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THE PERILS OF PARADOXES—COMMENT ON WILLIAM A. FISCHEL, "EXPLORING THE KOZINSKI PARADOX: WHY IS MORE EFFICIENT REGULATION A TAKING OF PROPERTY?"

VICKI BEEN*

Professor Fischel has provided several interesting insights about takings theory, especially in his discussion of the per se rule for physical takings and his criticisms of "regulation chopping."¹ I want to focus here, however, only on his analysis of the paradox he believes is posed by Judge Kozinski's holding in *Hall v. City of Santa Barbara*.² The paradox, Professor Fischel argues, is that a mobile home rent control regulation could be an unconstitutional taking,³ even though other forms of rent control uniformly have survived takings challenges, because mobile home rent control is more efficient than other rent controls.

Professor Fischel's analysis of this paradox of "improved efficiency" leads him to conclude that judges should not find a regulation to be a taking, even if that regulation is unfair, unless the regulation is "too efficient."⁴ The courts should see themselves as only one of the guardians of individual rights, and should hesitate to step in to protect such rights when one of the other guardians, such as the legislative branch, has a comparative advantage at doing so.⁵ Professor Fischel argues that if an unfair regulation is "too efficient," however, judicial intervention is warranted because such a regulation imposes its burdens so narrowly that its unfairness will never be corrected in a political system based upon majority preferences.⁶

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1. William A. Fischel, *Exploring the Kozinski Paradox: Why Is More Efficient Regulation a Taking of Property?*, 67 CHI.-KENT L. REV. 865 (1991).

2. 833 F.2d 1270 (9th Cir. 1986), cert. denied, 485 U.S. 940 (1988).

3. *Hall* did not hold that the mobile home rent control ordinance was in fact an unconstitutional taking, but only that it might be, depending upon the proof adduced at trial. The trial court granted the City's motion to dismiss the complaint for failure to state a cause of action, so the court of appeals had no facts before it, and could hold only as a matter of law that the facts alleged in the complaint, if proved, would constitute a violation of the Fifth Amendment's Takings Clause. *Hall*, 833 F.2d at 1270, 1274, 1282.

4. Fischel, *supra* note 1, at 866, 887.

5. *Id.* at 889-91.

6. *Id.* at 893.

I agree with Professor Fischel that the takings inquiry should focus, at least in part, on the ability of the property owner to protect himself or herself in the political arena. That was the theme of my article "*Exit*" as a Constraint on Land Use Exactions.⁷ I disagree, however, with each step of Professor Fischel's argument that what he calls "comparative" efficiency⁸ is a useful measure of that ability.

First, the paradox of "improved efficiency" that serves as the rhetorical anchor for Professor Fischel's argument has little to do with traditional notions of efficiency, and accordingly is confusing. Second, his argument that mobile home park rent controls are comparatively more efficient than regular rent controls overlooks the potential for capitalization in regular rent control. Third, even if mobile home park rent control is comparatively more efficient than regular rent control, it does not follow that the political process is less likely to protect mobile home park owners' rights than landlords' rights. Professor Fischel's assertion that mobile home park owners have no "hope of political influence to recoup some reciprocal gains in the future" takes a much too simplistic view of local politics.⁹ Finally, I argue that using efficiency as a proxy for failures in the political process makes no sense given the availability of exit and voice as direct measures of the ability of the regulated to protect themselves against majoritarian excess.

PROFESSOR FISCHEL'S DEFINITION OF "EFFICIENCY"

Let me start by exploring what Professor Fischel means when he says that the courts should not strike down a regulation under the Fifth Amendment unless the regulation is "too efficient." He cannot mean that a regulation that is Pareto optimal or Kaldor-Hicks efficient¹⁰ is necessarily a "stronger candidate" for a judicial determination that the regulation effects a taking.¹¹ If, for example, a mobile home park rent control ordinance did no more than address the potential for strategic behavior by the landlord,¹² and was designed so that it just prevented landlords

7. Vicki Been, "*Exit*" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 COLUM. L. REV. 473 (1991).

8. Fischel, *supra* note 1, at 876.

9. *Id.* at 893.

10. An ordinance would be Pareto optimal if it were impossible to move to any other state of affairs without making at least one person worse off than she was under the ordinance. See ECONOMIC FOUNDATIONS OF PROPERTY LAW at xii (Bruce A. Ackerman ed., 1975). An ordinance would be Kaldor-Hicks efficient if it would create a sufficient benefit that the winners under the measure could compensate the losers (regardless of whether the winners do, in fact, pay such compensation). See Richard A. Posner, ECONOMIC ANALYSIS OF LAW 12-13 (3d ed. 1986).

11. Fischel, *supra* note 1, at 867, 911.

12. As Professor Fischel acknowledges, because the cost of transporting a mobile home to a

from appropriating the quasi-rent created by the tenant's lack of mobility,¹³ the regulation would certainly be Kaldor-Hicks efficient,¹⁴ but nothing in Professor Fischel's argument would suggest that it should therefore be considered a taking.

Nor can he mean that a regulation which is Pareto superior to another regulation is necessarily more likely to be a taking.¹⁵ Mobile home park rent control can't be deemed Pareto superior or Pareto inferior to regular rent control: different tenants, landlords and other groups are affected by the two kinds of regulation, and therefore no Pareto comparison can be made. One mobile home park rent control regulation could be Pareto superior to another such regulation, of course, but it would be nonsensical to argue that if ordinance *A* leaves mobile home park owners better off, and no one else worse off, than ordinance *B*, the Pareto superior ordinance could be considered a taking, even if the Pareto inferior ordinance is not. Similarly, if ordinance *A* left tenants better off, but park owners and the rest of the world no worse off, than ordinance *B*, Professor Fischel's analysis does not suggest any reason that the Pareto superior ordinance should be considered a taking. A Pareto superior regulation is suspiciously efficient under Professor Fischel's scheme, then, only when ordinance *A* leaves the same tenants and landlords no worse off, but the rest of the world better off, than ordinance *B*.

Professor Fischel's claim that "certain efficient regulatory transfers"¹⁶ are stronger candidates for being found to be takings than inefficient transfers thus does not use the concept of efficiency in the traditional sense of Pareto optimality, Pareto superiority, or Kaldor-Hicks efficiency. Instead, it relies on a notion of "comparative" efficiency. A regulation is "too efficient" in a "comparative sense," according to Professor Fischel, when it results in less deadweight loss—when it

park site is fairly large, the mobile home park owner may be tempted to try to "hold up" existing tenants by charging them higher rents than the landlord could charge a new tenant who had not yet incurred the cost of transporting a coach to the site. Fischel, *supra* note 1, at 870-71. See also Werner Z. Hirsch, *An Inquiry into Effects of Mobile Home Park Rent Control*, 24 J. URB. ECON. 212, 216-17 (1988).

13. The capitalization studies on which Professor Fischel relies disclaimed any ability to refute the possibility that part of the increased value of coaches in rent-controlled parks may result from tenants taking *back* quasi-rents that would otherwise be appropriated by park owners. Hirsch, *supra* note 12, at 224.

14. Because the winners under the measure — the tenants — could compensate the losers — the park owners — out of the tenants' gain, the regulation would be Kaldor-Hicks efficient. See *supra* note 10.

15. Ordinance *A* would be Pareto superior to ordinance *B* if at least one person believes herself better off under *A* and no one believes herself worse off. See ECONOMIC FOUNDATIONS OF PROPERTY LAW, *supra* note 10, at xi.

16. Fischel, *supra* note 1, at 866.

imposes costs on fewer people or groups of people, or fewer costs on the same people or groups—than the regulation to which it is being compared.

THE COMPARATIVE EFFICIENCY OF MOBILE HOME RENT CONTROLS

In deciding that mobile home park rent control is comparatively efficient, Professor Fischel analyzes four socially undesirable results of rent control: below market rates of return will lead to suboptimal investment in rental housing; landlords will reduce their expenditures on maintenance; landlords will pull out of the rental market by converting their units to non-controlled uses; and tenants will hold on to rent controlled apartments longer than they otherwise would.

Professor Fischel regards mobile home park rent control as no better or worse than other forms of rent control regarding the first inefficiency; the below market rate of return allowed under mobile home rent control will discourage entry of new mobile home parks, just as regular rent control discourages entry of new apartments. But, Professor Fischel argues, the second inefficiency, undermaintenance, will not be as serious a problem (although it will still exist) in the context of mobile home rent control. The owners of the mobile homes can capitalize the land's rental value above the regulated amount into the sales price of their mobile homes and will therefore have an incentive to properly maintain the homes, which are the most visible and depreciable capital in the mobile home park, Professor Fischel reasons.

Professor Fischel's arguments assume that there is a significant difference between the ability of mobile home park tenants to capitalize the benefits of rent control and the ability of tenants of other forms of housing to do so. But there are a number of ways in which tenants in stick-built housing can capture part of the value of rent control. Although jurisdictions typically either forbid a tenant in a rent controlled apartment from subletting or limit the rent such a tenant could charge a sublessee,¹⁷ tenants can and do evade the restrictions, which are quite difficult to enforce except in owner-occupied buildings. If there are no vacancy decontrols, tenants can charge "key money" to potential successor tenants; if there is such decontrol, tenants can seek money from owners for the act of leaving.¹⁸ Tenants who leave the apartment or die can

17. See, e.g., NEW YORK, N.Y., CHARTER & ADMIN. CODE ANN. tit.26, ch.4, § 26-511(c)(12) (1992) (permitting tenants in rent stabilized units to sublet for not more than two years in a four-year period, but forbidding the tenant from charging the subtenant more than the stabilized rent, with exceptions for apartments furnished by the tenant).

18. Werner Z. Hirsch & Joel G. Hirsch, *Legal — Economic Analysis of Rent Controls in a*

make the apartments available to family members or spousal equivalents, for either monetary or psychological compensation.¹⁹ Indeed, tenants have been known to use the value of the rent controlled apartment as one of their main contributions to a divorce settlement.²⁰ The ability to sublet or charge "key money" provides an incentive for tenants to maintain their units (and to a much more limited degree, to maintain common areas),²¹ just as the ability to capitalize rent control's value into the price of a mobile home provides such an incentive.

Professor Fischel argues that the third inefficiency, conversion of units to non-regulated uses, is less of a problem in mobile home parks because the owner of a mobile home park cannot occupy the mobile home himself or herself, as a landlord can do with a rent-controlled apartment. That distinction is correct, although whether the distinction amounts to a significant difference depends upon the nature of the market for rent controlled apartments. A landlord can occupy only a limited number of apartments under the personal use exception. In a town where many rent-controlled landlords own only one or two rental units each, then, the comparative efficiency of mobile home park rent control on this score might be significant; in a city like New York, where units containing fewer than six apartments are not covered by rent control, it would be much less significant.

The fourth problem, tenants who overstay, is less of a problem in mobile home parks, Professor Fischel argues, because owners of mobile homes can capitalize the benefits of rent control into their sales price whenever they leave. Again, Professor Fischel underestimates the degree to which tenants in apartments are able to capture the benefits of rent control without remaining in possession, through subletting, succession rights, "key money," and vacancy payments.

Mobile Home Context: Placement Values and Vacancy Decontrol, 35 UCLA L. REV. 399, 425 n.87 (1988).

19. For discussions of the value of succession rights see Bradley L. Steere & Lisa A. Pieroni, Note, *The Broadening of Succession Rights: Braschi v. Stahl Associates*, 3 HOFSTRA PROP. L.J. 33, 34-36 (1989); S. Emily Poulard, Note, *The Question of Succession in New York City: Who Has the Right to Renew A Rent-Stabilized Lease*, 9 CARDOZO L. REV. 1831, 1852-54 (1988); Lawrence A. Kanusher, Note, *All in the Family: Succession Rights and Rent Stabilized Apartments*, 53 BROOK. L. REV. 213, 215-18 (1987).

20. Andrea Brooks, *Whose Apartment After the Breakup?*, N.Y. TIMES, Dec. 22, 1985, § 8, at 1.

21. It may be that tenants assume some of the burdens of maintenance even in the absence of capitalization. See Edgar O. Olsen, *What Do Economists Know About the Effect of Rent Control on Housing Maintenance?*, 1 J. REAL EST. FIN. ECON. 295 (1988).

COMPARATIVE EFFICIENCY AS A PREDICTOR OF THE POLITICAL PROCESS

But even if mobile home park rent controls are comparatively more efficient than regular rent control, the question then becomes whether that comparative efficiency renders mobile home park owners unable to ally with other voters and thereby "protect themselves politically by coalitions and vote trading."²² Professor Fischel contends that no one other than mobile home park owners is burdened by rent control,²³ so owners will have no allies, while regular rent control burdens so many different groups that landlords will have allies.

Professor Fischel's claim is puzzling. He admits that mobile home rent control is not perfectly efficient, so it must impose some costs upon groups other than owners, just as regular rent control does. An examination of who bears the burden of the various inefficiencies of mobile home rent control reveals that the types of people who bear those burdens are the same as those that bear the burden of regular rent control.²⁴ The difference between the two versions of rent control, then, is in the amount of the cost imposed, not in the nature of the groups who bear those costs. Yet Professor Fischel offers no evidence that the amount of the cost imposed is below the threshold required to motivate those burdened to take political action.

Indeed, his anecdotal evidence regarding the "political isolation" of mobile home park owners shows that the existence of political allies seems to have little to do with the incidence or extent of the costs imposed by mobile home rent control versus regular rent control. Professor Fischel's description of the politics of rent control on the state level completely ignores the relative abilities of mobile home park owners and

22. Fischel, *supra* note 1, at 898.

23. *Id.* at 893.

24. When a landlord reduces the maintenance that s/he provides a rent controlled apartment, for example, the groups who suffer are the current tenants, who either pay more themselves for maintenance or accept lower quality services; the future tenants, who also either pay more themselves to bring the apartment up to their standards and keep it there or accept lower quality; neighbors who suffer the externalities caused by decrepit property, and taxpayers who have to make up for the reduction in taxes the property in question must pay as a result of the reduction in its value. If a mobile home park is undermaintained as a result of rent control, the costs of the undermaintenance will fall on those same categories of people. Even if mobile home park rent control will result in less under-maintenance than regular rent control, as Professor Fischel argues, there will still be some under-maintenance, and that under-maintenance will give the park owner the same potential political allies as the landlord. The only difference will be that those potential allies will have been hurt less by mobile home park rent control than by regular rent control.

The other inefficiencies of mobile home rent control also fall upon the same types of people as the inefficiencies of regular rent control. The burden of under-investment and overstaying falls on future renters and home buyers. The burden of conversion falls on current tenants, future renters and home buyers.

landlords to secure allies among those burdened by the two forms of rent control—we hear nothing about alliances with the property taxpayers or neighbors hurt by the undermaintenance, or the future tenants and homebuyers hurt by undermaintenance and disinvestment, for example. Instead, Professor Fischel reports that mobile home park owners were unable to ally with owners and developers of other forms of housing because those other owners and developers had an interest in putting mobile home parks at a competitive disadvantage. That would be true even if mobile home rent control were every bit as inefficient as regular rent control.

The most telling aspect of Professor Fischel's report is his revelation that despite the supposed comparative inefficiency of regular rent control, landlords had no more success than mobilehome park owners in putting together a coalition to secure statewide legislation prohibiting rent control.²⁵ The revelation illustrates that even if comparative efficiency were a good predictor of the number of potential allies a burdened group has, that number tells us little about whether the political process will correct the unfairness of the regulation.

Professor Fischel seems to have two kinds of political "correction" in mind. First, the unfairness could be corrected if those hurt by this regulation can recoup their losses through some other regulation, and thereby secure an "average reciprocity of advantage." Second, the unfairness could be corrected if those hurt are able to get the regulation repealed or are otherwise able to escape the force of the regulation. Both forms of correction depend on much more than whether those hurt by a regulation—the property owner and his or her allies—constitute a majority.

As public choice theory tells us, corrective political action depends as well upon such factors as the intensity of people's preferences; the relative abilities of the allies and opponents to organize (as Professor Fischel's description of the superior ability of mobile home tenants to form an effective lobbying organization illustrates); the relative ability of the allies and opponents to logroll; the degree to which a jurisdiction's politicians campaign, and therefore need campaign funds; the extent to which the influence model rather than the majoritarian model holds in a particular jurisdiction; and the extent to which a jurisdiction's decisions can be overturned by higher levels of government.

25. Professor Fischel discloses in a footnote that mobile home park owners were successful in getting a law passed to disallow rent control on new mobile home parks. Fischel, *supra* note 1, at 875 n.33.

Professor Fischel ignores those variables by treating all local governments as majoritarian political animals. Just reading the various papers presented at this conference reveals, however, that there is enormous room for debate about whether all or even most local governments fit that model. Perhaps it is an accurate description of small suburban governments, but it certainly doesn't capture the complexities of the politics of the major cities that account for most of the rent controlled units.

Confronting such variables is critical to assessing whether the political process will correct unfairness. Efficiency tells us little or nothing about them, however, and therefore can't serve as a proxy for the potential for political correction. That is brought home quite forcefully by the fact that regular rent control, which is Professor Fischel's model for a comparatively inefficient regulation that imposes costs upon so many different groups that it is likely to be corrected in the political process, has stubbornly persisted, long after it could be valued as what Professor Fischel refers to as "an educational device." Hirsch & Hirsch's study of mobile home rent control in California, on the other hand, points to several instances in which mobile home rent control has been repealed, both by legislative action and by initiative.²⁶

What might be better proxies?

Luckily, we don't need efficiency to serve as a proxy for the corrective potential of the political process, because we can look at much more direct measures—the opportunities those affected by a regulation have for exit and voice. My Columbia article²⁷ took that tack in analyzing whether developers' ability to exit was sufficient to constrain local governments' exactions policies. The article noted that a similar inquiry should be made regarding developers' voice options, but didn't tackle that issue. Professor Fischel is skeptical of my conclusion that sufficient exit options do exist, because he believes that landowners, who are locked into the jurisdiction by the immobility of the land, are likely to bear the costs of exactions. I agree that landowners by themselves have insufficient exit options to affect local governments' exactions policies, so the difference between us boils down to an empirical question about the extent to which the incidence of exactions falls on landowners rather than developers or the ultimate homebuyers. The evidence regarding who actually bears the costs of exactions is sparse, but economic theory suggests that the most likely scenario is one in which the landowner,

26. Hirsch & Hirsch, *supra* note 18, at 408-11.

27. Been, *supra* note 7.

homebuyer and developer share the costs of the exaction.²⁸ In that case, my article shows that the developer's bargaining power will provide indirect protection for the landowner.²⁹

In any event, what is important here is the comparative efficiency of focusing on efficiency, rather than exit and voice, to assess whether the courts need to step in to protect property owners against the tyranny of the majority. Let me suggest a few reasons why exit and voice are more helpful in that assessment.

First, the availability of exit options is fairly easily and objectively determined. There is little doubt that mobile home park owners have few avenues for exit, for example, even though one can argue about the comparative efficiencies of regular rent control and mobile home park rent control.

Second, we have models for evaluating when a certain quantum of exit options is enough to regulate local governments, by using what economists have learned in measuring the competitiveness of various markets. We also have models for examining when voice options are sufficient, because we can use as a benchmark the characteristics that render certain groups the paradigm of a discrete and insular minority.

Third, if we focus on efficiency, it would be all too easy to evaluate the efficiency of a regulation purely by applying economic theory, without taking into account the differences that specific markets might make to the comparative efficiency of a regulation. In a small bedroom suburb, for example, homeowners may be no more likely to ally with landlords than with park owners because there are few rental units in the tax base and because homeowners would prefer to limit the number of apartments in town. The potential for error is high unless such a case by case analysis is performed. To look at exit and voice, on the other hand, we would be forced to examine the characteristics of the particular political processes of each of the comparatively few types of local government. I don't mean that we should fall prey to lumping New York City under the same local government heading as a small exclusive suburb, but we can identify the handful of different types of jurisdictions and make a broader determination than a case by case analysis.

Finally, by looking at voice and exit we can discern useful information about how courts can assure a political process that better protects against majoritarian excess. If we see, for example, that exit and voice options are not available to landlords in communities like Santa Monica,

28. Been, *supra* note 7, at 540-41.

29. *Id.* at 540-42.

the best remedy might be to give landlords more voice, by requiring, let's say, that decisions about rent control be made by higher levels of government.

These suggestions are not meant to discount the myriad of difficulties that would attend a thorough examination of the exit and voice options of those subject to regulations. Ultimately, however, those difficulties are likely to be much less serious than those which attend the use of efficiency as a proxy for the corrective potential of the political process. Professor Fischel has moved us forward by showing why the takings inquiry should focus on the potential for the political process to correct unfairness. But the tool he offers for evaluating that potential is flawed.