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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

The takings issue has involved a search for legal criteria which separate cases where compensation is justified, from those where it is not, in regulatory actions affecting property. A subsidiary issue is the amount of this compensation in relation to the bundle of property rights taken. In recent court cases, a concept central to these criteria is

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[1]James Bovard, Review of W. W. Cochrane and C. F. Runge, Reforming Farm Policy: Toward a National Agenda, *The Wall Street Journal*, Thursday, September 3, 1992, p. A8.

"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 among men with respect to resources will continue in existence.[2]

If such expectations are upset by regulatory action, a basis may exist for a "takings" claim. The issue of expectations is thus of special relevance to decisions to compensate for such takings. Four aspects of these decisions will be considered in this article.

First, to the extent that the disappointment of "reasonable investment backed expectations" is used to justify compensation, such a takings "test" will be continually frustrated 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" the costs of regulation, leading regulators to regulate less, and thus

[2]Frank I. Michelman. "Property, Utility and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law," Harvard Law Review 80:6 (April, 1967): at 1211-1212.

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. 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.

Reasonable Investment Backed Expectations

Since the 1922 Mahon case,[3] the Just Compensation Clause of the Constitution[4] has been subjected to various interpretations. In Mahon, 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,"[5] a somewhat vague concept in which an individual's private property rights must be weighed against the

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

[4]"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. Constitution. Amendment V.

[5]Pennsylvania Coal, 260 U.S. at 415.

effects of the use of that property on his or her neighbors.[6] 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; still other are based on the protection of public safety or natural resources, and the "neighbors" affected may be construed as society as a whole.[7]

In 1978, in Penn Central Transportation Co. v. New York City (438 U.S. 104, 104, 1978) the Supreme Court sharpened the economic criteria applied to the balance between private and public rights. It considered whether compensation was due after Penn Central's permit was denied to build a 50-story office building on top of Penn Station by the zoning authority of the New York Landmark Preservation Commission. The Court considered three factors to make such a determination: (1) whether the "economic impact" of the restriction on Penn Central was sufficient to require compensation; (2) whether the permit denial 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 historic landmarks.[8] In brief, the Court's answer was no, no and yes.

The second criterion, of "reasonable, investment-backed expectations," is the focus

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[6]See Kenneth Berlin. "Just Compensation Law and the Operation of Government: The Threat from the Supreme Court and Possible Responses." Harvard Environmental Law Review (forthcoming).

[7]Berlin, at 10.

[8]Penn Central Transp. Co. v. New York City, 438 U.S. 104, 104, (1978); 124-138. See Berlin, at 14-16.

here, and enters significantly into the much discussed 1992 Lucas case.[9] A 1988 South Carolina statute prevented Lucas, who had invested in 1986 in beach-front property, from building on it because of its proximity to the sea shore. Lucas argued that it had lost all of its economic value, and that the action interfered with his reasonable investment-backed expectations, entitling him to compensation. Weighed against these private claims were the public interests represented by the South Carolina Coastal Council, including the role of undeveloped beach-front as a storm barrier, as habitat for plants and animals, and as protection from erosion and harm to property.[10]

On appeal from the Supreme Court of South Carolina, which had denied Lucas' claim for compensation, the U.S. Supreme Court wrote five separate opinions in the case. Five Justices voted to remand the case to the South Carolina courts for further review, in an opinion written by Justice Scalia (joined by Justices Rehnquist, White, O'Connor and Thomas). Justice Kennedy concurred in a separate decision. Justices Blackman and Stevens dissented vigorously, while Justice Souter dissented on the technical grounds that the case was not yet ready for decision.

Kennedy's concurring opinion in Lucas was largely based on the argument that a takings occurs when a regulation "deprives the property of all value where the deprivation is contrary to reasonable investment-backed expectations."[11] These expectations, Kennedy claimed somewhat heroically, are "based on objective rules and

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[9]Lucas v. South Carolina Coastal Council, ___ U.S. ___ , 112 S. ct. 2886, 2892 (1992).

[10]Berlin, at 17.

[11]Berlin, p. 29. Citing 112 S. Ct. at 2903 (Kennedy, J., concurring).

customs that can be understood as reasonable by all parties involved," and through a review of the "whole of our legal tradition."[12] 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,"[13] 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.[14]

Justice Scalia's approach involved a more oblique appeal to expectations: whether regulatory restraint "will be seen as mitigating 'harm' to the adjacent parcels or securing a 'benefit' for them, depending on the observer's evaluation of the relative importance of the use [e.g., erosion control, habitat protection] the restraint favors."[15] If the "observer" believes that "the state's use interest in nurturing those resources is so important that any competing adjacent uses must yield,"[16] then a takings claim presumably is overridden.

But who is the "observer"? How much or how little foresight is attributed to this hypothetical observer in contrast to the investor (here Lucas) restrained by the regulatory

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[12] 112 S. Ct. at 2903.

[13] Id. at 2903-04.

[14] Berlin, at 30.

[15] Lucas. Id. at 2898.

[16] Id.

action?[17] The device of the "observer" allowed Justice Scalia to abstract from the fundamental question: whose expectations are to count?

In contrast to situations involving land (those of "personal property"), Scalia argued that the buyer of, say, a used car should anticipate and beware of unpleasant regulatory surprises: "by reason of the state's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulation will render his property worthless at least if the property's only economically productive use is sale or manufacture for sale."[18]

Why land is set apart from other commodities, according to Scalia, is related to the fact that land is generally bought and sold with written title (although so are used cars). Scalia argued that if restrictions on its use are not part of this title, or included in more general nuisance regulation, then they can be regarded more readily as a "surprise" deserving of compensation.

In this sense, Scalia's oblique reasoning favors even more strongly than Kennedy's the argument that unpleasant surprises resulting from regulation deserve compensation. In the case of land, what is in the title, plus the general law of nuisance, is the essential data which a person such as Lucas should be expected to know. If a later regulation upsets this expectation, then a basis for a takings claim may exist. Kennedy's argument suggests a larger amount of information which someone should be expected to know, and follows precedent from the Penn Central case more closely. But both arguments are

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[17]See Berlin, p. 33.

[18]Berlin. Id. at. 35.

ultimately about the disappointment of expectations, and what should constitute reasonable prior knowledge.[19]

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." What a buyer of property expected at the time he or she bought it is of course not directly observable. In Scalia's narrow test, what is written on a title (together with any liens, etc.) and the general law of nuisance constitute a minimum of what might be expected, but it is far less than an investor ought to know in order to purchase property in land. The broader scope of "reasonable investment backed expectations" used by Kennedy is still subject to the problem that these expectations are not observable, and are extremely subject to misrepresentation. ("I had no idea the state would pass such a law!"). If an appeal is made to what an reasonable "observer" might have known at the time about the likelihood of regulation, according to some "objective rules", the subjective essence of the

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[19]Berlin (Id, at. 38) observes:

> In today's highly regulated world, it is hard not to expect that regulation might restrict and even prohibit use in certain circumstances. Justice Scalia admits as much in the commercial, personal property context. Title, however, may not reflect this knowledge and while the concept of title includes prohibitions in the law not written explicitly in the title, Justice Scalia limits these prohibitions to ones in the relatively cramped law of nuisance, rather than ones also reflected in statutory law passed after the passing of title, but reflecting a community's judgment that the activity is harmful. In addition, use of "title" rather than investment expectations is very favorable to sophisticated developers who are treated differently than the average person in an investment-backed expectations test, but identically if the test is one of what is in the "title".

market investment mechanism is lost: as leading economic theorists of risk have emphasized, "It takes a difference of opinion to make a horse race."[20]

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, and could have done something else with it, he is validating his belief in a particular expectation of both the market and regulatory environment. However, the fact that an expectation is "investment backed" may or may not be evidence in 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, or what financial analysts call "plunging." Many investments, especially in natural resources property 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.[21] In some such 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.[22] Similar points have been made concerning financial assets using darts thrown at stock market quotations in newspapers. Expectations, even when investment backed, may reflect the judgment of a gambler or a fool.

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[20]See Michael Rothschild and Joseph Stiglitz. "Increasing Risk I: A Definition." Journal of Economic Theory 2:3(1970): 225-243.

[21]Graham-Tomasi, Runge, and Hyde. "Foresight and Expectations in Models of Natural Resource Markets." Land Economics 62:3(1986): 234-249.

[22]C. F. Runge. "Energy Exploration on Wilderness: 'Privatization' and Public Lands Management." Land Economics 60:1(1984): 56-68.

Even worse, to the extent that compensation is known to be available for potential losses, truncating the downside risk of an investment, expectations are shifted in a way which actually draws money into higher risk ventures. As in insurance markets, problems of moral hazard and adverse selection come into play, as 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 Farber notes:

> 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 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.[23]

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[23]Daniel A. Farber. "Public Choice and Just Compensation." Constitutional Commentary 9:279(1992): 279-308, at 285. See also Robert Cooter, "Unity in Tort, Contract, and Property: The Model of Precaution." California Law Review 73:1,20(1985); Louis Kaplow, "An Economic Analysis of Legal Transitions." Harvard Law Review 99(1986); and Lawrence Blume and Daniel L. Rubenfeld. "Compensation for Takings: An Economic Analysis." California Law Review 72(1984).

In the case of U.S. agricultural subsidies, by truncating the downside risk of losses due to declines in market prices, the current system of compensation encourages over-investment in certain subsidized crops, and discourages the development of private markets in crop insurance. Since crops are only partially "insured" by government subsidy schemes ("deficiency payments") crop losses often lead to calls for "disaster relief."[24]

In summary, the attempt to define "reasonable investment backed expectations" as a basis for takings, either obliquely by reference to title and nuisance law (à la Scalia) or directly (à la Kennedy), 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 in compensated versus noncompensated property.

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

[24]W. W. Cochrane and C. F. Runge. Reforming Farm Policy: Toward a National Agenda. Iowa State University Press. 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." The American Economist 33:1(Spring, 1989): 36-44.

government regulation in the face of "rational expectations."[25] In brief, these theorists argued that if the expectations of investors were "rational,"[26] that is, provided accurate forecasts, on average, given current information, then this foresight would disarm policymakers who sought to manipulate monetary and fiscal aggregates. 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 should be jettisoned and policymakers should retire to setting monetary aggregates as a form of stable background noise.[27]

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 posses in no greater quantity than the rest of us) into the idiosyncratic sources and capacities for well-being of the several

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[25]See Robert E. Lucas, Jr. "Some International Evidence on Output-Inflation Tradeoffs." American Economic Review 63(June, 1973): 326-334. R.E. Lucas, Jr. "Econometric Policy Evaluation: A Critique." In K. Brunner and A. H. Meltzer (eds.), The Phillips Curve and Labour Markets, Supplement to the Journal of Monetary Economics, 1976.

[26]See John F. Muth. "Rational Expectations and the Theory of Price Movements." Econometrica (July, 1961): 315-335.

[27]See Finn Kydland and E. C. Prescott. "Rules Rather than Discretion: The Inconsistency of Optimal Plans." Journal of Political Economy (June, 1977): 473-491.

members of society."[28] Justice Scalia, writing in Lucas, is especially critical of legislative findings as a basis for takings, arguing that "since such a justification can be formulated in practically every case, this amounts to a test of whether the legislature has a stupid staff."[29]

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 market-clearing.[30] And in many markets, including the market for land, the rational expectations hypothesis (REH) was unsupported by the data.[31]

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" which are overturned by regulatory policy. In a "game" played by private investors against

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[28]Michelman. "Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law." Harvard Law Review 80:6 (April, 1967), p. 1180.

[29]Lucas, Id. at. 2898 n. 12.

[30]R. Frydman and E. S. Phelps (eds.) Individual Forecasting and Aggregate Outcomes: "Rational Expectations" Examined. New York: Cambridge University Press (1983).

[31]K. C. Moore and W. H. Myers. "Predictive Econometric Modeling of the U.S. Farmland Market: An Empirical Test of the Rational Expectations Hypothesis." Iowa State University. CARD Report 133 (1986).

government regulators, if the investors can forecast the actions of the regulators (as well as the forecasts of others) then they are positioned not only to avoid "takings," but actually to profit from them.[32] If it is known what 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. Hence the REH, generally embraced by opponents of regulation, has destructive implications for a theory of takings. 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 investors form expectations "adaptively,"[33] updating them as new information becomes available. This approach to expectations is entirely consistent with the argument for compensation. However, if possible 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."

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" was

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[32]See R. Frydman, G. P. O'Driscoll, Jr. and A. Schotter. "Rational Expectations of Government Policy: An Application of Newcomb's Problem." Southern Journal of Economics 49(1982): 311-319.

[33]See Moore and Myers, 1986. The classic theoretical treatment of adaptive expectations is M. Nerlove, The Dynamics of Supply: Estimation of Farmers' Response to Price. Baltimore: Johns Hopkins University Press (1958).

developing 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.[34] 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.

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, the Conservation Reserve Program (CRP) of the U.S. Department of Agriculture, will be discussed below. Second, pressure groups will attempt to affect regulations and the flow of compensation in ways which benefit them, spending resources on this manipulation rather than on directly productive activities.

These possibilities do damage to the argument of Fischel and Shapiro, and Richard Epstein,[35] that more widespread compensation for takings will deter governments from excessive regulations. Fischel and Shapiro assert that majorities tyrannize minorities through regulation. Without the brake to tyranny represented by at least partial

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[34]See C. K. Rowley, R. D. Tollison and G. Tullock. The Political Economy of Rent Seeking. Boston: Kluwer Academic Publishers. 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 by A. O. Kreuger, "The Political Economy of the Rent Seeking Society," American Economic Review 64(June, 1974): 291-303.

[35]W. A. Fischel and P. Shapiro. "A Constitutional Choice Model of Compensation for Takings." International Review of Law and Economics 9(1989). Richard A. Epstein. "A Last Word on Eminent Domain." University of Miami Law Review 41(1986).

compensation for takings, politicians will pander to majorities and overregulation will result. Compensation thus acts for government regulators like tort law does to 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, for the simple reason that government is anything but a profit-maximizing firm. As Farber observes 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."[36]

Political dynamics are driven largely by interest groups. Because those potentially taken from constitute a relatively small group vis-a-vis the public at large, their transactions 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.[37] Politicians, according to public choice theory, are thus more likely to respond to small rent-seeking groups, and to pass laws benefitting these minorities at the expense of the majority, rather than vice versa.

It is therefore odd that Richard Epstein has argued (1986) that compensation for

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[36]Farber, p. 289.

[37]See M. Olson. The Logic of Collective Action. Harvard University Press, 1965. Farber notes that "If public choice has any one key finding, it is that small groups with high stakes have a disproportionately great influence on the political process" (p. 289).

takings will actually reduce rent seeking.[38] Indeed, an anti-compensation doctrine might be considerably more effective in reducing interest group pressure 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 most: (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?[39] 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.[40]

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 examples of such behavior exists than American agricultural policy, or what one conservative critic has called "the farm fiasco."[41]

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[38]Epstein (1986).

[39]Farber, p. 293.

[40]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 K. J. Arrow and R. C. Lind, "Uncertainty and the Evaluation of Public Investment Decisions," American Economic Review 60(June, 1970): 365-78.

[41]James Bovard. The Farm Fiasco. San Francisco: ICS Press (1989).

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. In the case of agricultural price and income supports, farmers are induced to seek the shelter of these subsidies, especially when prices are low. Because the subsidies are paid on specific crops (wheat, corn, oats, barley, cotton, sugar, rice, wool and mohair, 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 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.

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 10-15 billion dollars a year, but which reached a high of 26 billion dollars in 1986. Second, they organize commodity groups whose special interest is to garner the highest possible levels of compensation for their crop. The corngrowers' focus is thus the corn subsidy level, the wheatgrowers' wheat, etc. In signing up for these subsidy programs, farmers protect themselves from downside market risks, leading to excessive investments in those crops which are most highly subsidized. This creates disincentives to purchase crop insurance in private markets, even at subsidized rates from the government. In effect, private 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. The fact that this compensation amounts to tens of billions of dollars each year, over 80 percent of which goes to fewer than 20 percent of the largest producers (those with the largest "base" acreage) has done almost nothing to deter the U.S. Department of Agriculture and the Congress from renewing and enlarging many of the programs over time. Given the rent-seeking behavior of the powerful commodity groups, the only check on such spending in recent years has been general budget deficits.

Not only has mandated compensation in agriculture, granted in return for intrusions on farmers' bundle of property rights in land, failed to reduce regulation ("internalizing" its costs); in fact, it has spawned farm-level behavior which actually increases the negative external effects of modern farming on the environment, while artificially inflating farmland values. By concentrating on a relatively few crops rather than a risk-reducing diversification, environmental impacts such as erosion and excessive chemical and fertilizer applications have resulted.[42]

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[42]National Research Council. Board on Agriculture. Alternative Agriculture. Washington, DC: National Academy Press (1989). On the inflation of farmland values, see Barry K. Goodwin and Francois Ortalo-Magné, "The Capitalization of Wheat Subsidies into Agricultural Land Values," Canadian Journal of Agricultural Economics 40(1992): 37-54.

In response, the Congress in 1985 proposed an additional compensation measure for farmers willing to surrender the majority of their cropping rights on lands subject to erosion. In return, the Conservation Reserve Program (CRP) paid as much as two times market prices to retire this land from cropping for ten years. The CRP program has been criticized by a variety of studies[43] for failing to target this compensation to lands most in need, and spending too much to do it.

In order to get land into the CRP program, 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, in order to qualify for the government buy-out of these cropping rights. Outside investors purchased farmland which was already enrolled in the CRP in order to receive this stream of benefits, even through they had no expectation of ever farming it. The federal government has now removed over 30 million acres of land from production for 10 years, leading a new set of interest groups to dedicate themselves to continuing this compensation indefinitely in order to protect the land from future environmental damages.

The record of compensation in agriculture, while never justified in the name of "takings" per se, provides a sobering example of how such policies function in practice. In general, they provide incentives to rational agents to misrepresent their expectations; to direct investments toward, rather than away from, regulated schemes of compensation;

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[43]U.S. General Accounting Office. Farm Programs: Conservation Reserve Program Could be Less Costly and More Effective. GAO/RCED-90-13. Washington, D.C. (November, 1989); S. J. Taff and C. F. Runge. "Wanted: A Leaner and Meaner CRP." Choices, First Quarter (1988).

to expand through special interests the scope of this 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.