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**Table of Contents:**

Introduction........................................................................................................................1

Mission: Tame Asset Price Bubbles, Editorial ...................................................................................2
Igor M. Tomic

State Budget Stabilization Funds: Effective Fiscal Discipline or Lip Service? ..............................6
Robert F. Salvino

Do Institutions Constrain Business, Citizen, and Government Interest Group Formation?..........21
Gregory M. Randolph and Michael T. Tasto

The Raid on Fort Trumbull:
Law, Justice, and Economic Rights in Kelo v. City of New London............................................33
Patrick D. Cullen

## Introduction

Welcome to the first edition of the *Journal of the Global Business Research Symposium*!

From the Editors:

We are pleased to bring you this first ever edition, a collection of research articles and case studies covering multiple business disciplines and offering a global perspective. For this and future issues, we welcome theoretical, applied, and empirical papers, as well as case studies in all areas of business, including accounting, finance, banking, management, marketing, business law, ethics, economics, real estate, technology, emerging markets, and cultural issues.

Articles in this journal have been submitted through a process of peer review after presentation at the Symposium's annual conference, the Global Business Research Symposium. We have made every attempt to match reviewers with articles according to discipline expertise in an effort to provide meaningful, timely feedback and to help ensure a quality final manuscript for publication in this journal.

As a conference journal, we take this opportunity to make you aware of our annual international conference held each summer. The Global Business Research Symposium facilitates a friendly, scholarly environment across all business disciplines. The 2016 conference was held in Rome, Italy from June 15 through June 17 at St. John's University's Rome campus. This year's conference theme, "Finding Roads to Prosperity," encouraged many papers, some of which you will see in this publication.

We would like to extend our thanks to the symposium staff and our editorial review board for timely, constructive reviews. If you are interested in attending the conference or submitting a paper, please see our conference "Call for Papers" at http://www.gbrsconference.org. In 2017, the 12th annual Global Business Research Symposium will be held July 26-28 at the Cork University Business School, University College Cork, Ireland.

Our mission is to encourage scholarly investigation and expression of important issues facing business in an ever-changing world. Thank you for your interest in the *Journal of the Global Business Research Symposium* and enjoy the first issue. We hope to see you at the next conference!

Sincerely,

The Editors

## Mission: Tame Asset Price Bubbles, Editorial

**Igor M. Tomic**
**St. John's University**

The financial crisis that started in 2008 surprised most observers by its sudden, deep intensity and degree of damage done to the economy. In many ways it was a perfect storm, for the rapid growth in asset prices driven by leverage led in time to their collapse. The surprise of the intensity of this financial crisis is also due to the fact that for many decades the recessions were tamer and our policy tools seemed to be adequate to the task. However, the crisis and the lengthy recovery from this recession made us question if any change in policies are needed in order to avoid another intense recession. Are our policy tools adequate to address another danger to financial stability?

Before 2008 the belief was that monetary policy by stabilizing inflation and output is unlikely to cause an asset price bubble. In case such a bubble did form, one would wait for the bubble to burst and affect the macro economy—then the Federal Reserve would intervene. That was the view held steady until our recent crisis by Cecchetti et al (2000); Greenspan, (2002); Borio, English, and Filardo (2003); White (2004); Kohn, (2006); and Mishkin, (2008). The argument in support of this thesis was:

- Bubbles are difficult to detect.
- The standard monetary policy tools may not be satisfactory in "leaning against" the bubble (trying to prevent it) as they are a blunt monetary policy tool that affects the whole economy. Monetary policy is not designed to address any event that shows up only in one sector.
- An increase in interest rates could be ineffective against a bubble as market participants expect high rates of return in the bubble driven assets. Bubbles are a departure from normal conditions and there is no guarantee that normal monetary policies will work in abnormal conditions.

However, the work that included historical evidence came to the fore after the crisis. Kindelberger (1978) examined historic evidence and concluded that bursting of bubbles was followed by sharp declines in economic activity. Rainhart and Rogoff (2009) found that after a financial crisis, the massive bailouts of financial institutions, fiscal stimulus packages, and a reduction in tax revenues due to a recession will tend to increase governmental indebtedness. If global in character, the financial crisis was likely to cause increases in debt for many countries. In addition, Rainhart and Rainhart (2010) pointed out that a strong recovery of a V-shape is not what follows after a financial crisis. A recovery will be slow, with smaller increases in GDP and higher levels of unemployment for years to follow. In other words, the **output losses from a financial crisis are rather larger than believed earlier**. Since a financial crisis impacts all sectors of the economy, the uncertainty about the future is deep and business investment is slow to grow and thus overall economic growth is likely to be below normal afterwards. All this implies that the cost of a bubble bursting (without intervention) is rather high. The current research has shaken the earlier belief that monetary policy, by stabilizing output and inflation, is likely to always bring stability to the financial system.

The GAO (2013) reported that the decline in output in our financial crisis just in the period 2009-2011 was about $13 trillion, almost a year's GDP. While this is an estimate, it points to the damage caused by a deep recession and supports the hypothesis that damage caused by a bursting bubble is rather high. Another type of evidence has brought a clearer picture of the consequences when a large financial firm fails due to the firm's complexity and interconnectedness. The failure of Lehman Brothers in 2009 shows the immediate and longer term effects (Fleming and Sarkar, 2014) as it encompassed over $1 trillion worth of creditor claims, four bodies of applicable U.S. laws, and insolvency proceedings that involved over eighty international legal jurisdictions. In sum, the bursting of the bubble in the last crisis was a heavy burden on the economy that was further complicated by the bankruptcy of a large financial institution.

The event of bubble formation and busts were of interest to many researchers (see Stiglitz, 2010, Keely and Love, 2010). Two types of bubbles were specifically identified—one referred to as irrational exuberance bubble, and the other, a more dangerous one, was described by Mishkin (2010) and Yellen (2011) as a credit driven bubble.

- The **irrational exuberance bubble** is driven by highly optimistic expectation as did the tech bubble in the 1990's. This bubble was not sustained by a feedback loop between bank lending and equity values and when it burst, no great damage was done to the balance sheets of banks. Thus the recession that followed was rather mild.
- In a **credit driven bubble,** the demand for some assets increases lending in that sector which leads to increase in the same asset prices. The rise in value of these assets further increases lending against these assets, thus continuing to increase their value and prices creating the beginning of a feedback loop. If credit standards are eased, a bubble may begin forming as lenders become less concerned about the ability of borrowers to repay, anticipating appreciation of the assets as protection against losses. The bubble eventually bursts, reversing the direction of value and prices of the assets in question significantly as seen with subprime lending in the recent past. Lenders reduce credit availability for these types of assets which reduces further their value and prices. Loan losses increase and combined with the declining prices of assets cause the erosion of the balance sheets of financial institutions which reduces credit and investment for a broader range of assets. This reduction in lending in other sectors has been seen to depress business activity as well as household spending, and possibly the financial system as a whole. In sum, the credit driven bubble is more dangerous as it could impact the whole economy. This describes well the asset bubble that led us into the Great Recession.

In the US, the response to the Great Recession led to the passage of Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Dodd-Frank or the Act) and globally, the Basel Committee on Banking Supervision introduced Basel III. The goal of both pieces of rulemaking was to improve accountability and transparency in the financial system, to protect taxpayers from bail-outs of firms as well as to protect consumers from abusive financial services practices. To meet these goals, in the US, three new agencies were created: the Financial Stability Oversight Council, the OFR, and the Bureau of Consumer Financial Protection. In Europe the Basel Committee on Banking Supervision created the Financial Stability Board that is responsible for assuring financial stability.

While new regulations focus on stability issues including increasing bank capital requirements and introduce capital surcharges for systemically important banks, each country is left to decide how to implement these stability policies. In the US, large financial firms that may threaten the financial system are known as Systemically Important Financial Institutions (SIFI) and have been subject to the most stringent rules and early phase-in periods starting in January 2015. A number of the new regulations and requirements include: holding extra capital to account for size, strategic focus, global reach and strategic importance plus holding larger amounts of good quality liquid assets. Institutions must also perform stress tests based on regulatory parameters (once a year) and based on internal measurements. Another major enhancement to financial stability is in the form of institutions' acceptable resolution plans, known as "living wills" that address how an institution would be closed in the event of financial failure so that taxpayers are not burdened with a rescue of a large financial institution. Policies that improve the stability of individual forms are also known as **microprudential policies**.

However, what if the monetary policies and the newly introduced microprudential policies still do not managed to prevent the credit driven bubbles and thus guaranty financial stability? In 2010, Basel III introduced a macroprudential policy known as the countercyclical buffer that allows regulators to limit credit growth in a sector where asset price increases could potentially effect financial stability. This would assure that the affected sector does not make conditions worse in times of existing shocks to financial system.

The application of macroprudential policies has been on the increase. In 2013 the Reserve Bank of New Zealand imposed higher loan-to-value ratio requirements on mortgage lenders as property prices were rising above their historic norms. This new policy resulted in prices of property leveling off and no harm occurred to the economy. The Bank of England had similar concerns over rising property prices; those were slowed down by restricted the size of mortgages relative to borrowers' income. On January 27, 2015, the Central Bank of Ireland announced new mortgage policies that restricted borrowing by introducing loan-to value and loan to income limits. Do notice that these restrictions were all in the mortgage fields, an area where the credit driven bubble certainly formed the feedback loops that that we experienced in the recent financial crisis.

In addition to specific macroprudential policies in several countries, some countries have established macroprudential authorities. In the European Union the macroprudential authority is the European Systemic Risk Board (ESRB) set up in 2011; while it has limited authority, it can influence national policies (Jeanne and Korinek, 2014).

Macroprudential policies are a new development and potentially a helpful addition to the regulatory toolbox in the goal toward greater financial stability. Nonetheless, they are still early in their adoption and it is too early to suggest that no credit bubbles will ever form. The Federal Reserve policy that aligns with the Basel III countercyclical buffer policy finished its comment period in March 2016. Early in this process some comments/concerns expressed were (**Federal Advisory Council, 2015)**:

- How to measure excess credit or systemic risk?
- When do we initiate a countercyclical buffer? What is the speed of implementation?
- Is there assurance that it will not impact healthy sectors?
- Are there unintended consequences?

Nonetheless, the potential for having a tool such as macroprudential policy is real and will certainly be tested in the future. In sum, the Great Recession led us to pay more attention to financial stability by:

- Realizing that asset bubbles can affect the economy worse than anticipated earlier
- Microprudential policies by stabilizing individual firms would guaranty more financial stability

- Examining macroprudential policies that can stabilize a sector where credit driven bubbles can potentially form and threated financial stability.

In sum, policy makers were not dormant in the aftermath of the Great recession. Policies to prevent asset bubble formation did changed and experiments with a new policy tool show promise is assuring financial stability.

# State Budget Stabilization Funds: Effective Fiscal Discipline or Lip Service?[1]

**Robert F. Salvino**
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**Abstract**. State budget stabilization, or rainy day, funds can be an effective fiscal tool, but they differ in their deposit and withdrawal requirements. These rule structures have been shown to affect their use as safeguards. In particular, weakly defined statutory funds are found to be relatively ineffective as fiscal stabilizers. This study considers rainy day funds as a form of direct fiscal constraint. Previous study findings suggest citizens seek stronger constitutional funds to constrain taxing and spending, while legislators favor weakly defined funds in order to circumvent tax and expenditure limitations (Wagner and Sobel, 2006). In the present study, I test the logic in an empirical analysis of the size of governments across states. The empirical results support the logic of constitutional constraints. Constitutional state budget stabilization funds are negatively correlated with the size of the total state and local public sector, while there is weak evidence of a positive correlation between statutory funds with weak withdrawal requirements and public sector size.

**Keywords:** fiscal institutions, rainy day funds, TEL's

**JEL Codes:** H11, H20, H72

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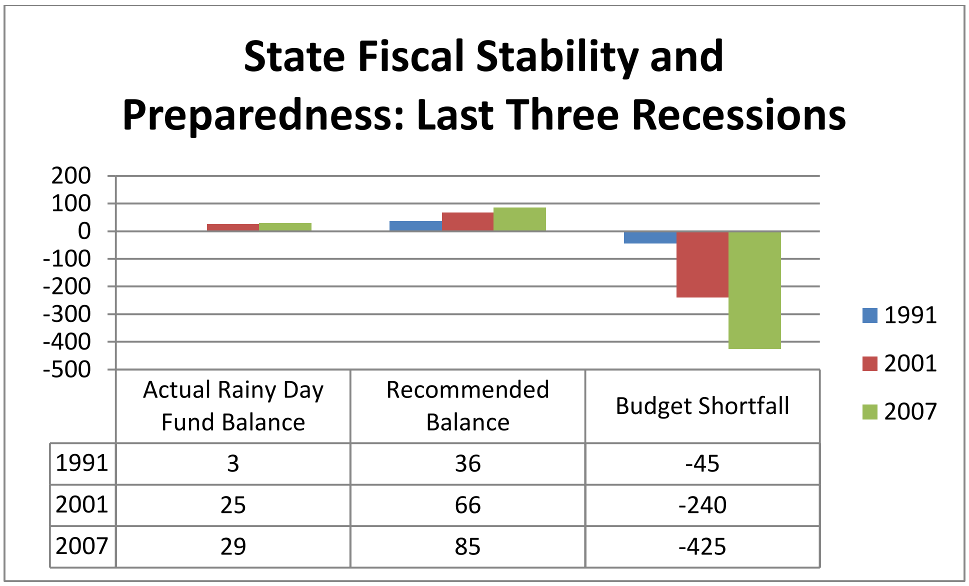
## 1. Introduction

In a little over two decades, states have faced three recessions corresponding with successively deeper fiscal disruptions. According to data from the National Association of State Budget Officers, the cumulative state budget shortfall of $425 billion in the 2007 recession was almost ten times the cumulative shortfall of the 1991 recession, $45 billion, and the 2001 recession shortfall of $240 billion was over five times the 1991 shortfall.

States' efforts to prepare for down times seem to have strengthened over the period; however, each successive recession's negative impact on state budgets has been of greater magnitude. Figure 1 shows how states have increased their rainy day fund balances over the period, a near ten-fold increase in the cumulative balance of funds. The recommended balances also increased over the period, and states made some progress toward the recommended balances, but even the recommended balances were far too small to smooth over the effects of successive recessions. The recommended balance just prior to the 2007 recession was $85 billion (cumulative) compared with the actual shortfall of $425 billion, and the actual balance was just $29 billion.

**Figure 1. Rainy Day Funds and State Preparedness for Recessions**




| | Actual Rainy Day Fund Balance | Recommended Balance | Budget Shortfall |
|---|---|---|---|
| 1991 | 3 | 36 | -45 |
| 2001 | 25 | 66 | -240 |
| 2007 | 29 | 85 | -425 |

Source: National Association of State Budget Officers[2]

Several questions arise given the difficulty in projecting shortfalls and the reluctance of states to fully fund and/or use their stabilization funds. One question concerns the growing impact of recessions on state budgets—a question reserved for future research and beyond the scope of this paper. Another question relates to the adoption and use of rainy day funds in particular. Forty-six states currently utilize some form of a budget stabilization fund. Only ten of these states had budget stabilization funds in place before 1980. Twenty states adopted their funds between 1981 and 1986. Gold (1983) and Douglas and Gaddie (2001) advocate the conventional view that the recession of 1980-1982, and resulting fiscal crises for many states, lead to the increase in the adoption of budget stabilization funds in the early 1980's. Wagner and Sobel (2006) present an alternative argument

[2] Adapted from Figure 2 "Pre-Recession Peak Rainy Day Fund Balances versus Budget Shortfalls that Followed" in http://www.cbpp.org/files/2-3-11sfp.pdf

for the increase in fund adoption. They note that tax and expenditure limitation laws (TELs) are another fiscal phenomenon arising in the period from 1980 to 1982. Since many of these laws have clauses requiring states to return some or all of a general fund surplus to citizens, state budget stabilization funds provide a way for states to retain their surpluses.

Every state except Vermont has some form of balanced budget rule; however, in almost all cases these rules are written in stock rather than flow terms (Wagner & Sobel, 2006). If only the stock of funds must balance, states can run annual deficits financed by drawing down general fund surpluses from previous periods. Following this logic, only a budget stabilization fund with stricter deposit and withdrawal rules than provided for in the general fund surplus would better prepare a state for upcoming fiscal downturns. This reasoning implies that strict constraints should govern state budget stabilization funds; however, Wagner and Sobel (2006) find that 38 of 44 funds are statutory funds (which they show are generally less constrained than constitutional funds) and the majority of these funds are no more constraining than requirements for deposit and withdrawal of general fund surpluses. State legislators have more flexibility in designing statutory funds (they impose these on themselves) than they would in designing constitutional funds, which citizens typically impose on legislatures through a successful voter referendum or citizen initiative.

This study builds on Wagner and Sobel's (2006) finding that weakly defined statutory state budget stabilization funds are positively correlated with tax and expenditure limitations and that weakly defined statutory funds allow states greater flexibility to bypass revenue and spending constraints imposed by tax and expenditure limitations. States choose weakly defined funds in order to circumvent these limits and stronger constitutional funds to constrain leviathan power. Our results support this logic. Constitutional state budget stabilization funds are negatively correlated with the size of the total state and local public sector, while there is weak evidence of a positive correlation between statutory funds with weak withdrawal requirements and the size of the state and local public sector. However, analyses of the state and local sectors separately are inconclusive. The remainder of the paper proceeds with a discussion of institutional factors and public sector performance, and the data and empirical methodology are presented in section 3. The results section concludes.

## 2. Institutions and Public Sector Performance

There has been a renewed interest in the use and design of rainy day funds to smooth over fiscal disruptions caused by business cycles. This renewed interest is coincident with major adjustments to the federalist structure of government in the United States that has changed state and local public sector spending mandates and the relationship with the federal tier. No Child Left Behind and the Patient Protection and Affordable Care Act (Obamacare) are just two examples. At the same time, state and local governments have had to contend with the deepening impact of recessionary-induced fiscal imbalances—substantially worse in each of the last three recessions. Much of the research has focused on direct institutional factors as possible tools for averting or contending with the significant revenue imbalances. Less of the recent research focuses on indirect factors including fiscal decentralization, a popular research field in the 1980s. In this study, direct and indirect institutional factors will be examined simultaneously, and future research should revisit the dynamics of fiscal federalism and its relationship with revenue stability. With this in mind, I briefly reference the fiscal federalism literature and then the more specific work on state budget stabilization.

Fiscal federalism (Oates 1972, 1999), rather than merely describing the appearance of the split of duties among the different tiers of a federalist government structure, concerns itself with identifying the appropriate vertical tier of government for each function or instrument in an effort to maximize efficiency or social welfare. It considers the interrelation of these tiers and the effects various instruments will have if exercised at one level versus another or at two or more levels simultaneously. On efficiency grounds, revenue stability remains an unanswered question as far as the structure of government is concerned. Fiscal federalism considers tax instruments, user fees, debt financing, intergovernmental grants, or any combination thereof as potential revenue sources for providing government services and suggests efficient and equitable approaches to financing programs or distributing funds across the various tiers of government. On these grounds its relationship with revenue stability is a natural concern.

In general the theory of fiscal decentralization maintains that social welfare is maximized when decentralized tiers provide local public goods because it is likely that preferences and costs of provision of local public goods will vary across jurisdictions, hence the efficient level of provision will also differ.[3] If, instead, a centralized government determines a uniform level of provision for a particular service benefiting a local area, for example public park amenities, different localities will be forced to provide this level of service for which there may be very little demand among its residents. Decentralization allows local preferences to determine local provision and helps ensure that marginal cost of provision equals the sum of residents' marginal benefits.

Fiscal federalism has indirect implications for the leviathan hypothesis (Brennan and Buchanan, 1980). These implications derive more directly from Charles Tiebout's (1956) model of efficient public good provision. Tiebout was interested in exploring why private markets efficiently provide private goods, but do not fare so well in the provision of public goods. He determined that shopping and competition in private markets keep firms from providing inferior, inefficiently-produced goods. Consumers have alternatives. Tiebout recognized that it is not likely for residents of a country to move frequently move from one country to another because of inefficient public good provision. Even inter-state migration is unlikely to discipline public good provision in this way. However, he reasoned that competition for residents among local jurisdictions may provide the efficient level of public goods, since residents can more easily choose a particular location in a select region as well as move from one jurisdiction to another if they become dissatisfied with a jurisdiction's bundle of public services. In this way, pushing public good provisions down to the local tier will discipline local governments to effectively and efficiently provide public services in order to keep existing residents and attract new residents.

Fischel's (2001) homevoter hypothesis provides another argument for decentralization that does not directly depend upon the existence of interjurisdiction competition, reinforcing Oates' (1999) suggestion that interjurisdiction competition is not necessary to attain the efficiency-enhancing results associated with fiscal decentralization. Citing evidence from numerous empirical studies that taxes and public services and amenities are capitalized into the value of homes, Fischel argues that homeowners make efficient decisions in the interest of protecting the value of their largest asset, their homes (Hughes & Sirmans, 1992; Katz & Rosen, 1987; Yinger, Bloom, Borsch-Supan, & Ladd, 1988). Drawing upon the analogy of municipal corporations to private corporations, Fischel maintains that homeowners are the largest "stockholders" of municipal corporations. They have a vested interest in maintaining the value of their communities and ultimately their homes. Pushing more responsibilities down to the local governments

[3] Oates (1999) summarizes the decentralization theorem (Oates, 1972) stating that "…in the absence of cost-savings from the centralized provision of a [local public] good and of interjurisdictional externalities, the level of welfare will always be at least as high (and typically higher) if Pareto-efficient levels of consumption are provided in each jurisdiction than if *any* single, uniform level of consumption is maintained across all jurisdictions."

incorporates the homevoter into the local government process. Exercising their voting options to approve decisions that enhance the community and increase the value of their homes has the direct benefit of helping ensure that local practices and policies are carried out efficiently. One can surmise the interest of these "stockholders" in helping to ensure a more optimal taxing and spending mix that is also less vulnerable to business cycle fluctuations.

A vast and growing empirical literature examines rainy day funds and their effectiveness at achieving revenue stability. Sobel and Holcombe (1996) provides some of the earliest analysis of stabilization funds. Since most funds came about after the 1980–1982 recession, their study period, the 1989 recession, is the first opportunity for such analysis. They note the important differences in short-run and long-run fiscal concerns for state and local governments. Cyclical revenue instability is a short-run problem compared with various long-run challenges facing sub-national governments. Of these they mention the increased demands on budgets from growing mandates for Medicaid, prisons, law enforcement, and education. They do not address a potential link between these structural changes and growing revenue instability. Their research also finds that deposit rules make stability funds more effective.

Most recently Wagner and Elder (2013) have explored the potential for a national fund pool to spread risk and reduce the size of each individual state's fund balance necessary to avert the fiscal stress normally accompanying an economic slowdown. Since some states fare better than others due to differences in economic and fiscal composition, the larger collective pool would be available to states suffering a revenue shortfall. Their study does not address moral hazard or adverse selection concerns with such pooling or the possibility for a private concern – such as an insurance company—to provide revenue loss protection. Nevertheless, it highlights the ongoing concern and realization that state and local governments have increasing difficulty navigating budget shortfalls accompanying business cycle downturns.

Schunk and Woodward (2005) test the likelihood of a fixed spending rule accompanying a stabilization fund to mitigate business cycle budget shortfalls. Their research also acknowledges the poor record of states and local governments associated with managing increasingly volatile revenue streams throughout the business cycle. They find that fixed rules for spending out of the fund are necessary for these funds to have a positive effect on budget smoothing. Unfortunately, states have not on average adopted such rules. Similarly, Stansel and Mitchell (2008) found that the strength of withdrawal rules was negatively associated with fiscal stress during the 2001 recession.

Wagner and Sobel (2006) empirically test the hypothesis that some states created budget stabilization funds, or "rainy day" funds, to circumvent tax and expenditure limitation laws rather than to safeguard states from future fiscal crises similar to those experienced during the 1980–1982 recession. They use a discrete dependent variable with three possible values that represent whether a state has a constitutional budget stabilization fund, a statutory fund, or no fund. They find that each of four indicator variables representing the existence of a TEL is positively correlated with the probability of adopting a statutory fund but not significantly correlated with the probability of adopting a constitutional fund. Furthermore, their results indicate that the presence of a TEL that restricts the usage of general fund surpluses strongly influences statutory fund adoption. These results motivate the present study, and the next section discusses the data and empirical model used to test the relationship between rainy day fund structures and the size of state and local government.

## 3. Data and Empirical Model

The empirical approach is general and follows previous empirical leviathan tests in the economic literature (Oates, 1985; Nelson, 1987; Zax, 1989). The basic empirical model specifies government size as a function of state and local government structure and socio-economic factors. The variables are consistent with the different forms used in the empirical leviathan literature (Campbell, 2004; Oates, 1985; Nelson, 1987; Zax, 1989).

Census data from the periods of 1990 and 2000 comprise the sample, which pools 94 observations from 47 continental U.S. states.[4] Chow tests do not reject that the effects of variables are structurally similar across this time period, thus enabling pooling. A year dummy variable is included in all regressions. Endogeneity correction is a challenge for the present model formulation. It is likely that TELs and rainy day funds are endogenous and motivated by similar factors if the theory of Wagner and Sobel (1996) is accurate. However, it is difficult to find instruments to control for the endogeneity simultaneously. Therefore, the analysis makes no claim regarding causality running from the institutional factors to government size.

The leviathan model is adjusted to include controls for constitutional rule funds or statutory state budget stabilization funds with weak withdrawal requirements as defined in Wagner and Sobel (2006), providing a simple test of the relationship between fund structure and government size. Two variables capture the effect of the funds. The variable *constitutional fund* is a binary variable equal to one if a state has a constitutional fund. The states of Colorado, Delaware, Maryland, Oklahoma, and South Carolina have constitutional funds in the sample period. The variable *weak withdrawal* is equal to one for a state with a statutory fund governed by weak withdrawal requirements. Sixteen states in the sample meet this criterion. The analysis examines the effect of the funds on the state and local combined sector, and separate models test the effect for the state sector alone and the local sector alone. The matrices of exogenous regressors are identical across the three levels of analysis. See Tables 1 and 2 for definitions of variables and summary statistics for the models.

The general fractional logit model describing government size is as follows:

$$G_i = f(\mathbf{i}_{ij}, \mathbf{w}_{ik}, \mathbf{x}_{il}) + u_i \qquad (1)$$

where $0 < G < 1$ represents the size of the public sector scaled by aggregate state personal income, and is either *Local Tax Size, State Tax Size, or S&L Tax Size* depending on the level of analysis. The vector, **i**, consists of institutional variables: *TEL*- measuring a composite of state tax and expenditure limitations and the measures for rainy day funds – *Constitutional fund* and *Weak withdrawal* in separate regressions. The vector, **w**, includes indirect fiscal structural variables: *E decentralization*— decentralization measured as the share of local expenditures in total state and local spending, *fragmentation*—fragmentation as measured by the total number of local governments in a state, and *intergovgrants*— a measure of grants to local governments as a share of state expenditures. The vector, **x**, comprises socio-economic and political variables: *income*-median household income, *population*, *msapop*—Metropolitan Statistical Area population, *unemployment*—unemployment rate for state, *incomevariance*—the variance of median household incomes across counties in a state, and *democratvote*—the percent of state population voting for democrat president in1992 and 2000 elections, *lawyers per capita*, and u is a random error ~ N (0, $\sigma^2$).

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[4] Virginia is omitted from this study because cities are independent of counties in Virginia, a unique institutional arrangement that by itself can lead to as yet undetermined effects on public sector size. Hawaii and Alaska are also omitted.

*TEL* is a dummy variable obtained from Skidmore (1999) that signifies whether or not a state has any kind of tax or expenditure limitation in force. It captures another type of direct constitutional constraint on state and local governments. The *lawyers per capita* variable employs data on occupations from the Equal Employment Opportunity Files of the Census for 1990 and 2000. This variable is a crude proxy for the extent to which special interests in a state may use courts to advance public policy initiatives. This variable contains any person in the Census whose occupation is lawyer or judge, thereby excluding people who may have a degree in law but do not practice it as their primary occupation. Baker, Micelli, Sirmans, and Turnbull (2001) introduced this variable to capture differences in the efficiency of the legal institution in each state in a study examining length of statutes with regard to adverse possession of land.

Decentralization and fragmentation are commonly used measures to test the Leviathan hypothesis dating back to Oates (1985), who models Leviathan using two measures of fiscal decentralization and a measure of "non-fiscal decentralization" (now referred to in the literature as "fragmentation" ). *E Decentralization* measures the degree to which direct expenditures are carried out at the local level as opposed to the state level. *Fragmentation* is the number of local governments in the state including all county governments, sub-county general purpose governments, public school systems, and special districts. This definition is consistent with that of Oates (1985). Nelson (1987) and Zax (1989) argue that this measure of fragmentation is too broad and propose splitting single purpose governments from general purpose governments. Models using this break-out were tested, but the results do not change significantly. Zax further suggests that the effects of fragmentation may not be picked up at a level of aggregation beyond that of county or metropolitan statistical area. He reasons that, since fragmentation measures local inter-jurisdiction competition, state-level data will include many jurisdictions that are not in direct competition with one another, thus masking the effects of inter-jurisdiction competition going on at local levels. Nevertheless, an attempt is made here to measure fragmentation effects consistent with Oates (1985). The effects of fragmentation are significant in some studies (Nelson, 1987; Zax, 1989) and insignificant in others (Oates, 1985). *Intergovgants* controls for the effects of fiscal illusion. The fiscal illusion literature suggests that intergovernmental grants may have a positive impact on government spending if taxpayers underestimate the marginal tax price of public services due to the greater complexity of a tax system using intergovernmental grants. Furthermore, the flypaper effect says that a dollar increase in grants to local governments yields a larger increase in local government spending than a dollar increase in voter incomes. On the other hand, benefit uncertainty may cause taxpayers to underestimate the benefit of public services, decreasing overall demand for public services.

The socio-economic variables control for factors other than the fiscal effects described above that also have an impact on government size. For example, *income* tests Wagner's Law, increasing levels of personal income, generally consistent with higher levels of economic development, should have a positive effect on the share of government expenditures in gross state product (Oates, 1985). *Unemp* attempts to capture changes in demand for government-provided services as the proportion of the population needing government assistance changes. Higher levels of unemployment may put a greater strain on state and local governments for the services they provide, but may also reduce the level of demand for the same services. The MSA variable, *MSApop,* controls for effects due to economies of scale. Unit costs of certain public services, for example capital infrastructure, decrease with greater population density. *Population* captures the effect of low population density because the model also controls for urban density. As a state tends to have a more rural population, government spending may increase or decrease depending upon whether high fixed cost services dominate or whether a general lower demand for public services dominates.

*Incomevariance*, defined as the variation in household median incomes across counties in a state, controls for differences in the level of demand for services within each state. A greater variance of median household incomes across counties indicates a more diverse population in terms of income, which in turn may create a greater need for a wider range of local government services to meet the divergent demands of different groups within the state. *Democratvote* captures the proportion of state popular votes for the democrat presidential candidate and is a proxy for political ideology. Other measures of ideology were also tested, but the measured effects were not significantly different.[5] While the expected effect might be for largely democrat states to favor bigger government, ceteris paribus, Holcombe (2005) suggests that the power of minority special interest groups may overcome political party interests, thus masking or neutralizing effects of ideological controls.

**4. Results**

Table 3, Table 4, and Table 5 report results for the state and local sector combined, state sector, and local sector respectively. For brevity, consider the results for the total state and local sector reported in Table 3. Models 1 through 3 each measure the impact of the variable, *constitutional fund,* while controlling for other factors. The coefficient on *constitutional fund* measures -0.070 in Model 1, -0.054 in Model 2, and -0.095 in Model 3. This suggests on average states with constitutional funds have smaller government sectors by about seven percent. Evaluating at the mean, the typical state and local sector tax revenue is 10.1 percent of aggregate personal income in the state. A state with a constitutional fund would average 9.4 percent of aggregate personal income.

Also in Table 3, Models 4, 5, and 6 report results for the measured effect of adopting the weak withdrawal, statutory fund. The sign is of the opposite, expected sign compared with the constitutional fund; however, the results are significant at the 10% level in two models and the five percent level in only one. The economic magnitude is smaller, approximately five percent larger state and local sector for states adopting these weaker funds.

These are meaningful results, and the findings suggest some states may indeed have adopted weaker funds as a way around constraints, as Wagner and Sobel (2006) find. The effect on government size is not trivial. The results for the state sector and local sector separately, however, are somewhat puzzling. With this data, the local sector seems to drive the results, and in fact the state level analysis reveals no significant impact from the choice of fund. As the fiscal relationship between the state and local sectors continues to evolve and grow more complex, these findings are not surprising.

[5] For a description of other measures of political ideology, see Berry, Ringquist, Fording, and Hanson (1998).

**Table 1. Variable Definitions and Sources**

| Variable Name | Variable Definition | Source |
|---|---|---|
| **Dependent Variables** | | |
| *Local Tax Size* | local tax revenues as share of personal income | Computed from *Census of Governments* and *Census of Population* |
| *State Tax Size* | state tax revenues as share of personal income | Computed from *Census of Governments* and *Census of Population* |
| *S&L Tax Size* | state and local tax revenues as share of personal income | Computed from *Census of Governments* and *Census of Population* |
| **Independent Variables** | | |
| *Constitutional Fund* | denotes state has constitutional state budget stabilization fund as of 2000 | Variable obtained from Wagner and Sobel (2006) |
| *Weak Withdrawal* | denotes state legislature has appropriation authority over withdrawal of rainy day funds as of 2000 | variable obtained from Wagner and Sobel (2006) |
| *E-decentralization* | share of local expenditures in total state and local spending | Computed from *Census of Governments* |
| *Fragmentation* | total number of all local government units in a state | *Census of Governments: Vol.1, No. 2, Individual State Descriptions* |
| *Intergovgrants* | dollar value of grants to local governments as a share of state expenditures | Computed from *Census of Governments* |
| *Population* | state population | *Census of Population* |
| *MSApop* | share of population in MSA | *Census* Tiger Database |
| *Medhhincome* | median household income (1989 $'s) | *Census* SF3 |
| *Incomevariance* | variance in *Medhhincome* across counties divided by state population | Calculated by author |
| *Unemployment* | state rate of unemployment | BLS: Local Area Unemployment Statistics |
| *Democratvote* | % of state popular vote for democrat presidential candidate (1992 and 2000) | 1994 City and County Data Book and http://www.cnn.com (Date: 01/06/01) |
| *Lawyers per capita* | # of lawyers (primary occupation) in state divided by state population | Equal Employment Opportunity Files of *Census 1990* and *2000* |
| *TEL* | dummy variable for whether state has any type of tax or expenditure limitation | Variable used in Skidmore (1999) |
| *Year2000* | dummy variable for year 2000 = 1, base year is 1990 | Compiled by author |

**Table 2. Summary statistics**

| Variable | Obs | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|---|
| **Dependent Variables** | | | | | |
| *Local Tax Size* | 94 | 0.039 | 0.012 | 0.018 | 0.096 |
| *State Tax Size* | 94 | 0.064 | 0.010 | 0.04 | 0.086 |
| *S&LTax Size* | 94 | 0.101 | 0.011 | 0.067 | 0.141 |
| **Independent Variables** | | | | | |
| *Constitutional Fund* | 94 | 0.106 | 0.310 | 0 | 1 |
| *Weak Withdrawal* | 94 | 0.340 | 0.476 | 0 | 1 |
| *E-decentralization* | 94 | 0.514 | 0.082 | 0.323 | 0.654 |
| *Fragmentation* | 94 | 1,829 | 1,500 | 119 | 6,835 |
| *Intergovgrants* | 94 | 0.246 | 0.060 | 0.089 | 0.411 |
| *Population* | 94 | 5,448,832 | 5,921,957 | 453,588 | 33,900,000 |
| *MSApop* | 94 | 4,388,063 | 5,469,860 | 134,368 | 29,300,000 |
| *Medhhincome* | 94 | $29,465 | $4,939 | $20,136 | $41,721 |
| *Incomevariance* | 94 | 1033 | 582 | 293 | 2808 |
| *Unemp* | 94 | 0.050 | 0.016 | 0.024 | 0.096 |
| *Democratvote* | 94 | 0.434 | 0.075 | 0.250 | 0.610 |
| *Lawyers per capita* | 94 | 0.003 | 0.001 | 0.001 | 0.005 |
| *TEL* | 94 | 0.404 | 0.493 | 0 | 1 |
| *Year2000* | 94 | 0.500 | 0.503 | 0 | 1 |

**Table 3. S&L Tax Size**

| *y = S&L Tax Size* | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 | Model 6 |
|---|---|---|---|---|---|---|
| | Coefficient | Coefficient | Coefficient | Coefficient | Coefficient | Coefficient |
| *Constitutional Fund* | -0.070 *** | -0.054 * | -0.095 ** | | | |
| | -2.96 | -1.94 | -2.53 | | | |
| *Weak Withdrawal* | | | | 0.047 * | 0.043 * | 0.066 ** |
| | | | | 1.77 | 1.69 | 1.97 |
| *TEL* | | -0.038 * | -0.044 * | | 0.042 * | -0.021 |
| | | -1.64 | -1.75 | | -1.92 | -0.79 |
| *TEL*Constitutional Fund* | | | 0.062 | | | |
| | | | 1.53 | | | |
| *TEL*Weak Withdrawal* | | | | | | -0.061 |
| | | | | | | -1.34 |
| *E-decentralization* | -0.663 *** | -0.587 *** | -0.616 *** | -0.576 *** | -0.508 *** | -0.534 *** |
| | -4.05 | -3.69 | -3.74 | -3.52 | -3.24 | -3.22 |
| *fragmentation* | 0.008 | 0.006 | 0.005 | 0.013 | 0.009 | 0.012 |
| | 0.95 | 0.7 | 0.58 | 1.6 | 1.17 | 1.48 |
| *intergovgrants* | -0.115 *** | 0.801 *** | 0.820 *** | 0.783 *** | 0.749 *** | 0.759 *** |
| | -0.82 | 3.46 | 3.53 | 2.97 | 2.98 | 2.89 |
| *population* | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 * | 0.000 ** |
| | -0.82 | -1.24 | -1.29 | -1.46 | -1.82 | -2.03 |
| *msapop* | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| | -1.2 | -0.78 | -0.7 | -0.11 | 0.21 | 0.51 |
| *income* | 0.002 | 0.002 | 0.003 | 0.002 | 0.002 | 0.001 |
| | 0.81 | 0.84 | 0.97 | 0.7 | 0.75 | 0.51 |
| *unemployment* | -0.451 | 0.337 | 0.286 | 0.149 | 0.856 | 0.890 |
| | -0.41 | 0.27 | 0.23 | 0.14 | 0.78 | 0.81 |
| *democratvote* | -0.036 | -0.066 | -0.049 | 0.003 | -0.036 | -0.005 |
| | -0.16 | -0.3 | -0.22 | 0.01 | -0.16 | -0.03 |
| *lawyers per capita* | 0.008 *** | 0.008 *** | 0.008 *** | 0.008 *** | 0.008 *** | 0.008 *** |
| | 4.86 | 4.86 | 4.67 | 4.07 | 4.04 | 4.11 |
| *incomevariance* | 0.008 | -0.008 | -0.007 | -0.035 ** | -0.033 * | -0.033 * |
| | -0.55 | -0.55 | -0.47 | -2.11 | -1.9 | -1.9 |
| _cons | -2.060 *** | -2.104 | -2.107 *** | -2.130 *** | -2.170 *** | -2.160 *** |
| | -11.79 | -11.88 | -11.98 | -13.82 | -14.13 | -13.98 |
| AIC | 0.752 | 0.773 | 0.795 | 0.752 | 0.773 | 0.795 |

N = 94
*,**,*** coefficient significant at 10%, 5%, 1% respectively
z-values under marginal effects, calculated using Huber-White robust standard errors
Aikake Information Criterion for model optimization. GLM-logit does not generate R-squared in STATA.

**Table 4. State Tax Size**

| *y = State Tax Size* | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 | Model 6 |
|---|---|---|---|---|---|---|
| | Coefficient | Coefficient | Coefficient | Coefficient | Coefficient | Coefficient |
| *Constitutional Fund* | -0.027 | -0.027 | 0.030 | | | |
| | -0.79 | -0.76 | 0.51 | | | |
| *Weak Withdrawal* | | | | 0.020 | 0.020 | 0.039 |
| | | | | 0.89 | 0.86 | 1.25 |
| *TEL* | | 0.000 | 0.009 | | -0.002 | 0.015 |
| | | 0 | 0.37 | | -0.08 | 0.48 |
| *TEL*Constitutional Fund* | | | -0.091 | | | |
| | | | -1.4 | | | |
| *TEL*Weak Withdrawal* | | | | | | -0.048 |
| | | | | | | -0.97 |
| *E-decentralization* | -2.604 *** | -2.604 *** | -2.558 *** | 2.574 *** | -2.570 *** | -2.598 *** |
| | -11 | -10.79 | -10.68 | -10.82 | -10.63 | -10.16 |
| *fragmentation* | -0.007 | -0.007 | -0.005 | -0.005 | -0.005 | -0.003 |
| | -0.79 | -0.77 | -0.59 | -0.55 | -0.55 | -0.31 |
| *intergovgrants* | 3.139 *** | 3.139 *** | 3.107 *** | 3.125 *** | 3.122 *** | 3.141 *** |
| | 10.54 | 10.44 | 10.38 | 10.69 | 10.53 | 10.39 |
| *population* | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| | 1.37 | 1.37 | 1.45 | 1.04 | 1.04 | 0.65 |
| *msapop* | 0.000 ** | 0.000 | 0.000 | 0.000 * | 0.000 * | 0.000 |
| | -2.34 | -2.31 | -2.41 | -1.94 | -1.95 | -1.63 |
| *income* | -0.002 | -0.002 | -0.002 | -0.002 | -0.002 | -0.003 |
| | -0.56 | -0.56 | -0.7 | -0.61 | -0.61 | -0.74 |
| *unemployment* | -1.966 | -1.965 | -1.894 | -1.743 | -1.711 | -1.701 |
| | -1.34 | -1.34 | -1.3 | -1.29 | -1.29 | -1.29 |
| *democratvote* | -0.209 | -0.209 | -0.231 | -0.189 | -0.191 | -0.167 |
| | -1.37 | -1.35 | -1.49 | -1.19 | -1.16 | -1.05 |
| *lawyers per capita* | 0.005 *** | 0.005 *** | 0.005 *** | 0.005 *** | 0.005 *** | 0.005 *** |
| | 3.82 | 3.73 | 3.77 | 3.42 | 3.43 | 3.51 |
| *incomevariance* | -0.003 | -0.003 | -0.008 | -0.013 | -0.013 | -0.012 |
| | -0.16 | -0.16 | -0.39 | -0.7 | -0.69 | -0.61 |
| _cons | -1.818 *** | -1.818 *** | -1.813 *** | -1.848 *** | -1.849 *** | -1.842 *** |
| | -8.56 | -8.610 | -8.59 | -9.35 | -9.46 | -9.47 |
| AIC | 0.631 | 0.653 | 0.674 | 0.631 | 0.653 | 0.674 |

N = 94
*,**,*** coefficient significant at 10%, 5%, 1% respectively
z-values under marginal effects, calculated using Huber-White robust standard errors
Aikake Information Criterion for model optimization. GLM-logit does not generate R-squared in STATA.

**Table 5. Local Tax Size**

| *y = Local Tax Size* | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 | Model 6 |
|---|---|---|---|---|---|---|
| | Coefficient | Coefficient | Coefficient | Coefficient | Coefficient | Coefficient |
| *Constitutional Fund* | -0.213 *** | -0.191 *** | -0.362 *** | | | |
| | -2.76 | -2.35 | -2.59 | | | |
| *Weak Withdrawal* | | | | 0.058 | 0.050 | 0.1 |
| | | | | 1.01 | 0.88 | 1.35 |
| *TEL* | | -0.050 | -0.071 * | | -0.073 * | -0.030 |
| | | -1.17 | -1.65 | | -1.72 | -0.55 |
| *TEL*Constitutional Fund* | | | 0.257 * | | | |
| | | | 1.76 | | | |
| *TEL*Weak Withdrawal* | | | | | | -0.132 |
| | | | | | | -1.36 |
| *E-decentralization* | 1.748 ** | 1.837 ** | 1.730 ** | 1.950 ** | 2.054 ** | 2.029 *** |
| | 2.21 | 2.35 | 2.25 | 2.35 | 2.52 | 2.5 |
| *fragmentation* | 0.040 * | 0.037 | 0.033 | 0.049 ** | 0.043 * | 0.048 ** |
| | 1.68 | 1.56 | 1.4 | 2.03 | 1.82 | 1.99 |
| *intergovgrants* | -2.600 *** | -2.634 *** | -2.573 *** | -2.663 *** | -2.704 *** | -2.726 *** |
| | -3.91 | -4.06 | -4.07 | -3.54 | -3.74 | -3.66 |
| *population* | 0.000 ** | 0.000 ** | 0.000 ** | 0.000 ** | 0.000 ** | 0.000 ** |
| | -2.1 | -2.21 | -2.24 | -2.31 | -2.45 | -2.57 |
| *msapop* | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 * | 0.000 * |
| | 1.27 | 1.45 | 1.5 | 1.51 | 1.73 | 1.84 |
| *income* | 0.004 | 0.005 | 0.006 | 0.004 | 0.005 | 0.004 |
| | 0.5 | 0.52 | 0.66 | 0.52 | 0.55 | 0.41 |
| *unemployment* | -1.595 | -0.543 | -0.839 | 0.213 | 1.498 | 1.627 |
| | -0.46 | -0.16 | -0.24 | 0.06 | 0.44 | 0.48 |
| *democratvote* | -0.536 | -0.570 | -0.505 | 9481.000 | -0.552 | -0.490 |
| | -1.31 | -1.41 | -1.25 | -1.21 | -1.36 | -1.23 |
| *lawyers per capita* | 0.013 *** | 0.013 *** | 0.012 *** | 0.013 *** | 0.012 *** | 0.013 *** |
| | 4.41 | 4.27 | 4.19 | 3.88 | 3.78 | 3.99 |
| *incomevariance* | 0.020 | 0.015 | 0.029 | -0.051 | -0.047 | -0.050 |
| | 0.5 | 0.39 | 0.76 | -1.5 | -1.37 | -1.5 |
| _cons | -3.313 *** | -3.377 *** | -3.376 *** | -3.521 *** | -3.583 *** | -3.578 *** |
| | -4.19 | -4.3 | -4.28 | -4.42 | -4.57 | -4.57 |
| AIC | 0.528 | 0.549 | 0.571 | 0.528 | 0.549 | 0.571 |

N = 94
*,**,*** coefficient significant at 10%, 5%, 1% respectively
z-values under marginal effects, calculated using Huber-White robust standard errors
Aikake Information Criterion for model optimization. GLM-logit does not generate R-squared in STATA.

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# Do Institutions Constrain Business, Citizen, and Government Interest Group Formation?[*]

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**Abstract:** Due to the impact that interest groups have on U.S. policy outcomes, recent research has explored interest group formation and evaluated the factors that contribute to interest group growth. This paper adds to the literature by examining the impact of institutions on state subpopulations of interest groups in the U.S. We analyze the impact of institutions on specific categories of business, citizen, and government interest groups. While the results vary across subpopulations, the analysis suggests that stronger state government institutions as measured by government control over state resources are associated with smaller state interest group populations for a number of business interest groups while citizen and government state interest group populations are largely unaffected by state government spending.

**Keywords:** Special Interest Groups; Government

**JEL Codes:** D73, P16, C21

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## 1. Introduction

While the general public often focuses on the impact of elections and politicians, scholars have long recognized the critical role that interest groups play in the political process in the U.S. at the federal and state level. A great deal of research across the fields of economics and politics analyzes the role of interest groups. Interest group activity can supplement the traditional political process by providing an additional avenue for businesses and citizens to influence policy outcomes. Recent research suggests that interest groups do in fact impact policy. A recent study by Grossman (2012) suggests that interest groups were involved in the development of almost half of all significant public policy decisions at the federal level in the U.S. from 1945 through 2004.

Given the significant impact of interest groups on the political process and policy outcomes, interest in the growth of interest group populations has increased in recent years. The original consideration of interest group formation can be traced to Olson (1965), who considers the costs and benefits associated with interest groups. He notes that any policy benefits associated with interest group activity would need to outweigh the costs of mobilization in order for an interest group to successfully form. However, once an interest group overcomes the startup costs and mobilizes, he hypothesizes that it is likely that the group will remain active. After the half century that has passed since Olson's original work, many questions regarding the formation of interest groups remain despite the excellent scholarship focused on the topic.

The seminal work of Gray and Lowery (1996) provides the foundation for understanding interest group populations at the state level in the U.S. They utilize a population ecology model to analyze interest group populations and identify state government expenditures, economic activity within a state, and political stability at the state level as the primary determinants of interest group populations. Gray and Lowery evaluate the impact of these state level variables on overall interest group populations, business groups, and citizen groups. However, research has yet to consider the impact of state-level factors on subpopulations of interest groups. The work of Olson (1965) and Gray and Lowery (1996) suggest that each individual interest group faces different costs and benefits associated with forming and remaining active. Further, Gray and Lowery find that state-specific conditions impact business and citizen groups in somewhat different capacities. This paper extends the analysis to examine specific subpopulations of interest groups.

We evaluate subpopulations of interest groups within the categories of business groups, citizen groups, and government groups. After controlling for other state-level factors, we utilize a measure of government institutions from the Economic Freedom of North America to consider the impact of government expenditures on subpopulations of interest group populations. When combined with the previous research on interest group formation and interest group behavior, our findings help to explain differences in interest group populations across states and imply that government decisions regarding expenditures can influence interest group populations within states. After reviewing the relevant literature regarding interest group populations in section 2, the data utilized in our analysis and the econometric model is discussed in section 3. Results are discussed in section 4. The implications of our findings are outlined in section 5 while section 6 concludes.

## 2. Literature Review

Scholars have produced a great deal of high-quality research concerning interest groups over the past fifty years. Notable studies include Olson's (1965) analysis of the mobilization problem associated with interest groups, Tullock's (1967) work on the rent seeking costs associated with interest group activity, and Becker's (1983) examination of competition between interest groups. The rich history of scholarship regarding interest groups and interest group activity highlight the importance of understanding interest groups given their impact and influence on policy outcomes. However, Gray and Lowery (1996) offer the most comprehensive approach to understand interest group behavior at the state level in the U.S. The authors meticulously collect state-level data regarding interest group populations and utilize a population ecology approach to modeling interest group formation. Gray and Lowery's work highlights several important determinants of the concentration of interest group populations and variations regarding interest group populations across states.

Gray and Lowery (1996) test the impact of several important variables on interest group populations that were theorized in the literature over time. They find support for the theory that interest groups are more likely to form when there are more resources available, showing that higher levels of state government expenditures and higher levels of state economic activity are both associated with greater interest group populations at the state level. This finding reinforces the idea that interest groups are more likely to overcome the challenges associated with organization and mobilization when the potential payoffs to interest group activity are greater. Additionally, Gray and Lowery find that interest groups populations are greater when the political environment is more stable, reinforcing the idea that interest groups are more likely to organize and continue operations when they are able to build relationships and set reasonable expectations regarding their potential gains going forward. The authors ultimately conclude that the environment in which interest groups operate provide constraints regarding their growth and ultimate impact on policy decisions.

Additional research has expanded on Gray and Lowery's (1996) work in order to further explain interest group populations at the state level. Boehmke (2002) expands their research to examine additional elements of the political process that influence interest group populations. He specifically focuses on the availability of direct democracy at the state level, which offers an additional opportunity for interest groups to influence policy outcomes. While interest groups traditionally rely on standard lobbying practices, the voter initiative process allows interest groups to collect signatures and directly pose policy questions to the general public during elections. Boehmke shows that interest group populations are in fact greater in states where the voter initiative process is available. This result makes sense as the voter initiative process affords interest groups with another option to accomplish their goals.

Randolph and Tasto (2012) further extend the interest group population analysis to account for the impact of spatial relationships between interest group populations across states. The authors theorize that interest group populations in a given state could encourage the formation of interest groups in neighboring states. The authors test spatial relationships across state interest group populations, defining neighbors in terms of geography and other economic terms. They find that state interest group populations are influenced by relationships across states. Their results suggest that once interest groups successfully organize in one state, interest groups may look to mobilize in states that are similar in terms of total economic activity, state government spending, union membership, and the manufacturing share of the state economy. Somewhat surprisingly, the authors do not find a relationship between interest group populations in states that are geographic neighbors.

In order to further understand the impact of the state environment on interest group populations, recent research has explored the influence of measures of state-level institutions on interest group populations. Sobel (2008) examines the impact of institutions on productive and unproductive activities at the state level, utilizing state interest groups per capita as a potential measure of unproductive entrepreneurial activity. Sobel utilizes Karabegovic and McMahon's

(2005) measure of state economic freedom as a proxy for institutional quality, finding that interest group populations are smaller in states with higher levels of state economic freedom. Randolph (2014) expands the analysis to consider the impact of state institutions on the interest group data utilized by Gray and Lowery (1996). He finds that the institutional measure of government spending from Ashby, Karabegovic, McMahon, & Bueno (2010) impacts state interest group populations, although state-level tax and labor institutions do not seem to influence interest group populations.

In addition to impacting overall interest group populations within states, it seems plausible that institutions may encourage different parties to engage in interest group activity to a different extent. The relative expected payoff between various activities may vary depending on the motivations and options available to interested parties. For example, a narrow business special interest group generally has much different goals and alternative methods by which to accomplish their goals than broad citizen groups. Additionally, two narrow business special interest groups are also likely to face different relative payoffs related to interest group activity. In order to examine the extent to which institutions impact different subpopulations of interested parties, this paper estimates the effect of state-level government economic freedom associated with government spending on interest group subpopulations. The initial hypothesis is that narrow business groups may be most likely to engage in interest group activity when institutions are weak as they are generally easier to mobilize than broad groups. Additionally, while institutions may generally alter the opportunities for rent seeking and policy influencing activities for all groups, narrow business groups may stand to gain the most from increased availability of economic resources or access to the political process. Broad groups and public groups may focus their energy on political entrepreneurship regardless of the institutional arrangement as they have little recourse in private market settings.

## 3. Data and Empirical Model

Following Sobel (2008) and Randolph (2014), we utilize a measure of state-level government institutions to further examine the impact of environment on interest group populations. This paper adds to the literature by specifically analyzing the impact of state government institutions on subpopulations of interest groups within states. Interest groups vary in terms of their goals and composition, with groups broadly fitting into the categories of business groups, citizen groups, and government groups. This suggests that different subpopulations of interest groups could face different mobilization costs and experience varying levels of success in attaining their goals based on the environment in which they operate. Gray and Lowery (1996) note that different types of interest groups are likely to face diverse incentives, resulting in different interest group populations across states depending on the environment within a given state. Our econometric model is based on the results from Randolph (2014). Summary statistics for all variables are included in Table 1.

**Table 1: Descriptive Statistics for Interest Group Populations**

| Variable | Average | Standard Deviation | Maximum Value | Minimum Value |
|---|---|---|---|---|
| Total Registered Interest Groups | 749.83 | 477.68 | 2272.00 | 72.00 |
| Per Capita Registered Interest Organizations | 206.49 | 126.39 | 644.67 | 52.38 |
| Economic Freedom Index | 6.61 | 0.57 | 8.20 | 5.10 |
| Government Freedom Index | 7.39 | 0.87 | 9.10 | 4.90 |
| Tax Freedom Index | 5.50 | 0.72 | 7.90 | 3.70 |
| Labor Freedom Index | 6.95 | 0.46 | 8.10 | 5.90 |
| Government Ideology | 43.37 | 25.22 | 97.92 | 2.50 |
| Population % w/college | 23.82 | 4.49 | 38.70 | 14.60 |
| Population Density | 178.20 | 241.75 | 1097.60 | 4.90 |
| Population % Male | 48.90 | 0.69 | 51.16 | 47.91 |
| Population % Black | 10.44 | 9.61 | 36.48 | 0.34 |
| Median Age | 35.47 | 1.79 | 38.90 | 26.70 |

Note: There are 144 observations that cover the 48 contiguous states for 1997, 1998, and 1999.

We utilize unpublished data regarding interest group populations across states in the U.S. developed by Gray and Lowery (1996), who collected the data by examining lobbyist registration at the state level. This data is unique in the sense that it allows for the analysis of subpopulations of interest groups in addition to overall state interest group populations. We first examine total state interest group populations, narrow business interest groups, broad citizen interest groups, and government interest groups as dependent variables in separate regressions. We then analyze each subpopulation of interest groups individually. By breaking the interest group population apart, we are able to get a sense of the institutional environment impact on groups with different goals.

Narrow economic groups include interest groups in communications, manufacturing, health, law, banking, business services, small business, agriculture, utilities, transportation, natural resources, construction, and hotels. The broad citizen groups include organizations associated with civil rights, environment, good government, religious, sport, tax, welfare, and women groups. Government groups include groups focusing on education, military, police/fire, and government. While it is likely that some groups may not fit entirely in one category, this arrangement combines groups with somewhat similar motivations. For example, narrow economic groups are made up of profit industries while broad citizen groups are generally larger membership organizations with goals that are broader in scope. The dependent variable in each regression is divided by the state population in millions, giving us a measure of per capita interest groups across states. Other things constant, states with larger populations tend to have more interest groups.

Ashby, Karabegovic, McMahon, & Bueno’s (2010) Economic Freedom of North America index is employed as our main independent variable. The authors construct an index of economic freedom across states by examining government spending, tax freedom, and labor market freedom. Our analysis focuses specifically on the government element of the index as a measure of state-level institutions. Randolph (2014) finds that the government freedom component is a significant determinant of interest group populations at the state level while tax and labor freedom do not influence interest group decisions. The government institution measure is constructed by considering state government spending as a percentage of gross state product, subsidy and transfer payments as a percentage of gross state product, and social security expenditures as a percentage of gross state product. The authors assign a score on a scale of 1-10, with higher scores indicating lower levels of government expenditures as a percentage of state income.

Other independent variables are included to control for additional factors that influence interest group populations. In addition to government spending and economic capacity, Gray and Lowery (1996) identify state political stability as a determinant of interest group populations. In order to control for political stability, we include several independent variables that are commonly utilized in the research. We include a dummy variable as a dependent variable that takes a value of 1 if the state government is divided, which represents a governor that is the opposite party of a unified state legislature as is common in research studies. The relationship between the governor and the legislature at the state level can impact interest group activity as Rogers (2005) shows that legislative output is altered by divided government. The U.S. Census Bureau provides data regarding the political composition of state legislatures.

We include Berry, Ringquist, Fording, and Hanson's (1988) ideology measure at the state level as a dependent variable to control for politics. Previous studies find that policy outcomes are impacted by political ideology (Nelson and Sillerberg, 1987; Tollison, 1988), which could in turn impact the success on interest groups. The index ranges from 0–100, with lower scores indicating a more conservative government. We also include a dummy variable for states that have access to the voter initiative process as Boehmke (2002) finds that interest group populations are greater in states with direct democracy. Following Matsusaka (2004), we do not include Wyoming as a voter initiative state due to the relatively high signature requirement of 15%. Illinois is also excluded as voter initiatives can only be utilized to change the organization of the state legislature Voter initiative states are coded according to the rationale outlined in Matsusaka (2004).

Other variables are included to control for the demographic composition of the state. Demographic data were collected from the Bureau of Labor and Statistics and the U.S. Census Bureau. We include demographic dependent variables as follows: college educated individuals as a percentage of population at the state level, the population per square mile divided by 100 as a measure of population density, the male percentage of population at the state level, the percentage of the state population that is black, and the median age at the state level. We address fixed effects across years with dummy variables and standard errors are clustered to control for interclass correlation due to the multiple observations of individual states.

## 4. Results

The regression results with separate dependent variables across columns (a) through (d) for overall state interest group populations, narrow business group populations, broad citizen group populations, and government group populations are presented in Table 2. In column (a), the government freedom index is significant at the five percent level. The coefficient shows that an increase of one score on the government freedom index leads to a decline of 43.91 total interest groups per million state residents. Additionally, a one unit increase in the government index is associated with 31.70 less narrow business groups per million residents, significant at the five percent level. A one unit increase in the government freedom index results in 7.23 less broad citizen groups per million state residents in column (c), significant at the ten percent level. The government freedom index is insignificant in column (d), where the number of government groups per million residents is the dependent variable.

Furthermore, several other independent variables appear significant in the determination of interest group populations. Interest group populations of all types are generally larger as the male percentage of the population grows across states. States with greater populations of black residents as a percentage of all residents appear to have lower populations of most types of interest groups.

Additionally, median age appears to have a significant impact on government interest groups. The other independent variables are insignificant across all regression specifications.

**Table 2: Per Capita Interest Groups by Type**

| Independent Variables | (a) | (b) | (c) | (d) |
|---|---|---|---|---|
| **Institutions** | **-43.91**** | **-31.70**** | **-7.23*** | **-4.46** |
| | **-20.67** | **-15** | **-3.87** | **-2.77** |
| Divided Govt. | -23.51 | -20.82 | -1.41 | -1.22 |
| | -26.53 | -20.9 | -3.97 | -2.82 |
| Ideology | 0.62 | 0.57 | 0.08 | -0.02 |
| | -0.71 | -0.57 | -0.1 | -0.06 |
| Voter Initiative | -25.4 | -17.82 | -5.26 | -1.49 |
| | -25.04 | -18.93 | -3.99 | -3.22 |
| College | -0.46 | -0.96 | 0.18 | 0.33 |
| | -3.13 | -2.14 | -0.58 | -0.41 |
| Median Age | 4.12 | 0.98 | 1.33 | 2.13** |
| | -7.27 | -5.02 | -1.27 | -0.96 |
| Pop. Density | 3.74 | 3.44 | 0.63 | -0.47 |
| | -6.66 | -4.65 | -1.37 | -0.91 |
| Percent Black | -3.25*** | -2.45* | -0.60* | -0.17 |
| | -1.81 | -1.34 | -0.31 | -0.19 |
| Percent Male | 87.23** | 58.95*** | 14.74*** | 11.94*** |
| | -34.47 | -23.47 | -6.44 | -4.17 |
| Constant | -3852.47 | -2500.82 | -685.63 | -606.63 |
| | -1733.42 | -1167.4 | -327.2 | -210.72 |
| R-squared | 0.38 | 0.36 | 0.39 | 0.41 |

Note: The dependent variables are as follows: (a): per capita interest groups at the state level; (b): per capita business groups at the state level; (c) per capita broad citizen groups at the state level; (d): per capita government groups at the state level. The institution independent variable is the state government freedom index. There are 144 observations that cover the 48 contiguous states for 1997, 1998, and 1999. Standard errors are reported in parenthesis. Asterisks indicate significance as follows: *** = 1%, ** = 5%, * = 10%. Year dummy variables are not reported. Clustered standard errors are employed at the state level.

The regression estimates for interest group subpopulations are included in Table 3. The regression specification is identical to those previously displayed in the paper, but includes the subpopulations of interest groups as dependent variables. The table reports the coefficients and standard errors of the government freedom index independent variable from the regression analysis and excludes all other independent variables. The government freedom index coefficient on several of the individual narrow business group subpopulations is negative and significant. The results suggest that lower scores on the government freedom index lead to greater populations of communications, manufacturing, health, agriculture, utilities, transportation, and natural resources interest group populations. Additionally, greater scores on the government freedom index result in significantly lower populations of environment, civil rights, good government, and welfare groups under the broad citizen group category and less police/fire groups under the government group category.

**Table 3: Institution Coefficients for Interest Group Subpopulations**

| Narrow Business Groups | | Broad Citizen Groups | |
|---|---|---|---|
| Subpopulation | Institution Coefficient | Subpopulation | Institution Coefficient |
| Communications | -2.12** | Environment | -1.54* |
| | (0.83) | | (0.83) |
| Manufacturing | -4.94** | Civil Rights | -1.20** |
| | (2.12) | | (0.50) |
| Health | -5.25** | Good Government | -1.10* |
| | (2.27) | | (0.63) |
| Law | -0.58 | Religious | -0.13 |
| | (0.50) | | (0.54) |
| Banking | -0.25 | Sport | -0.68 |
| | (1.42) | | (0.95) |
| Business Services | -0.30 | Tax | 0.39 |
| | (1.34) | | (0.25) |
| Small Business | -2.53* | Welfare | -2.52*** |
| | (1.34) | | (0.89) |
| Insurance | -2.22 | Women | -0.46 |
| | (1.98) | | (0.30) |
| Agriculture | -2.75*** | | |
| | (0.75) | | |
| Utilities | -3.17*** | Government Groups | |
| | (1.10) | Subpopulation | Institution Coefficient |
| Transportation | -1.42* | Education | -1.69 |
| | (0.82) | | (1.37) |
| Natural Resources | -5.72*** | Police/Fire | -0.92* |
| | (1.08) | | (0.53) |
| Construction | -0.26 | Military | -0.19 |
| | (0.91) | | (0.37) |
| Hotel | -0.17 | Government | -1.67 |
| | (0.66) | | (1.08) |

Note: Separate regressions were performed with each of the above categories of interest groups as the dependent variable and identical independent variables with previous regressions. The coefficient above is the government component freedom index. Coefficients for other independent variables are not reported. There are 144 observations that cover the 48 contiguous states for 1997, 1998, and 1999. Standard errors are reported in parenthesis. Asterisks indicate significance as follows: *** = 1%, ** = 5%, * = 10%. Year dummy variables are not reported. Clustered standard errors are employed at the state level.

## 5. Implications and Discussion

We find evidence that the state institutional environment has a differential impact on interest group subpopulations with varying motivations. The state population of narrow economic groups appears to grow much larger as government economic freedom declines. Broad citizen group populations increase slightly as government freedom declines while government freedom does not appear to impact government interest groups. This suggests that lower state government freedom may provide increased relative payoffs to narrow economic groups in particular. Additionally, a number of the individual narrow business group populations are significantly greater as government freedom declines, suggesting that government freedom may impact the relative payoffs to interest group activity in different industries to a different degree. The majority of the citizen and government interest groups are unaffected by the measure of government institutions. The general results reinforce Gray and Lowery's (1996) original theory on interest groups at the state level. The availability of resources seems to be a primary determinant of interest group populations and business groups appear to be the most motivated by the size of government resources available for transfer.

Individuals and groups are likely to pursue the activities that appear to provide the greatest relative payoffs. The large significant coefficient on the government freedom independent variable for narrow business interest groups and a number of the subpopulation business groups suggests that the potential benefits to business groups are altered to a greater extent when compared to the impact of government freedom on broad citizen interest groups and government groups. Many of the broad citizen groups and government groups rely almost exclusively on government involvement to accomplish their goals regardless of the level of government freedom. However, narrow economic groups are only attracted to rent seeking when the relative payoff is great enough to justify the activities. This could be particularly concerning due to the opportunity costs of narrow business group activity. These groups could engage in a wide variety of activities that could benefit customers rather than pursuing rent seeking opportunities.

The findings reinforce the idea that state policy decisions can directly impact both the overall number of interest groups within the state and the composition of state interest group populations. In particular, states that limit the portion of economic resources controlled by the government can not only potentially limit the number of interest groups in operation, but can reduce the quantity of business oriented interest groups relative to citizen and government interest groups. This finding is important given the breadth of research that highlights the impact of interest groups on policy outcomes. Additionally, it is important to note that business interest groups can have a very different influence on public policy in comparison to citizen and government groups. Given the potential value that may be created or destroyed by these different interest group populations, the consideration of the state institutional environment is extremely important.

## 6. Conclusion

We find that lower levels of state government freedom appear to provide a greater relative payoff to interest group activities for narrow economic groups compared to broad citizen groups and government groups. High populations of narrow economic groups in states with weak government freedom represent a significant potential opportunity cost in terms of productive entrepreneurship. Additionally, due to the impact of interest group activity on policy outcomes highlighted in the literature, it is likely that business interest groups have a disproportionate impact on policy outcomes in states with weaker government institutions.

While this finding suggests that states can alter overall interest group populations and the mix of interest group subpopulations of interest groups across business, citizen, and government groups, many questions remain regarding interest group formation and operation. Future research should consider the extent to which changes in government institutions can influence interest group populations and activity. Once group form, they are likely to remain in operation and may be resistant to policy changes. Scholars should also explore the value added or destroyed by different types of interest groups as business, citizen, and government groups have different goals and face varying incentives. Furthermore, additional attention should be visited on the overall impact of interest group activity on policy outcomes given previous findings in the literature.

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# The Raid on Fort Trumbull: Law, Justice, and Economic Rights in Kelo v. City of New London

## Patrick D. Cullen

**Abstract:** The Bill of Rights of the United States Constitution is rooted in western legal, justice, and rights theories. These theories emanate from many sources, including Greek Classical and Judeo-Christian ethical and moral philosophy. As a result, consistency in interpretation and application of constitutional principles requires coherence with these core law, justice, and rights concepts articulated by Aristotle, Saint Thomas Aquinas, Jacques Maritain, and others. However, consistency does not serve as the norm despite institutional protections. Instead, the U.S. Supreme Court, like American culture, exhibits trends and shifts in perspective and priority. Two judicial safeguards – stare decisis and justiciability – commonly serve to embed these shifts over multiple decades until legal holdings are further interpreted or overturned. Therefore, a careful review of the philosophical underpinnings of more impactful decisions is helpful to better understand relative strength and weakness, challenge or fortify applied logic, or seek to redress grievous error.

Eleven years ago, the Court issued their opinion in *Kelo v. City of New London,* 545 U.S. 469 (2005). This decision expanded the Takings Clause under the Fifth Amendment by holding "public use" as functionally equivalent to "public purpose"; thereby allowing the seizure of property belonging to Susette Kelo and neighbors in the Fort Trumbull section of New London via eminent domain for the purpose of economic stimulus. When analyzed through the lens of traditional western legal, justice, and rights theories, this holding begs questions regarding philosophical and logical consistency. In particular, when viewed as an infringement on economic rights and negative rights, reasonable concern arises regarding future abuse by government and/or corporate interests.

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> As Augustine says (De Lib. Arb. i, 5) "that which is not just seems to be no law at all": wherefore the force of a law depends on the extent of its justice. Now in human affairs a thing is said to be just, from being right, according to the rule of reason. But the first rule of reason is the law of nature, as is clear from what has been stated above (91, 2, ad 2). Consequently every human law has just so much of the nature of law, as it is derived from the law of nature. But if in any point it deflects from the law of nature, it is no longer a law but a perversion of law. *Thomas Aquinas, Summa Theologica II-i, q. 95, a. 2*

## 1. Introduction

When considering the law, justice, and rights impacts of *Kelo v. City of New London*, the analysis must first be framed from a philosophical level; more specifically, a question of ethics as it involves the rights of citizens to maintain what they lawfully own without interference or coercion. According to Aristotle, it is this concern for "good and evil in human affairs" which serves as the basic issue of moral philosophy (Schall, 1992). The following serves as analysis of this controversial decision through the lens of traditional western theories of law, justice, and rights. In particular, foundational texts of western philosophers and their conceptions of such matters.

By analyzing *Kelo* from this philosophical perspective, deviations from core ethical principles are clarified. As *Kelo* now serves as United States Supreme Court precedent, further interpretation and potential expansion of eminent domain rights now accrued by state and federal governments, and their commingled corporate interests, are probable. To fully consider the impact of this decision on the understanding of property rights of American citizens, a macro-level approach is necessary due to the alteration of the core principles of rights theory inherent in the *Kelo* holding. It is these rights principles from which the limits of regulatory policy are balanced.

## 2. Synopsis of *Kelo v. City of New London*

The facts of the *Kelo* case are well known in legal, economic, and political circles. Given the reaction of citizenry to this decision as a perceived injustice, the facts have become known to even casual observers of current events (Benedict, 2009).

In short, the City of New London, Connecticut approved a development plan intended to improve a depressed economy. The city, through a development agent, purchased the bulk of the property intended for development through willing sellers. However, condemnation proceedings were initiated against Susette Kelo and other residents of the earmarked property unwilling to sell. In response, Kelo and the petitioners claimed the taking of their properties would violate the Fifth Amendment's Taking Clause, specifically the "public use" restriction. Central to their argument was the fact the development plan was established to allow a private company—Pfizer, Inc. —to occupy the taken land. Therefore, the eminent domain question was novel; more common instances involve construction of public roads, bridges, etc. The advocates for the proposed taking argued Pfizer's presence would serve as an economic anchor in New London to increase employment opportunities, secondary industries serving the new facility, and property values and tax revenues.

In a 5-4 decision of the U.S. Supreme Court, in an opinion delivered by Justice John Paul Stevens, it was held that the City of New London's disposition of the property qualified as a "public use" under the Takings Clause of the Fifth Amendment. The rationale of the court being that this taking was not for private party (i.e. Pfizer) benefit only and thereby not intended to benefit solely a specific class of private individuals. Instead, the Court relied on *Fallbrook Irrigation Dist. v. Bradley*, 164 U.S. 112 (1896), in broadly interpreting "public use" as equivalent in this instance to "public purpose". This interpretation then allowed for the taking of the land through a development agent, for use by a private corporation, for intended benefit of the city revitalization.

More simply, Kelo and her neighbors found their property rights, which include a negative right ensuring freedom from encroachment by the state, subordinated to potential "public purpose". Their land was possessed against their will and they were provided compensation for the taking. The decision was met with a considerably unfavorable response at the local, regional, and national level (Benedict, 2009). This was compounded when the redevelopment project with Pfizer was ultimately abandoned after the taking. This left the section of the city in further disrepair. In recent years, the Fort Trumbull section has served as a dumping zone for storm debris.

## 3. Philosophical Considerations

When considering the law, justice, and rights implications of *Kelo*, philosophical analysis is necessary to properly understand the potential reshaping of the social contract resulting from this decision. In addition, this philosophical perspective of a largely economic based decision provides insight into the profound deviations from traditional western theory. In the following sections, *Kelo* will be filtered through various western lenses, including legal philosophy, justice philosophy, and rights theory.

### 3.1. Legal Philosophy

When reviewing Justice Steven's majority opinion in *Kelo*, there exists significant departures from the philosophical tenants of western legal theory, particularly natural law, which undergird the Bill of Rights. There also notable deviations from the purpose of *lex* [law] in a civilized society. Instead, a more expansive, government-centric approach is applied.

When viewed from a Thomist perspective, law itself serves as rule whereby the citizen is "induced to act or is restrained from acting" (Aquinas, ST II-i, Q 90, a.1). Aquinas further states it follows that law is something "pertaining to reason" which ultimately "exists to bind or restrain the individual" (Aquinas, ST II-i, Q 90, a.1). In this sense, law serves as an external concept in terms of how it is derived and promulgated. However, as a "dictate of reason", law also serves an internal concept (Aquinas, ST II-i, Q 90, a.1). This is an internal concept whereby the individual under the law recognizes the law as serving the common good, and as a function of reason, seeks to follow the law.

Therefore, assuming a reasonable person, a reaction to legal pronouncements, or in this instance Supreme Court precedent, is worthy of consideration. If the reasonable person reacts to law with a sense of inherent skepticism, it follows that this law may require further consideration regarding equity. The overwhelmingly negative reaction to *Kelo*, particularly in the wake of the economic revitalization project failing, provides insight into whether the decision, which serves as law, demonstrates the qualities and conditions of valid human law (Castle Coalition Polls, 2009).

#### 3.1.1. Conditions for Human Law

When proceeding with this analysis, it is important to consider the Thomist concept of the hierarchy of laws. In order of superiority, this hierarchy is as follows: eternal law, divine law, natural law, and human law (Aquinas, ST II-i, Q 91, a.1-4). In this schema, no law is just if violative of the superior law (Aquinas, ST II-i, Q 95, a.2). For example, all human law must be in accord with natural law to bind the conscience. When viewing a U.S. Supreme Court decision, we are most directly analyzing human law in this Thomist hierarchy. However, there are conditions which exist in human law to allow for better determining whether the law is just or unjust from a western perspective, particularly in the Judeo-Christian tradition.

Three basic conditions exist for the human law from a Thomist perspective. First, the human law "is called virtuous because it fosters religion" (Aquinas, ST II-i, Q 95, a.3). Thus, the law must be "just in light of country custom, time, place, and helpful to discipline" (Aquinas, ST II-i, Q 95, a.3). This requires proper application of the first principle – reason. Second, the human law "depends on the ability of the agent" as different disciplines are deserved by different agents and same burdens may cause injustice (Aquinas, ST II-i, Q 95, a.3). Third, the human law is "ordained to the common good" and requires "clearness of expression" through promulgation (Aquinas, ST II-i, Q 95, a.4). Moreover, the human law is to be derived from the law of nature, ordained to the common good, framed by those who govern the community, and directs human action.

Analyzing *Kelo* through this prism wields interesting results. The first condition of human law relates to the virtue and fostering of religion. Though Aquinas would surely differ, it can be argued the virtue perspective is of priority in this specific analysis. It should be noted that Aquinas writings on virtue are profoundly shaped by the secular treatment of virtue theory proffered by Aristotle in the *Nicomachean Ethics*. As referenced above, Aquinas holds that human law must be "just in light of country custom, time, place, and helpful to the discipline" (Aquinas, ST II-i, Q 95, a.3). Based on the popular consensus which holds *Kelo* as wrongly decided, the precedent does not appear just in country custom despite the belief of five (5) U.S. Supreme Court justices (Castle Coalition Polls, 2009). Property rights in the American system are strongly influenced by John Locke, respect for private property, and an emphasis on negative rights and liberties. In addition, the Fifth Amendment Takings Clause is to be viewed in the entire context of the Bill of Rights. It is the Bill of Rights which clearly maintains an emphasis on the individual in our political system, particularly in relation to the state and federal government. Furthermore, Aquinas warns of such change of "customs" recognizing the practical impact of abolishing custom. The human law is then never to be changed unless the common good is benefited to the extent of the harm done in changing custom, which is evident when the existing law is patently unjust or observance is harmful (Aquinas, ST II-i, Q 97, a.2). This Thomist argument would then advance both the calls to overturn *Kelo* as well as the action of numerous statute legislatures to fortify private property protections in the wake of the decision (Castle Coalition, 2007b).

The second condition of human law relates to both law dictating reason of the individual and framing of the law by those who govern community. Post-*Kelo* there exists no dictate of reason; meaning the conscience of the individual is not expressed, or shaped by, the decision. Instead, the precedent is considered by many as unjust and an example of poor jurisprudence. Therefore, the binding principle of human law is not satisfied. The second principles also relates to the framing of the law. In this instance, we are not considering the historical framing of the Takings Clause. Instead, this begs questions regarding the role of the U.S. Supreme Court and relates to the legitimate authority of the Court. Therefore, we are left with additional arguments regarding judicial philosophy; in particular, the issue of judicial activism potentially devolving into judicial tyranny. This transitions into the debate pertaining to the proper role of the court, balance of powers, and strict constructionist versus progressive interpretation.

The third condition of human law relates to both the "common good" and "clearness of expression" (Aquinas, ST II-i, Q 95, a.4). The lawgiver my enact unjust laws by promulgating a law contrary to human good in respect to the end of the law or the scope of the law (Aquinas, ST

II-i, Q 92, a.4). Aquinas considers these acts of violence rather than laws as "a law that is not just, seems to be no law at all" (Aquinas, ST II-i, Q 92, a.4). This raises the question of how the precedent established in *Kelo* serves the common good. Prospectively, the decision provides enhanced power of the government to take private property of individuals for future exchange with corporations when deemed of “public purpose”. However, by weakening private property rights of the individual, it is reasonable to believe rational individuals will be less likely to endeavor in regards to their property interest (i.e. invest in property improvement and maintenance); thereby, the *Kelo* decision serves as an economic disincentive to private investment with the obvious impact on the larger community or neighborhood. With increased collaboration of the state and government interests, rent-seeking opportunities also increase which do not prioritize the common good. Retrospectively, *Kelo* forced homeowners from their neighborhoods while prioritizing corporate interests with the end result being a refuse pile. *Kelo* serves as an example of the lawgiver – the U.S. Supreme Court – requiring the citizen to abide by human law contradictory to higher law, more specifically natural law, resulting in coercion. As the will of the good citizen is in harmony with the law, the law is not binding if coercive to the otherwise virtuous citizen.

### 3.1.2. Natural Law

The three conditions for human law, based on the Thomist hierarchy, also rely on synthesis with eternal, divine, and natural law. As previously discussed, inferior law (i.e. human law) must not violate superior law (i.e. natural law) or the law is considered no law at all (Aquinas, ST II-i, Q 95, a.2). Once again, a more secular perspective – contrary to that employed by Aquinas – will also be employed in this section. Therefore, we now further consider natural law implications of the *Kelo* decision.

Aquinas holds the natural law, even in the instance of the corrupt culture, cannot be entirely "blotted out" (Aquinas, ST II-i, Q 94, a.6). However, the natural law may be "blotted out" by custom or human law when failing to recognize the general principle in a specific action. (Aquinas, ST II-i, Q 94, a.6). Alternatively, the natural law may be absent in human law (Aquinas, ST II-i, Q 94, a.6). If, however, a thing is contrary to natural right which is a product of natural law, the human will cannot make it just by decreeing that it is lawful. Furthermore, it has long been held that “[t]he philosophical foundation of the [r]ights of man is [n]atural [l]aw” (Maritain, BBBB). Thereby, human law cannot make theft, or other action contrary to natural law, legal or just. Therefore, regardless of time or place, the natural law exists as it is has both external and internal characteristics; external as existing before the individual and internal as existing within the individual. This specific decision relates to the natural law as it is a “taking” both constitutionally and physically. Taking of property violates natural law and natural right theory. In addition, property ownership is considered a natural right as it also represents a freedom and liberty interest. In this instance, the Court holds this specific natural right as subordinate to “public purpose” – a collective benefit. In the Thomist legal hierarchy, the Kelo decision – as human law – fails to adhere to the superior natural law interest. As a result, the human law does not bind the conscience, fails to advance the common good, and is deemed “no law at all” (Aquinas, ST II-i, Q 92, a.4).

In addition, Jacques Maritain holds “the philosophy of the rights of the human person is based upon the true idea of natural law, as looked upon in an ontological perspective and as conveying through the essential structures and requirements of created being the wisdom of the Author of Being” (Maritain, 1998). He recognizes two distinct elements of natural law which are necessary for development of natural right theory; the ontological element and the gnoseological element (McInerny, 1991). It is the ontological element of the natural law which is central to recognition of any natural right. Maritain describes this ontological element of natural law as that "to which every human person is gifted with intelligence and is capable of pursuing ends in a way for which he is or she is answerable" (McInerny, 1991). He holds it is this nature which serves as a basis for determination of normal functioning of man, specifically "what man should be and do" (McInerny, 1991). Alternatively stated, how man should *do good and avoid evil*. As a result, this ontological element regarding man's nature is a moral law which is both given and ideal (McInerny, 1991). The second element—gnoseological—is simply man's ability to grasp the first ontological element (McInerny, 1991).

Therefore, by applying Maritain, we find the grounding of human rights is based firmly in the natural law (Fay, 1991). This, in turn, provides further basis for assessing the justice implications of the *Kelo* decision as the rights of man are central to the function of the U.S. Supreme Court interpretation of the Bill of Rights. No reasonable interpreter of the role of the judiciary would argue their role as contrary to the rights of man. Therefore, by prioritizing simply a potential impact of an action above the natural right of a citizen, *Kelo* may be challenged by western conceptions of valid human law and natural law theory.

### 3.2. Justice Theory

When applying a western justice theory analysis to *Kelo*, additional infirmities in the decision become apparent. First, it must be understood that justice is a virtue, which is an excellence and mean (*Nicomachean Ethics*, 1130a14-16). The object of justice is the just, which places justice above other virtues (Aquinas, ST II-i, Q 57, a.1). There exists a certain sort of justice as a whole, and a part of it, sharing the same name because its definition is the same genus. "Of the justice that is a part, and of what is just in this sense, one sort is the one found in distributions of honour, or money, or the other things to be divided up among those who are members of the political association; while another is rectificatory, operating in interactions between one person and another" *(Nic. Ethics,* 1130b30-1131a2).

*Kelo* is a civil case requiring the interpretation of the Fifth Amendment Takings Clause and the relationship of the state to the individual. When filtered through this Aristotelian-Thomist lens, *Kelo* is more properly deemed a question of distributive justice. It is distributive justice which relates to the division of money, property, etc. Whereas, the rectificatory justice analysis commonly relates to the individual – not political – transactions and is often associated with criminal determinations.

#### 3.2.1. Proportionality

Ultimately, what is just is the proportionate and what is unjust is what contravenes the proportion *(Nic. Ethics*, 1131a17-19). In distributive and rectificatory justice, pure reciprocity (*lex talionis*) fails to substitute or satisfy proportion (*Nic. Ethics*, 1132b24-25). Particularly in the commercial or city setting, reciprocal action governed by proportion is required (*Nic. Ethics*, 1132b34-38). It is the necessity of coupling opposites in exchange that begs for proportional reciprocity (*Nic. Ethics,* 1133a7-9). The equalization allows for exchange. It is from these needs and understanding of equalization from which currency derives (*Nic. Ethics,* 1133a30). Therefore, distributive justice represents a kind of geometric proportion (*Nic. Ethics*, 1131a30, 1131b14).

In eminent domain law, requirements for taking include payment of "just compensation". However, problems arise when determining just compensation for a taking which is government coerced and, thereby, not voluntary in exchange. Traditional distributive justice geometric proportionality relates to merits of the recipient as well. Though this provides a clearer picture, market valuation does not include the intangible, personal value associated with home ownership. Though this may be reflected in a voluntary market transaction – as a seller may set a price and reject any deviation therefrom based on such intangible measures – a coerced transaction of this nature does not allow for such valuation. Therefore, the eminent domain process, and the valuation of just compensation, lends toward disproportionality. Without proportion, there can be no justice in the transaction.

**3.2.2. Legal Justice**

Though not capitulating entirely to legal realist arguments, stare decisis does hold the *Kelo* decision as binding precedent influencing future law. As law is the attempt of the rational creature to benefit the common good, Aquinas maintains consistency in justice and law as a specific virtue – legal justice (Aquinas, ST II-i, Q 58, a.5). This is where man is in harmony with the law lending toward acts of virtue toward the common good. (Aquinas, ST II-i, Q 58, a.5). In keeping with Aristotle, Aquinas maintains this concept of legal justice stands "foremost among all the moral virtues" (Aquinas, ST II-i, Q 58, a.12). As it is considered the most excellent of virtues by Aristotle and Aquinas, attainment of justice will not be common as excellence, or virtue, is not achieved by all men. Legal justice begs an opposite which is the failure of human law to exact justice.

Consistency in justice and law is not guaranteed as we see in the case at hand. However, legal justice is necessary to harmonize the action of individuals with the common good. This attempt to repair the relationship between these two concepts is evident by post-*Kelo* attempts by state legislatures to reform eminent domain laws after the 2005 decision. Nonetheless, these efforts to achieve the common good create an opportunity costs – in terms of time, money, and resources – to remedy prior failures of law. Further, in this specific instance, only a remedial form of legal justice is possible given the destruction of the Fort Trumball area.

**3.2.3. Reasonableness and Equity**

It should be further noted that justice, and legal justice, are distinct from reasonableness. Reasonableness, or *epieikeia*, shares many traits of justice but relates more specifically to equity. While the reasonable is just, it is not the just according to the law but a "rectification of the legally just" (*Nic. Ethics*, 1137b10-12). While law is universal there are instances where the application is incorrect.

In the context of *Kelo*, one could argue the decision as just based on interpretation of the caselaw and statute as judicial philosophies may differ. It is this reasonableness argument which then begs correction of the legally valid opinion. Yet, application of the reasonable, or equitable, is no less correct as the "error is not in the law, or in the lawgiver, but in the nature of the case” (*Nic. Ethics*, 1137b18-21). Therefore, the reasonable is just and better in specific instances. However, the reasonable is never better than what is just without qualification (*Nic. Ethics*, 1137b25-26). So, clearly a just decision from the start is obviously preferred and allows for legal justice. However, attempts to remedy *Kelo* post-decision may then be based on either justice or reasonableness (i.e. equity).

**3.3. Negative and Economic Rights Theory**

When considering rights theory, there are definitional understandings to allow better understanding of the position of Susette Kelo, and reluctant neighbors, to the state. There is a philosophical distinction between positive rights and negative rights. Positive rights are generally considered to be participatory in nature (i.e. right to education). Positive rights require active participation by the citizenry which are beyond mere recognition or compliance. These positive rights are considered by some as economic and social in nature (Donnelly, 2007). A violation of a positive right involves "only failing to provide assistance, a (presumably lesser) sin of omission" (Donnelly, 2007).

Whereas negative rights refer to freedoms from encroachment by the government or others (i.e. prohibition against cruel and unusual punishment). They prohibit intrusion on the individual or their rights. Negative rights are negative liberties, civil and political in nature, which allow redress if encroached upon (Donnelly, 2007). These include Fourth and Fifth Amendment protections against unlawful search and seizure, takings, et al. "Negative rights require only the forbearance of others to be realized"; thereby violation "involves actively causing harm, a sin of commission" (Donnelly, 2007).

*Kelo v. City of New London* allows differing interpretations from a rights theory perspective. Based on definitions above, the Takings Clause language requiring "public use" affords Kelo a negative right, or negative liberty interest, in her private property. The underlying ethos of the Fifth Amendment, and Bill of Rights in general, is that of protected individual rights accruing to the citizenry to limit government power. The violation of the right is far from passive. Instead, the violation of Kelo's right required an absolute dissolution of her interests and physical displacement; all resulting from a failure to recognize the forbearance principle.

In this instance, the intrusion on Kelo's rights has consequences beyond most rights violations. The result is Kelo losing in all four rights categories – economic, social, civil, and political. Economically, Kelo has lost the ability to continue to invest in the improvement and accrue potential appreciation of her property. Similarly, she has lost the freedom to endeavor in her home improvement and potentially fail. Socially, Kelo was displaced from her property resulting in different living arrangements, change in community setting, and forced acclimation to a new setting. Civilly and politically, Kelo was clearly at the blunt end of a direct intrusion by state and federal government officials and courts which now results in a new interpretation of eminent domain jurisprudence going forward.

As Maurice Cranston argues in *Political Theory and Rights of Man*, it is the violation of these negative rights, including freedom of movement, right to life, and right to liberty, which serve as an "affront to justice" (Hayden, 2001). The response of the public, as well as many legal and economic scholars, has been one of serious concern for the potential abuse of the precedent established by *Kelo*. The assertion of rights may serve to protect the individual from the state or, conversely, grow the state and limit individual rights (Schall, 1992). *Kelo* is clearly the later. As Maritain notes, if there are no truth limits to rights except what is legislated or willed, then the state has practically unlimited power to define and promote rights (Schall, 1992).

*Kelo* stands for collective rights, more specifically "public purpose", trumping the rights of the individual in their home. This sources of these rights, specifically the home, is not one to go unnoticed. Legal doctrine in criminal procedure, criminal law (i.e. Castle Doctrine), tort, and housing law recognize a special property and privacy interest in the home. Further, the interplay of private industry in this specific case is also important. A natural progression from *Kelo* rests not just in eminent domain, but concerns for private property in general. As property rights are diminished, could "public purpose" allow for takings of other personal property? The rationale of *Kelo* may reasonably be employed for additional property takings, including savings, retirement accounts, pensions, or social security. In the most extreme example of a socialist welfare state, such natural and human rights are potentially suppressed into extinction (Fay, 1991).

**4. Conclusion**

*Kelo v. City of New London*, 545 U.S. 469 (2005), has resulted in extensive legal, economic, and political analysis and scholarly treatment due to the interdisciplinary nature of the case. However, the core western philosophical inconsistencies of the case have been given lesser review. Yet, it is these underlying western philosophical ties, namely the legal, justice, and rights theories which allow for the interdisciplinary scrutiny of the decision.

When applying the western theories, a fuller understanding of core flaws in the decision become apparent. As Greek Classical and Judeo-Christian ethical and moral philosophies fundamentally shape our understanding of law, justice, and rights, their application to *Kelo* provide insight on direct and future impacts. Application of the philosophies of Aristotle, Saint Thomas Aquinas, Jacques Maritain, and Maurice Cranston, in particular, are insightful. Direct impacts include possible violations of natural law, human law, distributive justice, natural rights, negative rights, and economic rights principles. Future impacts include the ramifications of these violations over an extended period of time due to the nature of stare decisis and precedent in the American justice system.

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