

Choosing Metarules for Legal Change

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The central issue of Professor Tideman's paper[1] is not what legal rules we ought to have but how we ought to implement a change in legal rules. The question is one of constitutional rules—more pretentiously, metarules -- for legal change.

How we change legal rules may depend on why they are being changed. One possible reason is that existing rules were correct in the past, but are no longer so. This is not the sort of situation Tideman is considering. He is concerned with a change such as the abolition of slavery, where the reason for changing legal rules is not a change in our circumstances but in our understanding. The view of an abolitionist c. 1860, or almost any American at present, is that slavery is wrong and always was.

How ought such a change to be implemented. Should slave owners be reimbursed for the loss of their valuable "property"--and if so, by whom? Should slaves be reimbursed for the cost unjustly imposed on them under the old rules? If we institute a modern version of Henry George's single tax, should we reimburse landowners for the drop in the value of their land or should we bill current landowners, and anyone else with wealth derived from past land rents, for rents that should have been taxed?

Two Possible Metarules

At least two different metarules suggest themselves.[2] One is continuity: Change legal rules in a way that minimizes the effect on the relative welfare of members of the society. The other is retroactivity: try to create the situation that would have existed if we had recognized and enacted the correct rules in the distant past.

One argument for continuity is that it reduces the cost of changing legal rules. If a change makes me much better off and you much worse off, I have an incentive to work for it, and you to work against it. A society whose metarules imply that changes in legal rules will be accompanied by large changes in individual wealth is therefore likely to spend considerable resources fighting over such changes. It may also get bad rules, since desirable changes may be blocked by the opposition of politically influential groups that expect to be injured by them, and undesirable changes may be implemented by politically influential groups that expect to be benefitted.[3]

One ethical argument for continuity is that it is unjust to punish people for getting the wrong answer to a hard ethical question. If we confiscate the site value of a landowner's land, still more if we bill him for all past site value rents received, we are punishing him severely for not getting the right answer to an ethical question that almost everyone has gotten wrong for hundreds of years. This seems to violate the moral norm of basing punishment on moral desert.

An alternative ethical argument might be made from an entitlement rather than a desert standpoint.[4] Even if the state could and should have taxed away past rents on the site value of land, it didn't. By failing to do so, it implicitly gave away that value to the landowner, and cannot now reclaim it.

One might carry the argument further. When the landowner bought his land, his title was based on the existing legal system. If, relying on that system, he bought a claim that we now consider invalid, he has a reasonable case for reimbursement.

Continuity, whether right or wrong from an ethical or economic standpoint, appears at least twice in the U.S. constitution. The fifth amendment's takings clause[5] seems designed to prevent government acts from reducing the wealth of particular individuals, and the prohibition on ex post facto punishment[6] explicitly forbids the retroactive imposition of legal changes.

To see the economic argument on the other side, imagine that, over time, more and more people realize that the existing legal rules are wrong and will eventually be changed. Under a metarule of continuity, someone who anticipates the change has no incentive to act on his anticipation. Money made under the old rules will still be kept under the new, so he might as well take advantage of the old rules while they last.

That is not true under retroactivity. Once I realize that legal rules are going to change I also realize that everything done until the change will ultimately be reevaluated under the new rules. So it is in my interest to act as if the new rules were already in place. Thus retroactivity provides retroactive incentives for those who correctly foresee the legal change.

Retroactivity also provides an incentive for research designed to predict what legal rules will become persuasive in the future. If I realize that site value is going to be taxed away before it actually happens, I can modify my behavior to take account of the new legal rule--avoid, for instance, acquiring large amounts of undeveloped property.

One ethical argument in favor of retroactivity is that it is equivalent to requiring property to be returned to its owner. Even if the present possessor has committed no

legal or moral offense, the real owner has a better claim. A slaveholder who did not realize that a slave was a person with rights that he was violating may perhaps be morally innocent, but he is still in possession of property produced by labor stolen from its true owner.

Choosing a Metarule

These arguments suggest that the choice between the two metarules should be based on the answer to one question: How clear is the nature and desirability of the legal change to which the metarule is being applied? If, once the arguments have been made, it is obvious to everyone that the proposed new rule should be adopted, the problem of rent seeking disappears. There is no point in hiring a high priced lawyer to argue that two plus two equals three. And the clearer the correctness and nature of the new rule, the more practical it is for far sighted individuals to predict the change and adjust their behavior accordingly.

If the arguments for the new rule, or the detailed nature of the rule implied by those arguments, are unclear, the balance tips the other way. Investments in lobbying, propagandizing, and litigating may determine whether the change occurs and what form the new rule, if adopted, will take. Such expenditures may make the change an expensive one. And it will be hard for even very farsighted individuals to adopt to the new rule in advance if there is no way of knowing whether it will be adopted or in what form. Under those circumstances, retroactivity will only produce legal confusion during the period just before the change.

The ethical arguments are also affected by how clear the decision is. We will be more willing to consider people morally culpable for taking advantage of the old legal rule the clearer it is to us now that that rule was wrong--and the clearer it is what the right rule is under which they should have acted. The conclusion seems straightforward. If the new rule is sufficiently clear, it should be adopted retroactively; if it is sufficiently fuzzy, it should be adopted under a metarule of continuity.

Application to the Case in Hand

Tideman appears to favor retroactivity, insofar as it is practical to impose it. The arguments I have offered above suggest that this is a sensible rule only if the case for, and the implications of, site value taxation are clear. On the evidence of the paper, that

condition is not met. The conclusions he reaches are rich in maybe's. The criteria he suggests are not only difficult to apply, they are difficult even to define.

Consider the following:

"On the other hand, if trades in land have created a pattern of holdings in which there is no discernible relationship between the sale value of a person's current land holdings and the value in his or her portfolio that is attributable to past appropriations of land, past rises in the sale value of land, and gifts and inheritances of value derived from such sources, then the initiation of social collection of the rent of land falls so far short of its goal, that some form of compensation may be necessary."

The author does not explain what it means for a gift or inheritance to be derived from a particular source. Suppose I am the son and heir of a farmer half of whose income was due to his labor, half to the rental value of his land. Which half is my inheritance derived from? If he gave gifts to people during his lifetime, which half were they derived from? If he purchased the land himself from a previous owner, can he deduct the purchase price from the part of his income "derived from" the site value of the land?

In discussing Case 6, where land prices fall gradually as more and more people anticipate the victory of site value taxation, Tideman appears to argue that the only people who may have legitimate claims to compensation are those who held their land throughout the period of change. What about those who sold at a reduced price?

Consider a retired farmer. As the movement for site value taxation spreads, the value of his land falls. Afraid of being entirely wiped out, he sells his land for half its original value. Is he less entitled to compensation than if he had held the land? Why should the claim to compensation be retained if one person holds the land throughout the period, but vanish like a burst bubble with a transfer? How should the period during which a transfer will annihilate a claim be determined? Ever since Adam Smith discussed the virtues of site value taxation, all sale value of real estate has, arguably, been depressed, albeit only slightly, by the possibility that such a policy would be adopted. Does it follow that compensation is only due to those who have held their land since before 1776?

These are a few of the problems that occurred to me in reading through Professor Tideman's paper. My claim is not that his answers are wrong--merely that good arguments can be made both for and against them. If so, the correct conclusion is fuzzy, which is an objection to the metarule that Tideman appears to be arguing for.

The Retroactive Metarule: Alternative Definitions

Consider two different ways in which the metarule might be defined.

Version 1: A change in legal rules should create, insofar as possible, the situation that would have existed if the legal rule we now consider correct had been in force forever.

Professor Tideman, after a long career as an economic theorist, turns his talent to a wider field, authoring several wildly successful books in defense of site value taxation. One result is the triumph of the proposal. A second result is an income of several million dollars in royalties.

According to the version of the metarule proposed above, all of his royalties are forfeit, since they would not have been made in a world where site value taxation had been in force forever.

This is an extreme example of a very general problem. A legal rule affects many people who do not themselves make use of it. Realtors, land surveyors, taxpayers, and very nearly everyone else will have different incomes in worlds with and without private ownership of the site value of land. Version 1 of the metarule conflates the illegitimate gains of the thief with the legitimate gains of the manufacturer of locks and burglar alarms--both made possible by a system with insufficiently strong laws against theft.

Version 2: A change in legal rules should create the situation that would have existed if the legal rule we now consider correct had been in force forever, but individuals all acted as if the old legal rule was in force--as they in fact did.

This version is suggested by the passage quoted earlier, where Tideman refers to "sale value ... attributable to past appropriations of land, past rises in the sale value of land, and gifts and inheritances of value derived from such sources." His objective seems to be to identify and confiscate gains that would have been illegitimate if the new rule had been in force.

Here too there are problems. Some I have discussed earlier--how do you decide who got the tainted part of the inheritance? Others are suggested by the attempt to limit the transmission to "gifts and inheritances." Presumably the idea is that someone who provided something of value in exchange for the tainted money deserves his payment. But stolen property does not become legitimate just because it is used to buy something.

Suppose that, in Tideman's case 4, where the land has been seized by a band of marauders, one of the marauders sells his land. Anticipating future legal changes, he specifies that he is transferring whatever rights he has in the land, and makes no claim as to what those rights are. After a later democratic revolution cancels the rights of the conquerors, can he justly claim that he is entitled to every cent he received, since he transferred all the rights he had in the land--i.e. none? If so, then the claims of anyone who sold his land depend on the detailed wording of the contract--and there may be many intermediate cases.

To make sense out of version 2, one must construct a complete liability system describing exactly how actions making use of legal rules now known to be unjust create claims by some people against others.

Perhaps it could be done, but it would be difficult--and any difficulty in applying the retroactive metarule is a strong argument in favor of using continuity instead.

I have offered two versions of the retroactive metarule. Perhaps there is another that avoids the difficulties. I accordingly close this section with a challenge to Professor Tideman: Give a clear definition of exactly what it would mean to impose a new legal rule retroactively.

Final Words

It is almost always a mistake to use political or legal mechanisms to do complicated things--not only because they are likely to get them wrong, but because the attempt to get them right provides an opportunity for large expenditures designed to influence the outcome. It is especially dangerous when the decision matters a great deal to many private individuals. If we change our legal rules, we should do so in a way that is as simple as practical, and designed to avoid large transfers of wealth. If site value taxation is implemented, it should either provide no reimbursement for landowners (the simplest rule) or reimburse them for the drop in their land value.

In closing, I would like to suggest that the arguments I have applied to the choice of metarule are also relevant to the particular legal change under discussion. As with the metarule, so with the rule--the fuzzier

the prescription, the greater the room for rent seeking behavior. Professor Tideman has proposed elsewhere^[7] elaborate and ingenious versions of the Georgian single tax scheme. As theoretical curiosities they are interesting and admirable. As practical legal and political proposals they are neither, since they require the legislature and the

courts to engage in complicated calculations, using mechanisms that could easily be subverted to serve the private interests of those controlling them.

Consider a much simpler version, and one that might have seemed practical early in American history, when most of the country belonged to the Federal government. Let all public lands be auctioned off to the highest bidder. The result will be to transfer to the public purse the ex ante estimate of the site value--including any future increases thereof. This does not provide the side benefits of more elaborate schemes, but it does achieve the core purpose, and it does so in as simple a way as one could reasonably hope for.

It has been tried. For the first sixty years of the nineteenth century, the Federal government attempted to raise revenue by auctioning off the public lands. The result was a massive failure, with de jure auctions converted to de facto homesteading through a mixture of political pressure, rigged bidding, and threats of physical injury to any "speculator" rash enough to bid against an (illegal) settler for "his" land.

A full account of that particular episode in American history would take me far beyond the bounds of this paper. But the failure of the government to apply the simplest possible version of site value taxation does not leave me optimistic about the prospects for more elaborate versions.

References

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