

Vince Spaulding and Kathy Chamberlain have lobbied for 15 years to polish the condition of Skyland Shopping Center in southeast Washington, D.C. Last year, the city council approved a plan that would allow the taking of the 16.5-acre Skyland property through eminent domain, to be replaced with a new shopping mall.



The Economics of Eminent Domain

The recent Supreme Court decision on takings encourages economic development leaders but worries some economists BY DOUG CAMPBELL

Vince Spaulding has lived within a few blocks of Skyland Shopping Center going on 40 years. Back in the 1970s and 1980s, this short sweep of retail in southeast Washington, D.C., “was well maintained. It was better managed and you did not have all this disorganization,” Spaulding says.

Today, Spaulding scorns the aging storefronts that bend along Alabama Avenue and Good Hope Road. There’s Checks Cashed, Ron & Dee Clancy’s Adult Entertainment, Discount Mart, and, simply, “Liquor,” among the 30 or so tenants. The parking lot is pocked with potholes; trash piles up along the edges.

“It’s a raggedy old place,” agrees Kathy Chamberlain, Spaulding’s friend and co-officer of the Hillcrest Community Civic Association. “Why

is it so hard to get a decent little shopping mall?”

For 15 years, Spaulding and Chamberlain have helped lead an effort to change at least the face of Skyland Shopping Center. For all those years, they say, the Skyland property owners resisted their overtures. But last year, the city council sided with the Hillcrest group, voting unanimously to use the power of eminent domain to take the land from 16 property owners and turn it over to a public-private development group, National Capital Revitalization Corp.

To Spaulding, it’s about time. “This is a worthwhile application of the use of eminent domain if there ever was one,” he says.

As of September, at least six Skyland property owners strongly disagreed with that sentiment. “The

business is my livelihood ... I am very distressed that the government wants to take my business after I worked so hard to start it,” says Duk Hea Oh, owner of the property and business Beauty World, a Skyland tenant, in an affidavit. “I have lost faith in the American dream.”

In July, National Capital asked a D.C. Superior Court to let it take over the parts of Skyland Shopping Center not already under its control. National Capital is a publicly chartered economic development group whose mission is “spurring the revitalization of underserved and emerging neighborhoods in the District of Columbia.” It has named a private developer, Rappaport Cos., to handle the Skyland project.

As of the end of summer, National Capital had filed six condemnation

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Susette Kelo fought hard to protect her property from eminent domain seizure. In a closely watched property rights case, the U.S. Supreme Court ruled that the promotion of economic development is a suitable use of the government's power of eminent domain.

suits for properties that constitute about half the project site. There are a total of 16 owners, with five of them having agreed to sell and three close to an agreement; the remaining eight holdouts are the ones that have been taken to court. The project was dealt a setback in late September when a federal agency refused National Capital's funding request, but the organization said it was continuing to seek new financing options.

The new Skyland would have about 250,000 square feet of retail space and about 1,100 parking spots. With a \$100 million investment, the payoff would be \$3.3 million in new tax revenues each year and about 233 permanent jobs.

A spokeswoman for National Capital declined to comment about the project, citing the ongoing court proceedings. In previous public statements, the organization has said that the project could generate about \$325 per square foot as opposed to the current \$150 per square foot by existing occupants. The new shopping center is intended to have a major anchor, with Target as the most talked about prospect. To make way, everything on

the 16.5-acre site (5 acres of which is undeveloped) would be demolished.

People familiar with the project say it was no coincidence that National Capital made its official eminent domain request just weeks after June 23. That was the date the Supreme Court reaffirmed that local governments have the power to hand over private property to private developers in the name of economic development.

To proponents of the Skyland project, the *Kelo v. New London* decision enhanced their argument that eminent domain is a legitimate tool for improving neighborhoods in ways that go beyond traditional public infrastructure. To opponents, it was further disintegration of traditional U.S. property rights — and arguably not applicable in the Skyland case.

To some economists, the Kelo decision is complicated. The case brings into focus a number of economic problems with eminent domain and adds the twist of takings in the name of economic development. Does it make economic sense for private developers to have the power to essentially take commercial property mainly because neighbors find the Skyland Shopping Center ugly and inconvenient?

An Unfortunate Trade-Off

The power of eminent domain stems from the Fifth Amendment of the U.S. Constitution. "Nor shall private

property be taken for public use, without just compensation," it reads. The government can only force property owners to sell when the taking is for "public use" and the compensation is fair.

A public use example: Eminent domain was widely used in the 1950s and 1960s in building the nation's Interstate Highway System. As a result, travel became quicker and easier for millions of Americans. At the same time, many urban neighborhoods were disrupted as new roadways cut through them.

More notorious was the eminent domain case that happened in Detroit in 1981, when the city and General Motors announced a plan to build a new auto factory that would employ 6,000 people. On the downside, the plant would occupy property where some 4,200 people lived in 1,300 houses, even though the local government considered the urban neighborhood blighted and worthy of revitalization. The "Poletown" case ended up being ruled lawful by the Michigan Supreme Court, but not before bitter residents whose homes were soon to be bulldozed grabbed national headlines.

These examples demonstrate that even before the Kelo decision, there was no shortage of economic problems innate to eminent domain. Todd Zywicki, a law professor at George Mason University, says eminent domain always involves a fundamental trade-off: between property owners strategically "holding out" for an inflated payoff and those refusing to sell out of sincere subjective value. Inevitably in cases of eminent domain condemnations, there are widows who have lived at homes going on many years to whom moving — no matter what the price — would be emotionally traumatic.

Problematically, governments can't tell if property owners are of the true subjective value ilk or if they're strategic holdouts. So eminent domain treats everybody the same by simply allowing buyouts based on "fair" market value. That's because eminent domain isn't about individuals; it's presumably about the greater good.

Excerpt From The Opinion

The City has carefully formulated an economic development plan that it believes will provide appreciable benefits to the community, including — but by no means limited to — new jobs and increased tax revenue. As with other exercises in urban planning and development, the City is endeavoring to coordinate a variety of commercial, residential, and recreational uses of land, with the hope that they will form a whole greater than the sum of its parts. To effectuate this plan, the City has invoked a state statute that specifically authorizes the use of eminent domain to promote economic development. Given the comprehensive character of the plan, the thorough deliberation that preceded its adoption, and the limited scope of our review, it is appropriate for us, as it was in *Berman*, to resolve the challenges of the individual owners, not on a piecemeal basis, but rather in light of the entire plan. Because that plan unquestionably serves a public purpose, the takings challenged here satisfy the public use requirement of the Fifth Amendment.

SOURCE: Justice John Paul Stevens writing for the majority

Excerpt From The Dissent

Today the Court abandons this long-held, basic limitation on government power. Under the banner of economic development, all private property is now vulnerable to being taken and transferred to another private owner, so long as it might be upgraded — i.e., given to an owner who will use it in a way that the legislature deems more beneficial to the public — in the process. To reason, as the Court does, that the incidental public benefits resulting from the subsequent ordinary use of private property render economic development takings “for public use” is to wash out any distinction between private and public use of property — and thereby effectively to delete the words “for public use” from the Takings Clause of the Fifth Amendment.

SOURCE: Justice Sandra Day O'Connor writing for the minority

Sometimes, the general welfare all but demands that individual property owners will have to sacrifice to make room for a road, a post office or an airport. “A highway has to go from Point A to Point B, and potentially every person from A to B has holdout power,” Zywicki says. “These are good public uses and we’re willing to run the risk that people will be under-compensated because we believe these are necessary public uses.”

Economists haven’t agreed on the best way to minimize the risk of under-compensation, however. As recently as the 1980s, some economists believed that zero compensation should be standard because to do otherwise would encourage over-investment in property; private buyers would assume that the government would compensate them “fully” for any takings. This problem would be most acute in places where development otherwise wouldn’t make sense, such as along earthquake fault lines or known flood zones.

Ed Nosal, a senior economic adviser at the Cleveland Fed, has written papers that challenge that idea. He thinks paying market value is perhaps the only way to discipline governments from making poor taking decisions.

But even those who concur that market value is the optimal compensation can’t agree on how to ease the strategic holdout-subjective value trade-off. “Those bargaining problems are really hard,” Nosal says. “Once you throw in more than two people, the profession hasn’t come to any consensus on how these things can be resolved.”

In the face of all these shortcomings, the durability of eminent domain looks surprising. It has survived politically thanks to the understanding that it is invoked exclusively in cases where public use mandates it. Otherwise, property rights would dissolve as the government unilaterally applied eminent domain as a vehicle to avoid possibly expensive — and undoubtedly inconvenient — market transactions. Used correctly, the idea is

that eminent domain boosts social welfare. But in overly liberal practice, it can lead to a classic distortion of incentives for both property owners and governments.

That’s one reason why eminent domain as currently practiced has plenty of doubters. Nobel Prize-winning economist Gary Becker has long been a critic. “Government at all levels do so much that the temptation is irresistible to use eminent domain condemnation proceedings to hasten and cheapen their accumulation of property for various projects, regardless of a project’s merits,” Becker wrote in a recent Web-log entry.

For economists like Becker who already were wary about eminent domain, the Kelo case was a major red flag. This was in large part because the 5-to-4 ruling seemed to de facto expand the government’s discretion in deciding what constitutes “public use.”

The city of New London, Conn., wanted to take seven houses to make way for a redevelopment project, the centerpiece of which would be a \$270 million research plant for drug maker Pfizer. One of the homeowners was Susette Kelo, who joined her neighbors in suing to stop the eminent domain proceedings. Their case was closely watched not only because it reached the Supreme Court but also because it seemed to depart from standard eminent domain cases involving economic development projects. Usually, the properties being taken are clearly blighted or dilapidated. But Kelo and her neighbors, plus the advocates who joined the cause, argued convincingly that these homes were far from blighted. And therefore, they said, no amount of new tax revenues could justify the seizure.

In the majority opinion, Justice John Paul Stevens disagreed: “The city has carefully formulated a development plan that it believes will provide appreciable benefits to the community, including, but not limited to, new jobs and increased tax revenue,” Stevens wrote. “Because that plan unquestionably serves a public

purpose, the takings challenged here satisfy the Fifth Amendment.”

The backlash was swift. To many, it was as if the Supreme Court had taken a wrecking ball to traditional property rights. A political cartoon depicted Justice Stevens with an auction block crying, “Sold to the politically wired developer,” while a humble homeowner below him mumbles, “But, but, my house isn’t for sale.” The Institute for Justice, which represented homeowners in the Kelo case, called it “the worst Supreme Court decision in years” and an “abuse of power.” The number of states considering eminent domain law changes that would restrict takings for economic development purposes grew to 25.

Why the uproar? In purely economic terms, there may be little difference between the use of eminent domain for the provision of traditional public goods versus economic development projects. Theoretically, either a new airport or a new shopping mall could enhance overall well-being. So, from an economist’s standpoint, the line that ought to divide worthy uses of eminent domain from unworthy ones is not always so bright. Still, the use of eminent domain for economic development purposes tends to increase opportunities for abuse of the

system. The historical “public use” requirement acted as a gatekeeper to limit possibilities for takings of private property, while in a post-Kelo world the possibilities seem virtually limitless.

In addition, what some economists didn’t like about the Kelo ruling was the seeming artificiality of the strategic holdout problem. Pfizer, unlike a local school system or airport authority, could build in any number of communities, including many within the state of Connecticut. But instead of deciding on and bargaining for the precise location of its facility beforehand, it did so only after agreeing with the city of New London to locate there. Under those circumstances, it would seem too easy for Pfizer or any other organization to quickly back out of property negotiations and ask for eminent domain proceedings. “There’s no reason that Pfizer has to go to that neighborhood in New London,” Zywicki says. “So the holdout power is imaginary. Unlike traditional public uses where there’s a limited number of sites, here there’s an unlimited number of sites.”

That’s why New London is so desirable to Pfizer, Zywicki says. Because of the prearranged agreement between Pfizer and the city government, Pfizer has the unique opportunity to essen-

tially end-run a market transaction by getting the city to use the power of eminent domain. And what’s worse, Zywicki says, is that Pfizer, in addition to the incentive of eminent domain, gets the added enticement of tax breaks and other perks offered up in the corporate recruitment process.

The particular facts of the Kelo case aside, some economists who have studied eminent domain continue to believe that takings are warranted in many economic development efforts. John Blair, an economist at Wright State University in Dayton, Ohio, who has published extensively on urban development and eminent domain, believes the Supreme Court made the right call in terms of general economic principle. It remains desirable for governments to be able to capture the extra value of land that is generated when it’s assembled for development. The trick, he says, is clearly defining the circumstances under which properties are considered blighted enough to take for public use.

“We’ve got some reasonable grounds for using eminent domain for economic development. It seems to be almost necessary for cities in a lot of circumstances,” Blair says. “But there also is the potential for misuse. What the average citizen sees is that a

Before New London, Poletown

Perhaps the most infamous instance of eminent domain in the name of economic development happened 24 years ago in Detroit. About 4,200 people were moved from their homes when General Motors and two local governments launched a plan to build a new GM plant that would employ 6,000 people. The facility would encompass property in the city of Detroit and adjacent Hamtramck known as “Poletown” for its population of Poles, Albanians, and Yugoslavs, among others.

The idea was to provide a “glittering example of what the auto companies and their suppliers could do in the city of their birth,” according to a retrospective of the case by the *Detroit News*. It turned into a controversial *cause celebre* with the likes of Ralph Nader siding with holdout Poletown homeowners. The Archdiocese of Detroit endorsed the plan but was opposed by one of its own churches, the Immaculate Conception Roman Catholic Church, which was to be razed.

Despite the continued protests and nationwide attention, local politicians pushed through with the plan and were ultimately backed by the Michigan Supreme Court in March 1981. Homes were demolished along with the church.

In the aftermath, according to *Poletown, Community Betrayed*, a 1989 book about Poletown, Detroit ended up at least \$80 million over budget in land acquisition costs. A University of Michigan study concluded that most homeowners who were forced to leave ended up “better off,” with more than 80 percent happy in their new homes and less than 39 percent saying relocation payments were insufficient.

The Poletown case was widely cited as precedent by municipalities using eminent domain for economic development projects. But in July 2004, the Michigan Supreme Court overturned its earlier Poletown ruling and “sharply restricted governments such as Detroit and Wayne County from seizing private land to give to other private users,” according to the *Detroit Free Press*. The new case arose because of an effort by Wayne County, Mich., to take private land for a technology park.

In the recent *Kelo v. New London* case, the U.S. Supreme Court essentially revisited the basic question in the Poletown case: Can the government in certain instances take private property for economic development purposes? The answer was affirmative. — DOUG CAMPBELL

developer wants land and uses influence with the local planners and politicians, greases the wheels, and an average citizen gets removed from their home. That's clearly an improper use. It seems to me the solution would be to adopt clearer definitions."

The New Twist

That seems to be at least part of the challenge in the Skyland project. Elaine Mittleman, an attorney representing several Skyland property owners who don't want to sell, says that while New London can accurately be described as "distressed," the same can't be said for Washington, D.C. "There is a real estate boom in Washington, D.C., and the District certainly is not an economically distressed city," Mittleman wrote in a letter to officials with the Department of Housing and Urban Development, protesting a proposed HUD loan guarantee for the project.

The real goal of the Skyland project isn't economic development, Mittleman says. It's about catering to "higher-income persons who want to shop at a new, big box shopping center." To accomplish this, National Capital is assembling land with \$25 million and then selling it to a developer for \$4 million. Losing out are the business owners who must relocate with "no assurance that their business will be viable in the new location," Mittleman concludes. She notes that a leading property owner, First FSK Limited (not one of her clients) has proposed a private redevelopment of the shopping center that would answer many neighborhood concerns.

It's hard to say whether this neighborhood would blossom further if not for the existing Skyland shopping center.

To be sure, the southeast Washington, D.C., neighborhood where Skyland is located is neither wholly distressed nor wholly booming. While the Skyland shopping center itself is described by neighbors as run-down, across the street is a relatively new, clean shopping strip anchored by a Safeway grocery store. Surrounding both retail centers are single-family homes that average in sale price around \$400,000. It's hard to say whether this is a neighborhood that would blossom even further if not for the existing Skyland Shopping Center.

Skyland neighbors Vince Spaulding and Kathy Chamberlain think of the redevelopment of Skyland as the tipping point for the neighborhood. They believe the time for relying on private-led action or market forces has passed. It is time now for government intervention, they say. "They'd been given chance after chance to do something about it," Chamberlain says. "I think it's now the city's responsibility to do something."

As both sides await a court hearing on the Skyland case, they might do

well to remember that these sort of eminent domain proceedings contain more than one part. After deciding whether a property can be seized comes the valuation phase. If the liquor store and the strip joint are forced to sell in eminent domain, will they fetch prices equal to their current status as small parcels in a slumping retail area? Or will they be valued as integral pieces of a huge and possibly profitable private development? That's the sort of dilemma that doesn't surface in classic eminent domain cases, where park lands or roads suggest no obvious market value. Traditionally, condemned properties have been valued on their predevelopment worth. But courts may be forced to ponder whether that's fair in cases of eminent domain for economic development.

What if developers have to pay "enhanced" value for the Skyland properties? That is, what if they have to share some of their gains with the incumbent owners? In that case, arguments that property owners aren't being "justly" compensated, as per both the Constitution and economic principle, grow weaker. There might well be enough of a payout for a business to comfortably relocate — or even for the owner to retire. At the same time, an eminent domain project like Skyland becomes less desirable to cost-conscious developers.

For attorney Mittleman, that's an issue for another day. Right now, she is concentrating on her property owner clients. "It doesn't matter if it makes economic sense or any other sense," Mittleman says. "The whole premise is wrong." **RF**

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