

# INSIDE THE VAULT

An Economic Education Newsletter from the Federal Reserve Bank of St. Louis

## **Eminent Domain:**

Should Private Property Be Taken for Public Use?

LESSON PLAN



## Eminent Domain | Spring 2007 *Inside the Vault* Lesson Plan

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This lesson plan was written by Dawn Conner, economic education coordinator at the Federal Reserve Bank of St. Louis. *The views expressed in the Inside the Vault article and the accompanying lesson plans are those of the authors and are not necessarily those of the Federal Reserve Bank of St. Louis or the Federal Reserve System. Please address all comments and questions to Dawn Conner at 314-444-8421 or dawn.c.conner@stls.frb.org.*

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# Eminent Domain:

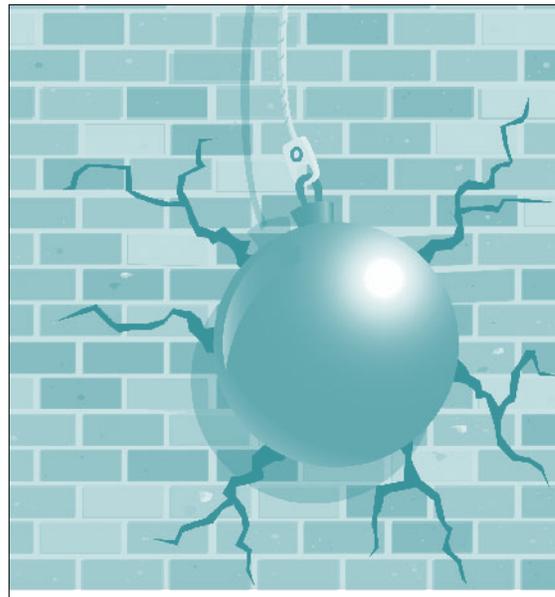
## Should Private Property Be Taken for Public Use

As published in Inside the Vault, Volume 12, Issue 1, Spring 07

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

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

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



### The Public Good vs. Public Goods

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

### **Who Wins? Who Loses?**

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

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

### **Private Property Rights**

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

### **Classroom Discussion**

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

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

## Lesson Description

Students will examine three Supreme Court rulings and analyze possible positive and negative impacts of the Court's decision on eminent domain.

### Concepts

Benefits

Costs

Eminent domain

Public good

Trade-offs

## Content Standard

National Voluntary Content Standards in Economics

Standard 2

- Effective decision-making requires comparing the additional costs of alternatives with the additional benefits. Most choices involve doing a little more or a little less of something; few choices involve all-or-nothing decisions.

National Standards for Civics and Government

- V. What are the roles of the citizen in American democracy?
  - B. What are the rights of citizens? - Economic rights
    - Students should be able to evaluate, take and defend positions on issues regarding economic rights.

## Objectives

Students will:

1. identify specific possible effects of Supreme Court decisions in eminent domain cases;
2. determine whether or not they agree with the Court's decisions and defend their position; and
3. define costs, benefits and trade-offs.

### Time Required

60 minutes

### Materials

- Handouts 1.1, 1.2, 1.3, 1.4, 1.5 and 1.6
- Transparencies 1.1, 1.2, and 1.3
- 2 sheets of easel paper
- 3 x 5 cards or slips of paper
- Tape
- Overhead projector

- Overhead pens

Preparation:

Draw a web diagram like the one on Transparency 1.3 on each sheet of easel paper. Write “*Hawaii Housing Authority vs. Midkiff* 467 U.S. 229(1984)” in the center circle on one sheet and “*Kelo vs. New London* 545 U.S. \_\_\_\_ (2005)” in the center circle on the other sheet.

### Procedure

1. Explain that eminent domain refers to the authority of the government to acquire private property for public use under certain conditions. Discuss the following:
  - A. What are some examples in which the government might force an individual to sell his/her property to the government? (*Answers might include forcing an individual to sell his house so that a highway can be constructed, or requiring an individual to sell a right-of-way through her land so that a pipeline can go through her property.*)
  - B. In a situation in which the government would require a homeowner to sell her home to the government so that a highway could be built, is it necessary for the government to compensate the homeowner? (*Answers may vary.*)
2. Display Transparency 1.1, Fifth Amendment to the U.S. Constitution (1791) and ask a student to read the statement in quotation marks. Explain that this statement is commonly referred to as the “takings clause.” Most courts have equated just compensation with a property’s fair market value. Narrowly defined, “public use” requires that the public at large use the taken property—what economists call a public good.
3. Distribute copies of Handout 1.1, “Eminent Domain: Should Private Property Be Taken for Public Use?” from *Inside the Vault*, Spring 2007, and ask students to read the article. After students have read the article, discuss the following:
  - A. Identify the two restrictions under which the government must operate when it exercises eminent domain authority. (*1. As with any federal action, it must be “necessary and proper” in accordance with the congressional powers enumerated in Article 1, Section 8, of the Constitution. 2. The use of eminent domain must obey the final clause of the Fifth Amendment, which states in part, “... nor shall private property be taken for public use without just compensation.”*)
  - B. Why are these restrictions important? (*Answers will vary.*)
4. Point out that ownership and private property rights are foundations of capitalism. Continue discussion of the article.
  - A. Define the term “public good” and give some examples besides those stated in the article. (*A good that is non-rival—one person’s consumption does not deny others use of the good—and non-excludable—people can’t be excluded from using a good because they can’t pay for the good. Examples might include public parks, public roads and highways and public schools.*)
  - B. How does a “private good” differ from a public good? (*A private good is rival in consumption—one person’s consumption does deny others the use of the good. A person can be excluded from using a private good because he can’t pay for it.*)
  - C. What are some examples of private goods? (*shoes, apples, hamburgers, cars, clothes, books and private amusement parks that require a ticket for entry*)

- D. Why are private property rights important? (*Private property rights are important for strong private markets, i.e. a strong, capitalistic economy. Without private property rights, individuals may not make the best economic use of their property and economic growth may be limited.*)
  - E. Why are public goods undersupplied in the market? (*Profit-making firms cannot earn a profit providing them.*)
4. Explain that once one person has paid for a public good, others can benefit from the good without payment. For example, if a person installs a streetlight near his home, nearby neighbors can benefit from the light provided without paying an additional amount. (Note: Neighbors share the light and can't be excluded from the benefits of the light.) As a result, it would be difficult for a profit-making firm to sell streetlights to individuals and earn a profit.
  5. Point out that because of the characteristics of public goods—shared consumption and non-exclusion—public goods are undersupplied in the marketplace. Communities, through government taxation, often provide public goods such as parks, streetlights and fire protection. Point out that government also undertakes programs or policies that are deemed for the public good, but aren't necessarily public goods. For example, government might provide transportation programs for the elderly not because transportation isn't provided in the marketplace, but because it is thought to be for the public good.
  6. Distribute copies of Handout 1.2, Select U.S. Eminent Domain Court Rulings and Display Transparency 1.2, Select U.S. Eminent Domain Laws and Court Rulings.
  7. Remind the students that even though the term "eminent domain" is not used in the Constitution, the clause in the Fifth Amendment that states "Nor shall private property be taken for public use, without just compensation," has been interpreted to support eminent domain court rulings.
  8. Ask a student to read to the class the U.S. Supreme Court ruling for the case *Berman vs. Parker*, 348 U.S. 26 (1954).
  9. Distribute copies of Handout 1.3, *Berman vs. Parker*, 348 U.S. 26 (1954), and display transparency 1.3, *Berman vs. Parker*, 348 U.S. 26 (1954). Instruct students to answer the following questions and to fill out Handout 1.3. Record answers on Transparency 1.3.
    - A. Identify some possible positive effects on the owners of the blighted property who were forced to sell their property. (*Answers might include that this gave the individual owners an opportunity to sell property that otherwise might be difficult to sell; might provide the opportunity for owners to move to a better neighborhood.*)
    - B. Identify some possible negative effects on the owners of the blighted property who were forced to sell their property. (*Answers might include that the owners were forced to move and may not have wanted to move from that location, area of the city, or school district; owners might feel that if they kept their property longer, they might have received a higher price for the property at some future date.*)
    - C. Identify some possible positive effects on the new property owners. (*Answers might include the opportunity for profits from the development.*)
    - D. Identify some possible negative effects on the new property owner. (*Answers might include the risks associated with developing blighted property.*)

- E. Identify some possible positive effects on the general public. (*Answers might include the elimination of blighted property in their city, possible increase in tax revenue due to higher-valued property.*)
  - F. Identify some possible negative effects on the general public. (*Answers might include the community's dealing with the challenge of relocating former property owners if those owners cannot afford housing; citizens might fear greater intrusion of government in the private sector.*)
  - G. Did this case involve a public good or a program that was deemed as being for the public good? (*something deemed as good for the public good*)
10. Explain that few decisions are all-or-nothing decisions; they usually involve trade-offs. Trade-offs involve getting a little more of one thing by giving up a little of something else. By identifying the positive and negative effects on various parties involved in this eminent domain court decision, the students have analyzed the costs and benefits of this action.
  11. Explain that costs are factors that are unfavorable to the decision maker and benefits are factors that are favorable to the decision maker. Costs and benefits may include more than monetary—dollars and cents—considerations; as the students identified in the *Berman vs. Parker* case, costs may include owners not wanting to move and benefits may include people's greater satisfaction with their community because there are fewer blighted neighborhoods.
  12. When the court makes a decision, there are benefits and costs to all parties involved. The objective is that the decision provides the most benefits with the least costs for the parties involved (current owners, new owners, and general public). Ask the students what kind of trade-off was made with the court's decision. (*Original owners had to give up property, but were compensated. The community had to deal with displaced citizens, but gained with newly developed area.*)
  13. Divide students into groups of 4-5 students each. Distribute Handout 1.4, *Hawaii Housing Authority vs. Midkiff*, 467 U.S. 229 (1984) to half of the groups and distribute Handout 1.5, *Kelo vs. New London*, 545 U.S. \_\_\_\_ (2005) to the other half of the groups. Tell the groups to identify the positive and negative effects of the court ruling that they were assigned on the two parties involved and also on the general public. Instruct students to fill out their handouts.
  14. Display easel paper with web diagrams on the wall. Distribute 3 X 5 cards or slips of paper. Instruct groups to identify a recorder. Instruct the recorder to write the positive and negative effects that their group identified, writing one possible outcome per card. Instruct the recorder to distribute the filled out cards to group members, including himself/herself.
  15. Ask a student from one of the groups that analyzed *Hawaii Housing Authority vs. Midkiff* to read the synopsis of the court ruling from Handout 1.2. Ask students who analyzed this case the following questions, and as answers are discussed instruct students to tape their cards in the appropriate section of the large easel paper.
    - A. Identify some possible positive effects on the landowners who were forced to sell their property. (*Answers might include that this gave the individual owners an opportunity to sell property at market value; might provide the opportunity for owners to diversify their investments from land into other types of investments; relieves landowners of property taxes on the land.*)
    - B. Identify some possible negative effects on the landowners who were forced to sell their property. (*Answers might include that the landowners were forced to sell land that they may not have wanted*)

*to sell; owners might feel that if they kept their property longer, they might have received a higher price for the property at some future date.)*

- C. Identify some possible positive effects on the new property owners. *(Answers might include the opportunity to purchase land not previously for sale; opportunity to use or develop the land.)*
  - D. Identify some possible negative effects on the new property owner. *(Answers might include bearing the costs associated with owning property, such as paying property taxes; bearing the risks associated with owning property such as whether or not the future price would be more than the current market price.)*
  - E. Identify some possible positive effects on the general public. *(Answers might include additional competition in land/property markets; possible increase in tax revenue due to higher-valued property based on the newly determined market price.)*
  - F. Identify some possible negative effects on the general public. *(Answers might include fear of forced land redistribution by both Hawaiian citizens and people considering doing business in Hawaii.)*
  - G. Did this case involve a public good or something deemed good for the public? *(something deemed good for the public)*
16. Ask a student from one of the groups that analyzed *Kelo vs. New London* to read the synopsis of the court ruling from Handout 1.2. Ask students who analyzed this case the following questions, and as answers are discussed instruct students to tape their cards in the appropriate section of the large easel paper designed like Transparency 1.5 which was previously prepared and displayed on the wall.
- A. Identify some possible positive effects on the landowners who were forced to sell their property. *(Answers might include that this gave the individual owners an opportunity to sell property at market value; might provide the opportunity for property owners to diversify their investments from real estate into other types of investments; relieves property owners of property taxes on the land.)*
  - B. Identify some possible negative effects on the landowners who were forced to sell their property. *(Answers might include that the property owners were forced to sell land that they may not have wanted to sell; owners may not wish to live in different location; owners might feel that if they kept their property longer, they might have received a higher price for the property at some future date.)*
  - C. Identify some possible positive effects on the new property owners. *(Answers might include the opportunity to purchase property not previously for sale; opportunity to use or develop the property.)*
  - D. Identify some possible negative effects on the new property owner. *(Answers might include bearing the costs associated with owning property, such as paying property taxes; bearing the risks associated with owning property such as whether or not the future price would be more than the current market price; risk of making a profit on developing the property.)*
  - E. Identify some possible positive effects on the general public. *(Answers might include economic development that might not otherwise happen; possible increase in tax revenue due to higher-valued property based on the improved property.)*
  - F. Identify some possible negative effects on the general public. *(Answers might include controversy between groups who support the eminent domain action and groups who oppose this action may distract local government and business leaders from other positive endeavors in the community and may create dissatisfaction with living in that community; risk that if the economic development fails, other organizations may be hesitant to engage in economic development in that community.)*
  - G. Did this case involve a public good or a program deemed for the public good? *(program for the public good)*

## Closure

17. Review the key points of the lesson as follows:
  - A. What are costs and benefits? (*Costs are things unfavorable to a decision maker; benefits are things favorable to a decision maker.*)
  - B. How do the analyses of the possible impact of these court rulings illustrate cost-benefit analysis? (*There were possible positive and negative outcomes for all parties involved.*)
  - C. What is a trade-off? (*giving up some of one thing in order to gain some of something else*)
  - D. What is a public good? (*a good that is non-rival and non-excludable*)
  - E. What are examples of public goods? (*streetlights, national defense, fire protection*)
  - F. In what way(s) did the government in all three Supreme Court cases comply with the requirements for its exercising eminent domain? (*All cases identify "a for the public good" rationale for requiring property owners to sell. It is assumed that all property owners who were forced to sell their property were paid the market value.*)
  - G. What are some examples of the "for the public good" given as the rationale for the government's exercise of eminent domain in these three cases? (*economic development, removal of blight and increased competition in the marketplace*)

## Assessment

18. Distribute a copy of Handout 1.6 to each student. Direct students to complete the handout on Charting Positive and Negative Outcomes of Eminent Domain Cases. Students will create bar charts and write a three- to-five sentence interpretation of their charts. Students' interpretations should correspond to the way in which they completed the benefit/cost analysis. For example, if the student has the following chart, a sample explanation would be:

*As a result of this court decision, the original property owners experience costs that exceed the benefits to them. I think this is the case because although they were compensated for their property, it will be difficult and costly for them to relocate. The new property owners experience benefits that exceed the costs. I think this is the case because the risks associated with redevelopment are not as high as the potential profits to be earned. The general public experiences benefits that exceed the costs. I think this is because the general public no longer looks at a blighted area, they have the potential of shopping at the new development and they bore no direct relocation costs. Overall, society experiences benefits that exceed the costs.*

Benefits	+4			
	+3			
	+2			
	+1			
Neutral	0			
Costs	-1			
	-2			
	-3			
	-4			
			Original Property Owner	New Property Owner

## Select U.S. Eminent Domain Laws and Court Rulings

### ***Berman vs. Parker, 348 U.S. 26 (1954)***

The U.S. Supreme Court ruled that taking private property (and paying just compensation) to remove blight served a public purpose and met the requirements of the Fifth Amendment. This was true even though the seized property was sold to private interests and would not necessarily have a wide use by the public.

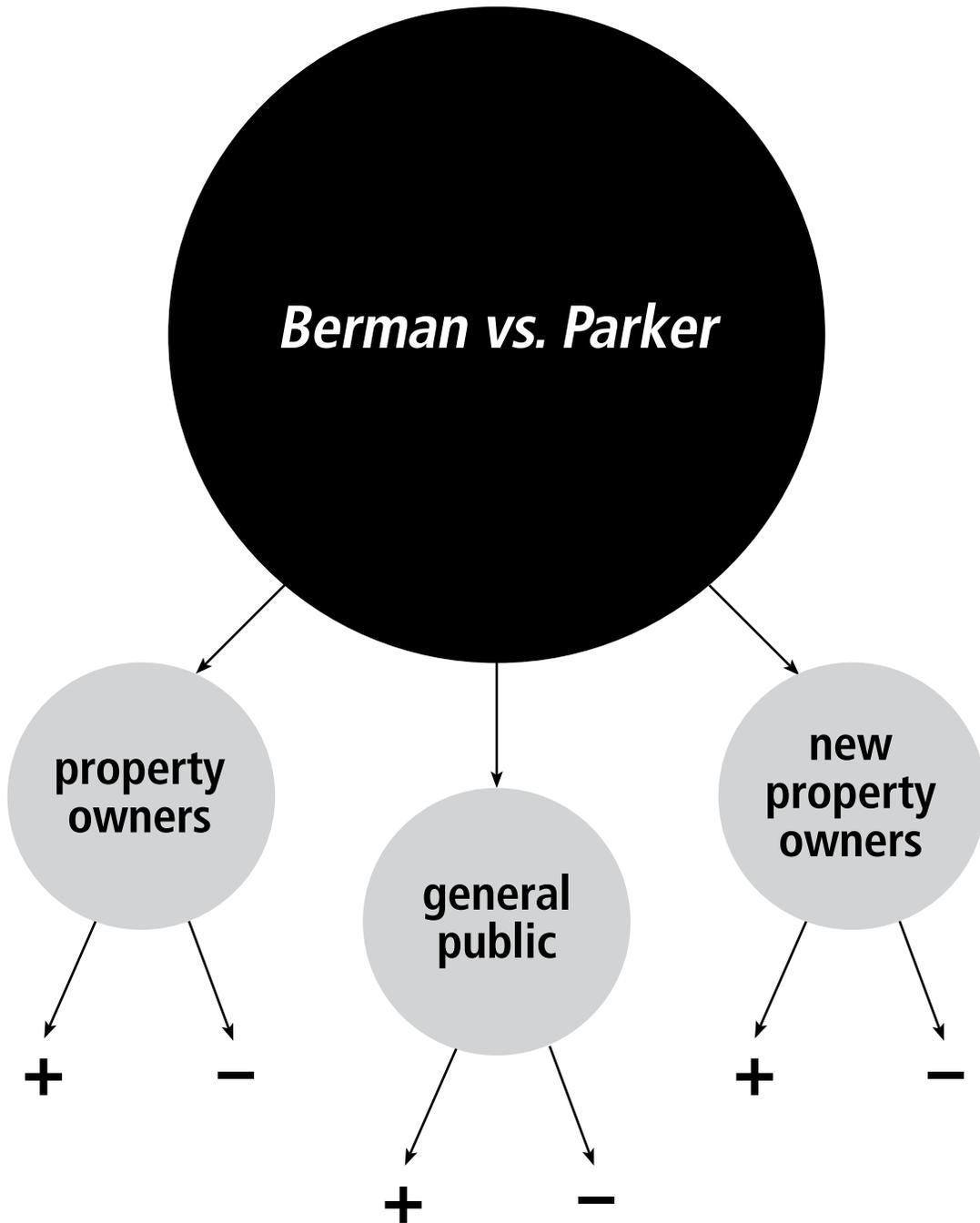
### ***Hawaii Housing Authority vs. Midkiff, 467 U.S. 229 (1984)***

The U.S. Supreme Court ruled that a state could use eminent domain to take land from private landowners and allocate it to others. The case was based on the state of Hawaii's complaint that a vast majority of the privately held land in Hawaii was in the hands of a few landowners, thus limiting competition in land and property markets. *Berman vs. Parker* served as precedent for the ruling.

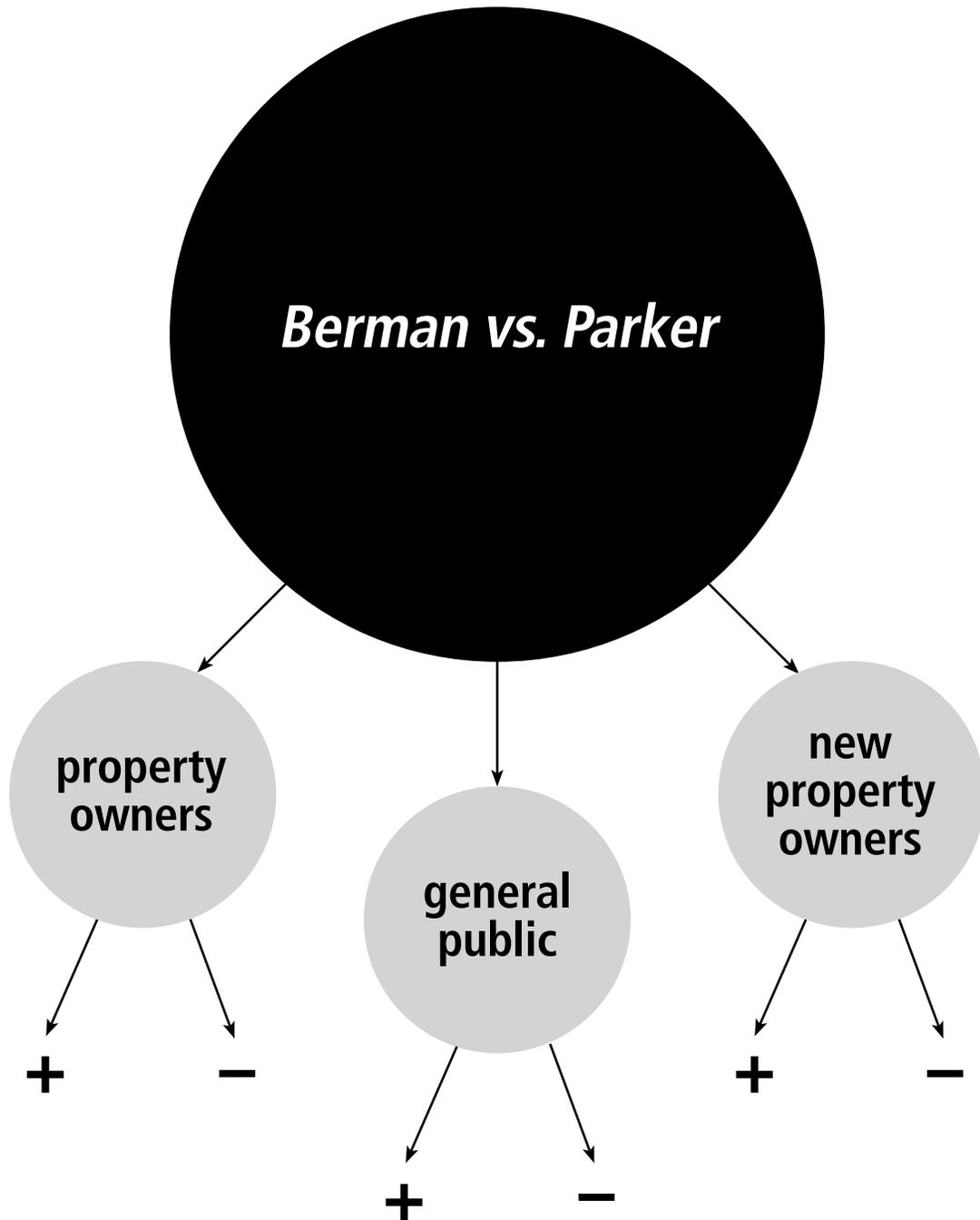
### ***Kelo vs. New London, 545 U.S. \_\_\_\_ (2005)***

The U.S. Supreme Court ruled that eminent domain could be used to take land from one private landowner and give it to another for the sake of economic development. *Berman vs. Parker* and *Hawaii Housing Authority vs. Midkiff* served as precedent for the ruling. Critics of the *Kelo* ruling argue that the court misinterpreted the Fifth Amendment by further broadening "public use" to mean "public purpose."

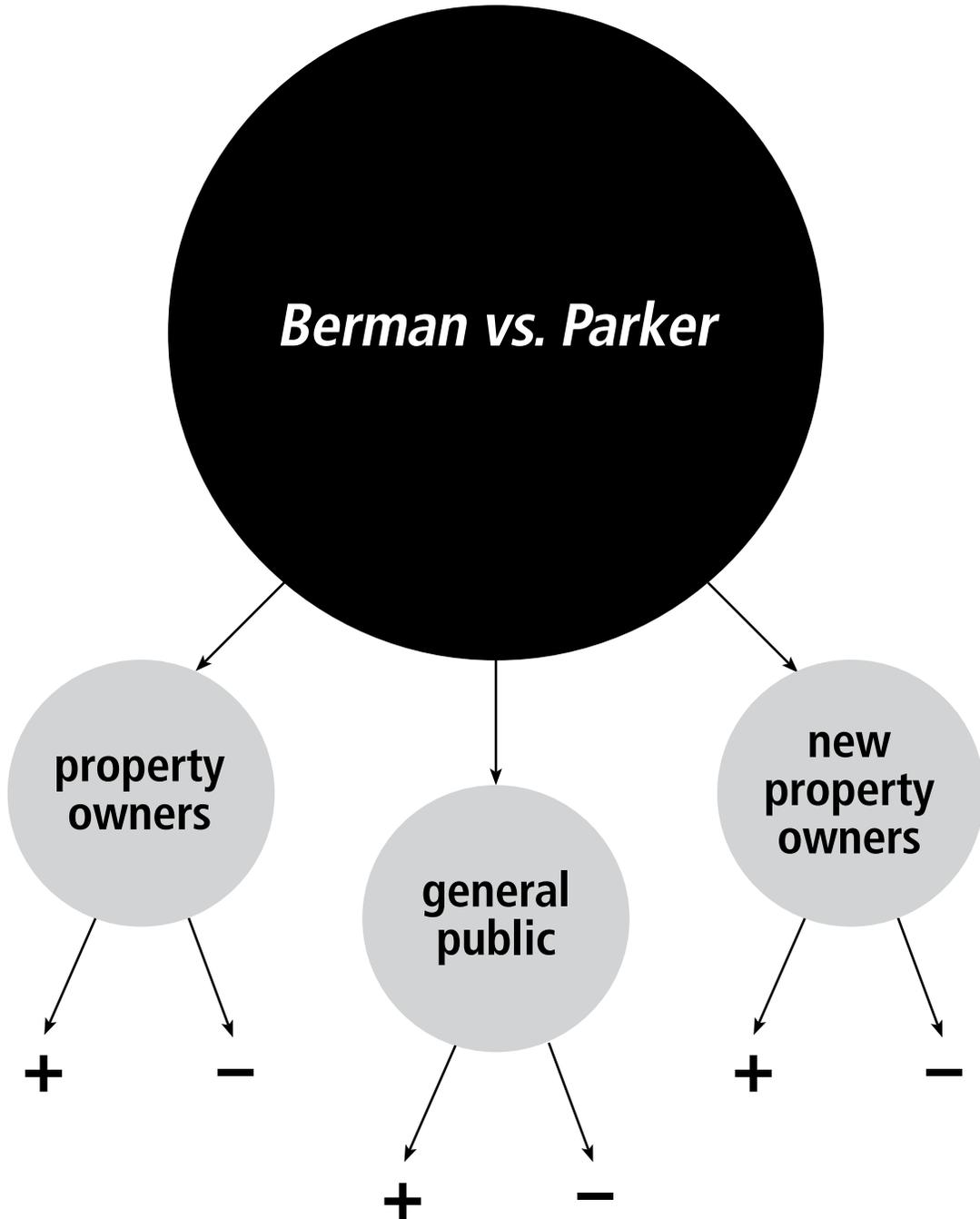
## ***Berman vs. Parker, 348 U.S. 26 (1954)***



## *Hawaii Housing Authority vs. Midkiff*



## *Kelo vs. New London*





# Fifth Amendment to the U.S. Constitution (1791)

“... nor shall private property  
be taken for public use,  
without just compensation.”

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