

# How Did *Kelo* Affect Business Formation?

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- *“While most constitutional decisions affect a small number of people, this decision undermines the rights of every American, except the most politically connected. Every home, small business, or church would produce more taxes as a shopping center or office building. And according to the Court, that's a good enough reason for eminent domain.”*

-- Dana Berliner, Institute for Justice, on *Kelo v. City of New London*, 505 U.S. 469 (Berliner, 2005).

- *“[I]f we don't use this power, cities will die.”*

-- Mayor Michael Brown, Riviera Beach, Florida, justifying attempts to condemn homes for conversion into luxury condos and a yacht marina (Price, 2005).

## So, How *Did* *Kelo* Affect Business Formation?

- Probably moderate, negative influence.
- State laws to restore property rights after *Kelo* probably associated with 10% increase in rate of business formation.

# How Eminent Domain Works

1. Gov't condemns, takes property by eminent domain.
2. Gov't pays former owner a market price as of *before* project announcement date.
3. Gov't expects to be repaid by explicit land rental contracts with new user.
4. In some cases (e.g. Lakewood, Ohio) gov't initiates redevelopment itself to raise the tax base in the targeted area. In such cases, gov't might sell acquired land to new users.

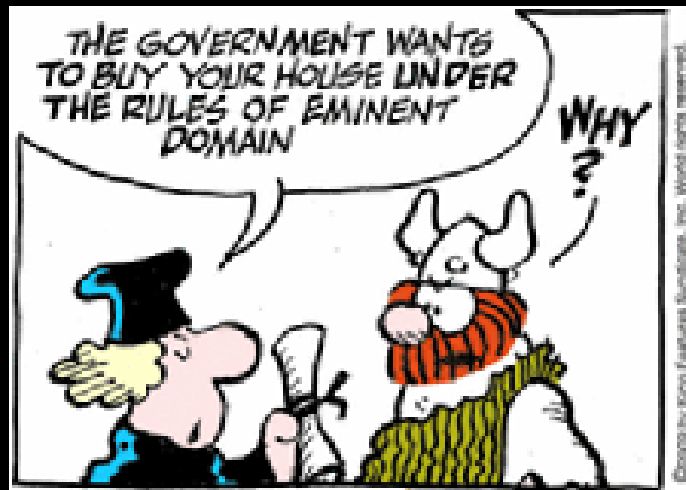
# History

- Long history!
  - "...nor shall private property be taken for public use, without just compensation."
    - Takings Clause, 5<sup>th</sup> Amendment, U.S. Constitution (1791).
  - "No freemen shall be taken or imprisoned or disseised or exiled or in any way destroyed, nor will we go upon him nor send upon him, except by the lawful judgment of his peers or by the law of the land."
    - Article 39, Magna Carta (1215).
- Eminent domain: Textbook way to handle hold-out problem (Goldstein 1987) in public goods.

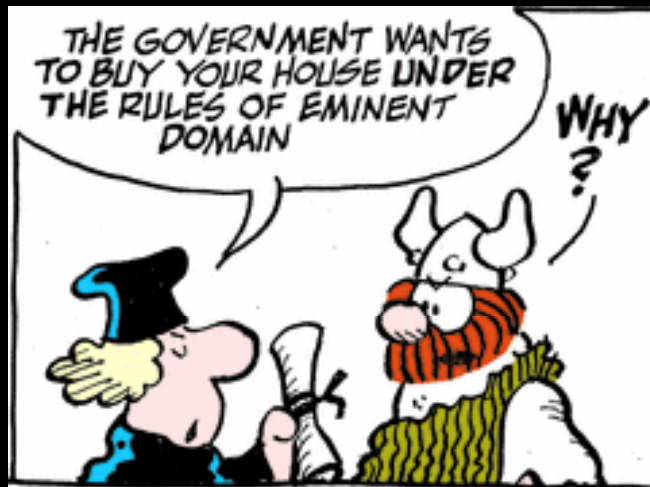
# History

- June 23, 2005: U.S. Supreme Court ruled in *Kelo v. City of New London*, 545 U.S. 469 (2005) that the Public Use Clause of U.S. Constitution lets gov't take private property for transfer to ***private*** owners to promote “economic development.”
- CSM poll found **98.5%** of Americans disagreed with *Kelo*.
  - Over 40 states have since passed legislation to protect property rights by limiting government takings via eminent domain.
- Despite being anticipated in legal circles (Garrett & Rothstein (2007); Salkin (2005)), “*The Kelo backlash probably resulted in more new state legislation than any other Supreme Court decision in history.*” Somin (2009); see also Brown (2009).

# Brown (2009)



# Brown (2009)



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# Natural Experiment

- Since *Kelo*, over 40 states have passed legislation to protect property rights by limiting government eminent domain takings.
  - Different times
    - Georgia (November 7, 2006); Maryland (May 8, 2007); Arkansas did nothing during the sample.
  - Different levels of protection
    - Georgia B+ (Castle Coalition)
      - Definition of “blight” requires “unsafe.”
      - Parcel-by-parcel.
    - Maryland D (Castle Coalition)
      - Condemners must act within 4 years of condemnation.

## Previous Research: *Determinants of Laws*

- López and Totah (2007)
  - Backlash led to state laws which may provide even *more* protection than federal laws.
  - Potential endogeneity
- López, Jewell and Campbell (2009)
  - Whether or not legislation is enacted is a function of voter backlash against *Kelo*, but strength of law is not.
  - States with more economic freedom, greater value of new housing, less racial homogeneity and more income equality are more likely to enact stronger restrictions.

## Previous Research: *Effect of Laws*

- Lu and Zelder (2008)
  - Housing prices are insignificantly related to enactment of state-level laws.
  - Point estimate negative.
- Carpenter and Ross (2008)
  - Construction jobs, building permits and property tax revenues unchanged before and after state-enacted legislation.

# Model

$$U(x) = p * v(x) + (1-p) * [c(x) + B] - x$$

where:

$x$  = investment by the entrepreneur,

$p$  = probability of government not taking business,

$v(x)$  = value of business if not taken,

$c(x)$  = compensation for business if taken,

$B$  = “public use” benefit to entrepreneur from taking.

# Model

Let  $c(x) = \gamma v(x)$ ;  $\gamma \geq 0$ :

$$U(x) = p * v(x) + (1-p) * [\gamma * v(x) + B] - x$$

Maximize and rearrange:

$$v'(x) = 1 / [((1-\gamma) * p) + \gamma]$$

# Digression

$$\begin{aligned}\hat{a}u(x)/\hat{a}p &= v(x) - [\gamma * v(x) + B] \\ &= (1 - \gamma) * v(x) - B\end{aligned}$$

1. If  $B = (1-\gamma)*v(x)$ , then  $\hat{a} = 0$ .
  - Rule out – *exceedingly* rare.

## Cases 2 & 3:

The way it's supposed to work

$$\begin{aligned}\frac{\partial u(x)}{\partial p} &= v(x) - [\gamma * v(x) + B] \\ &= (1 - \gamma) * v(x) - B\end{aligned}$$

2. If  $B > (1-\gamma)*v(x)$ , then  $\partial < 0$ .

3. If  $B > 0$  & either  $(\gamma = 1)$  or  $v(x) = 0$ , then  $\partial < 0$ .

## Cases 4 & 5: How opponents of eminent domain *fear* it works

$$\begin{aligned}\frac{\partial u(x)}{\partial p} &= v(x) - [\gamma * v(x) + B] \\ &= (1 - \gamma) * v(x) - B\end{aligned}$$

4. If  $B < (1-\gamma)*v(x)$ , then  $\partial > 0$ .

5. If  $B < (1-\gamma)*v(x)$  and  $\gamma > 1$ , then  $\partial < 0$ .



# Table 1: Summary Statistics

<b>Variable</b>	<b>N</b>	<b>Mean</b>	<b>Median</b>	<b>Minimum</b>	<b>Maximum</b>
<i>KIEA Index (%)</i>	612	0.30	0.286	0.08	0.72
<i>Income (\$)</i>	600	32147	31205	18658	60764
<i>Taxburden (%)</i>	600	9.40	9.50	5.7	12.01
<i>Unemployment (%)</i>	612	5.30	5.3	2.0	10.3
<i>White</i>	612	0.836	0.870	0.196	0.993
<i>Male</i>	612	0.484	0.484	0.433	0.525
<i>College</i>	612	0.233	0.231	0.127	0.414
<i>HS</i>	612	0.624	0.627	0.514	0.70
<i>Meanage</i>	612	36.106	36.200	28.900	41.30
<i>Services</i>	612	0.617	0.616	0.523	0.773
<i>Lawtype</i>	600	0.07	0	0	1
<i>Enlaw</i>	600	0.06	0	0	1

**Table 2: Summary Statistics, Aggregate Kauffman Index of Entrepreneurial Activity by Year, 1996-2007**

<b>Variable</b>	<b>N</b>	<b>Mean</b>	<b>Minimum</b>	<b>Maximum</b>
<i>Index96 (%)</i>	51	0.33	0.15	0.62
<i>Index97 (%)</i>	51	0.30	0.12	0.61
<i>Index98 (%)</i>	51	0.31	0.12	0.69
<i>Index99 (%)</i>	51	0.28	0.12	0.51
<i>Index00 (%)</i>	51	0.30	0.14	0.66
<i>Index01 (%)</i>	51	0.27	0.12	0.46
<i>Index02 (%)</i>	51	0.28	0.13	0.48
<i>Index03 (%)</i>	51	0.30	0.09	0.72
<i>Index04 (%)</i>	51	0.31	0.15	0.56
<i>Index05 (%)</i>	51	0.31	0.16	0.55
<i>Index06 (%)</i>	51	0.30	0.16	0.60
<i>Index07 (%)</i>	51	0.30	0.08	0.46

### Table 3: Regression Results (Model 1)

	Coefficient	t-statistic
<i>Constant</i>	0.00744	(2.20) <sup>*</sup>
<i>Taxburden<sub>it</sub></i>	0.0334	(1.60)
<i>Taxburden<sub>i(t-1)</sub></i>	-0.0412	(-2.01) <sup>*</sup>
<i>ln(Income<sub>it</sub>)</i>	0.00365	(2.11) <sup>*</sup>
<i>ln(Income<sub>i(t-1)</sub>)</i>	-0.00498	(-2.84) <sup>**</sup>
<i>Unemployment<sub>it</sub></i>	-0.000556	(-0.13)
<i>Unemployment<sub>i(t-1)</sub></i>	0.00378	(1.03)
<i>White<sub>it</sub></i>	0.000121	(0.43)
<i>Male<sub>it</sub></i>	0.0205	(5.09) <sup>**</sup>
<i>College<sub>it</sub></i>	0.00273	(1.46)
<i>HSit</i>	-0.000771	(-0.42)
<i>Meanage<sub>it</sub></i>	-0.0000953	(-3.28) <sup>**</sup>
Observations	550	
R-squared	0.227	

# Model 2

$Enact_{it}$	-0.00006 (-0.43)
$Enact_{i(t-1)}$	0.000299 (1.89)

Observations 550

R-squared 0.229

# Model 3 and Model 4 (drop *College*)

	Model 3		Model 4	
<i>Constant</i>	0.00455	(1.81)	0.00513	(1.94)
<i>Taxburden<sub>it</sub></i>	0.0357	(1.75)	0.0395	(1.93)
<i>Taxburden<sub>i(t-1)</sub></i>	-0.0415	(-2.07)*	-0.0453	(-2.27)*
<i>ln(Income<sub>it</sub>)</i>	0.00410	(2.81)**	0.00421	(2.85)**
<i>ln(Income<sub>i(t-1)</sub>)</i>	-0.00520	(-3.53)**	-0.00536	(-3.61)**
<i>Male<sub>it</sub></i>	0.0217	(5.86)**	0.0215	(5.81)**
<i>Meanage<sub>it</sub></i>	-0.00010	(-3.83)**	-0.000102	(-3.38)**
<i>Services<sub>it</sub></i>	0.00531	(4.43)**	0.00542	(4.49)**
<i>Enact<sub>it</sub></i>			-0.00009	(-0.64)
<i>Enact<sub>i(t-1)</sub></i>			0.000268	(1.64)
Observations	550		550	
R-squared	0.222		0.226	

# Robustness checks

- Property crime rate is insignificant and nothing else changes very much.
- Strong/law weak law doesn't matter too much; a little less significant.
- Dummy for *Kelo* insignificant.
- Castle Coalition's State Report Card for eminent domain legislation;
  - No clear trend. States in the "B" range tend to have lower rates of business formation.

# Next Revision

- Data:
  - State index of economic freedom (Fraser Institute)
  - States whose statutes or constitutions explicitly authorize takings for economic development purposes
- Endogeneity:
  - No need for such laws  $\Leftrightarrow$  No such laws.
  - Converse: Strong laws  $\Leftrightarrow$  many abuses.

# Summary

- We develop theory that says states which enact legislation to restore property rights should have higher rates of business formation.
- Mild support.
  - 10% higher
- Policy implication
  - Policy makers may enact state-level eminent domain restrictions to protect property rights without fear of retarding business formation. Business formation may even benefit.