Eminent Theft

The Fifth Amendment to the US Constitution recognizes the power of the government to seize private property for public use (eminent domain) as long as just compensation is given to the owner of the property. In 2005, the US Supreme Court expanded the definition of public purpose to include private economic development. In [*Kelo vs. New London*](http://civilliberty.about.com/od/freetradeopenmarkets/p/kelovlondon.htm), the Court ruled that the city of New London Connecticut could seize the home of Ms. Susette Kelo in order to transfer the property to a private developer. The developer was supposed to build a hotel and office buildings on the site thereby expanding the tax base for New London. Ms. Kelo was forced off of her property, [but years passed and no development even took place.](http://online.wsj.com/article/SB10001424052748704402404574527513453636326.html)

Even governments need to be careful for what they wish for. [Local governments are now contemplating using eminent domain to sieze underwater mortgages.](http://economywatch.nbcnews.com/_news/2012/08/16/13301668-governments-mull-radical-solution-to-underwater-mortgages-seize-them?lite)  Their plan is to take private houses owned by banks and then get a court to rule that just compensation to the banks is some number dramatically less than the banks have loaned out on the house. Once securing the homes they could be resold – presumably back to the same people who were underwater in their previous mortgages.

Such an action, if implemented, is nothing less than sanctioned theft. When governments are allowed to take people’s private property only so that they can give it to political allies for a fraction of the cost no property will ever be worth owning, unless you are politically connected. Access to credit will dry up in jurisdictions where private lending contracts can be seized and voided. This will further lower the demand for housing in the very areas where they are trying to increase it. So goes the law of unintended consequences.

It would be difficult to imagine a car dealer locating in a town where the town has the right, once car buyers drive cars off of the lot, to confiscate the car loan, force the car dealer to accept less for the car, and sell the car back to the car buyers for a fraction of what they agreed to pay for it in the first place. The right to engage in private contracts and have them enforced by a court of law is one of the most basic cornerstones signifying the rule of law rather than rule by thugs. States without the rule of law have abysmal economies, and towns that think they can steal property with impunity are sorely mistaken. They will become economic wastelands.

Robert Mugabe engaged in land seizures in Zimbabwe. His “war veterans” stormed white owned farms killing people and seizing control of their farms. As a result, food production fell dramatically, capital fled the country, and the unemployment rate rose to over 90%. [More than 40% of all the land seized from white farmers ended up in the personal hands of Mugabe and his allies.](http://www.guardian.co.uk/world/2010/nov/30/zimbabwe-mugabe-white-farmers) Still, even some at the [UN still laud Mugabe’s land seizures.](http://news.xinhuanet.com/english/world/2012-05/24/c_123181591.htm) The moral of that story is that politicians might find it in their narrow short term self-interest to steal things from one group of people in order to promise them to another. That is, after they skim some off of the top for themselves first. Yet, in the long term this strategy leads to economic doom and misery.

The US government’s own seizure of General Motors illustrates the same point. The auto bailout is now estimated to have cost taxpayers [$25 billion](http://www.detroitnews.com/article/20120813/AUTO01/208130392). In this case the government seized a company, paid off the people who were politically connected to them (unionized auto workers) and dumped the losses on the public. GM share prices have fallen from $33 (their IPO price) down to just above $20 and the government appears to be ready to ride the share price even lower.

If local governments seize underwater home loans they will be forced to be the financier of the new home loans to people who have trouble making home loans. No doubt they will just pass the losses onto taxpayers. The most ironic point is that many of these underwater loans are backed by Fannie Mae which is in turn backed by US taxpayers. Using eminent domain on underwater government backed mortgages means that local governments would be stealing from US taxpayers to give favors to politically connected people while exposing local taxpayers to loan repayment risk and reduced access to capital. This is exactly the lose-lose-lose scenario governments are good at creating, so it makes sense that politicians are seriously considering it. They have perfected lose-lose economics.