defend themselves against unlawful acts of their government rather than settle down as a result of generous compensation. A compensation which is somewhat lower than a full damage award motivates citizens to fight for their rights, i.e. for restitution of the land. They will do so if restitution is worth more to them than damage compensation. This guarantees that courts sort out the taking decisions which are not in the public interest and restitute the land to the affected. Less than full compensation thus helps to achieve an important policy target namely to prevent effectively unconstitutional takings which do not pursue the public interest. The many specific rules of German taking law, which allow for some deduction from full compensation and some contribution to the lawful taking in the public interest find a justification in economic considerations of giving the right incentives to citizen and make them guardians of the law. Some of those rules even explicitly try to destroy a “suffer and cash in” attitude among the affected.

Full compensation using the differential method can also not always be recommended on grounds of fairness. Takings might also lead to gains and they might follow huge subsidies. Both can justify a reduction of the damage award. Also the consequences of takings and regulatory takings are different, the latter leading to a damage award only in exceptional cases. This rift would be widened in case of a legal taking in the interest of the public with no participation at all being required on the part of a citizen.

Not only substantive law but also a fair procedure, which includes hearings and participation in planning decisions of large projects, committee meetings and procedures contributes to the justice of a taking decision. Extending those procedural rights will prolong planning procedures. If these procedural rights do not exist planners might even lack the information to make right decisions. The information coming from landowners in a planning process is valuable even though it emanates from a group pursuing their own specific interests. If procedural rights are overstretched or become too complex to handle they might lead to very lengthy and costly planning procedures and possibly even result in frustration, especially for large public investment projects. A tradeoff exists between the target of effectively protecting a citizen’s right and economic development. It is not certain that the thicket of German procedural rules properly strikes the balance between these two goals.