

on Property Rights, Takings
and Compensation

by

Bryce Wilkinson

with an introduction by Richard Epstein

prepared for Business New Zealand, Federated Farmers,
the New Zealand Business Roundtable,
and the New Zealand Chambers of Commerce

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Richard Epstein, James Parker Hall Distinguished Service Professor of Law at the University of Chicago, has kindly written an introduction.

The views expressed are the responsibility of the author, Bryce Wilkinson.

PREFACE

Does government exist to protect citizens in their persons, property rights and freedoms of action, or do these liberties exist only at the pleasure of passing central or local government majorities? Is parliament the servant of the individual and the community, or a master that rules them all? Much human blood has been spilt, and many civil wars and insurrections fought, over the proper limits to state power. Recognition of the legal rights extended to Maori in 1840 was hard-won.

Parliamentary legislation is often incoherent on these deep questions. As explained in this report for the country's major business organisations, the Public Works Act 1981 represents a tradition that is respectful of the sanctity of private property, whereas the Resource Management Act 1991 denies traditional freedoms to make land use decisions.

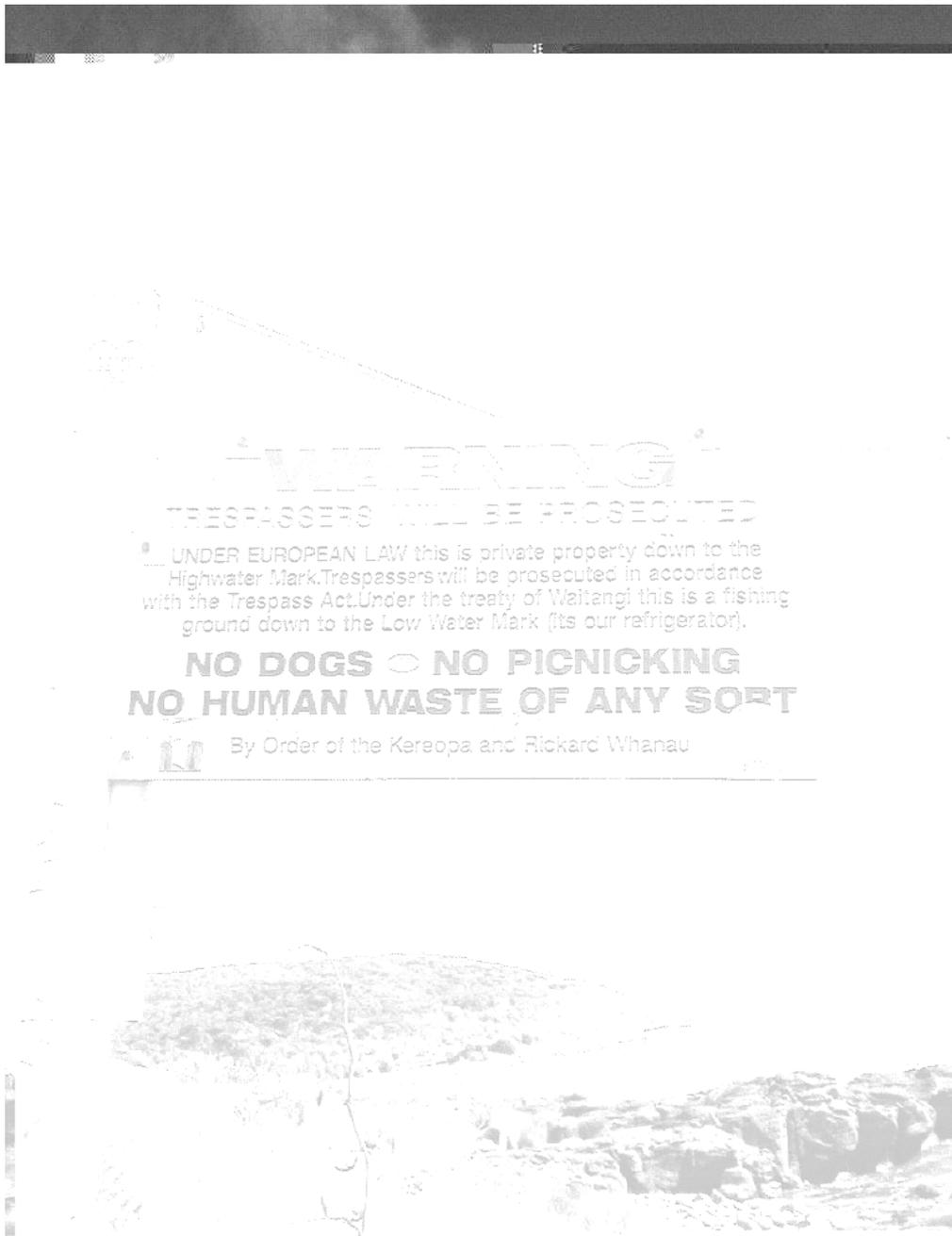
There is much at stake in these matters. New Zealand society is still deeply divided today because parliaments confiscated Maori land almost 150 years ago. Yet ill-justified confiscations of property rights continue to abound, be they foresters' cutting rights, developers' and landowners' rights, the foreshore and seabed issue, or investors' rights to the infrastructure they own and even their rights to freely buy and sell shares. Some of these takings have treated individuals unjustly and polarised communities. Investment confidence and potential economic growth have been undermined.

This report is motivated by the realisation that there is a need in New Zealand for a wider understanding of the importance of security of all property rights for civil peace, prosperity, constitutional government, social cohesion and ultimately the democratic system. Respect for private property rights implies the need for restraint, both by governments and by lobby groups. Such restraint is necessary for a civil society, and the reciprocal obligations confer mutual benefits. Indeed, any rule that asks people to treat others as they would like to be treated themselves has these attributes.

Bryce Wilkinson PhD
Capital Economics Limited

[T]he faithful protection of private property is not some parochial exercise, but is an indispensable part of any comprehensive constitutional order that advances long-term welfare.

Richard Epstein



This photograph was taken a few kilometres south of Raglan on 11 April 2008. It illustrates the universal human need for exclusive use of property. Rights are always easier to claim than to establish and the courts are the proper place to determine disputes as to the validity of asserted rights.

KEY POINTS

Property is generally thought of as something that is owned or possessed to the exclusion of others.

Courts in New Zealand have followed the international practice of defining property very widely to encompass real, personal, tangible and intangible things.

Property may be public, private, customary or open access.

Property rights are the formal and informal rules that govern access to and use of property. Key categories include the rights to exclude, to determine the use of, to appropriate the income from and to dispose of property. These rights may be separately assigned and traded for any given property, or one entity might own them all.

The exercise of property rights is limited by the obligation to avoid imposing private or public nuisances on others.

Beyond some point, the more widely a nuisance is defined, the more likely it is that the additional costs to the community of preventing the nuisance will exceed the benefits.

Well-defined and enforced property rights provide the basis for the sense of self, peaceful cooperative coexistence, liberty, prosperity and conservation.

Property rights are variously enforced by social, moral and legal sanctions. Legal rights have emerged from centuries of common law rulings, modified by parliamentary legislation. Their ancient origins can be traced back to biblical times and earlier ('Thou shalt not steal'). Their longevity reflects deep human needs.

A conflicting viewpoint from the Progressive Movement in the late nineteenth century is that property rights are "in need of constant review and adjustment" as the political balance of power changes in a society. According to this view, property rights are conferred by government and may be altered without compensation at its pleasure.

The Progressive Movement viewpoint is roughly the opposite of the earlier liberal position that a prime role of government is to ensure that citizens are secure in their longstanding rights in property (and person).

The tensions in New Zealand between these two viewpoints are evident in the contrast between the Public Works Act 1981 on the one hand, and the New Zealand Bill of Rights Act 1990 and the Resource Management Act 1991 on the other. The former once embodied, and still does to a considerable extent, the liberal view that the Crown should only take private land when it is necessary to do so for an essential public work, in which case compensation should be paid. The New Zealand Bill of Rights Act does not acknowledge any human right to the quiet enjoyment of one's possessions, let alone to private property in general. The Resource Management Act allows possibly ephemeral political majorities to dictate, within limits, the use to which private land is put without the consent of landowners and without compensation.

The current influence of the Progressive Movement viewpoint in New Zealand is evident in the widespread resistance amongst politicians and government agencies, with the acquiescence of much of the legal community, to recent proposals for protecting private property by amending the New Zealand Bill of Rights Act or passing a Regulatory Responsibility Act.

Nevertheless, both philosophies accept that there are occasions when it may be necessary for an important or essential public interest for the Crown to take private property without the consent of the rightful owner. (This shared acceptance does not mean that there would be agreement about where the lines should be drawn.)

Greater tension arises over the presumption in favour of compensation for a taking. This presumption is evident in countries with written constitutions and in countries like New Zealand that have an Anglo-Saxon common law tradition. The fundamental presumption in the common law that the Crown should pay compensation is a bulwark against the abuse of the Crown's coercive powers.

Governments might take property physically, as in the case of private land taken to build a public road. The Public Works Act provides for compensation in these cases. Alternatively, governments might allow the owner to retain physical possession of private property but regulate it so as to diminish the owner's ability to use and/or dispose of it. Such regulations are called regulatory takings. No law on the statute book ensures that the issue of compensation is addressed in all such cases.

The lack of a requirement to pay compensation for regulatory takings puts at risk all the benefits a community might obtain from a secure system of property rights.

Establishing a clear rule to pay compensation for regulatory takings, as in the case of physical takings of possession, would improve environmental policy, land use and political accountability.

To further improve the incentive to balance benefits and costs, compensation would ideally be paid by those who seek to benefit from the taking, which may not mean by taxpayers at large. Whether compensation should be paid in cash or in kind in a particular case depends on matters of law, principle and practicality.

Broadening the compensation principle would be an essential step towards restoring natural justice to landowners under the Resource Management Act. The principle that is respectful of property rights is that freedom of action in relation to property should be permitted unless the actions cause traditional notions of damage to other persons. Other proven safeguards for achieving natural justice include tests of standing and rules relating to burden of proof, liability to pay costs for groundless actions, and adequate notice of the case against the landowner. The ability of a minister to bypass parliament when making law under the guise of policy must also be limited for constitutional reasons.

A Regulatory Responsibility Act might extend the principles and philosophy underlying the Public Works Act to property generally. It would accept that property sometimes needs to be taken in the public interest, but only if due process is followed. Due process would normally include a thoroughgoing examination of public benefits and costs, and

addressing the issue of compensation. It might also apply the 'benefit principle' – that compensation is funded by those who want the taking to occur. This principle is widely used in government tax and user charge deliberations.

Coherence in government policy towards private property requires some agreement concerning the proper role of the state in this area. The chances of achieving such an agreement depend on a deep understanding of the importance of protecting private property rights while allowing for principled coercive government action.

INTRODUCTION

by Richard Epstein
James Parker Hall Distinguished Service Professor of Law
University of Chicago

Property rights versus regulation: why the difference matters

Two visions of land use regulation

It is my very great pleasure to write this short introduction to Bryce Wilkinson's insightful work, *A Primer on Property Rights, Takings and Compensation*, which has been sponsored by a number of business organisations including the New Zealand Business Roundtable under its long-time head, Roger Kerr. I count both Bryce and Roger among my long-term friends, and am pleased to see that this latest offering shows how sound classical liberal principles do far better in dealing with scarce natural resources than their modern regulatory alternative. In order to illustrate this theme, the report details the conflict between two visions of land use regulation: the classical liberal theory on the one hand and, on the other, the more interventionist attitudes embodied in other New Zealand statutes, most notably the New Zealand Bill of Rights Act 1990 and the Resource Management Act 1991. The former statute is noteworthy for its refusal to consider the right to own and retain private property as one of the fundamental freedoms in New Zealand. The latter statute is not directed toward ownership and retention of property but toward limiting its use. And the statute explicitly allows the state through its planning agencies to limit any future use or development of property unless it is done in accordance with some proposed plan on either a district or a regional level.

There is much to criticise in both of these cavalier approaches to land use regulation. In this brief introduction, I shall concentrate on the Resource Management Act because it ironically poses the more important threat to the general security of property rights. The argument here is not that restriction on land use matters more than a forcible dispossession from property. Clearly dispossession has pride of place. The key point, however, is that the political resistance to any forcible removal of property without compensation is in general high, so that public authorities are usually prepared to pay some compensation to local residents even if they frequently low-ball the proper estimate in individual cases. In contrast, land use restrictions play a much larger role in day to day life in both New Zealand and the United States for two interrelated reasons. The first is that these regulations are more pervasive by far than cases of seizure for state purposes. Second, there is much less local political resistance to land use regulation than to seizure. The upshot is that far greater wealth is tied up in these regulations than in the seizure cases. Let me explain.

The first illusion that must be dispelled is that these regulations do not much matter in the grand scheme of things. They do. It is common that many, but by no means all, land use regulations will reduce the value of land by 80 percent or more, even if, by definition, the current owner is not dispossessed from the property. The unwillingness to offer compensation for these routine losses in use value is sometimes justified on the ground that the actions are necessary to protect against harm to neighbours. But this formulation misses all that is essential in the externality debate. The system of public regulation is superimposed on the system of land use regulation that is already in place through the common law, which comprises the sophisticated rules governing nuisances and covenants. These rules require some explanation to put the regulatory choices in clear relief.

Nuisances and covenants

One part of the traditional private regulatory system is found in the tort law, specifically the law of nuisance which affords all landowners remedies in damages and injunctions against any landowner who emits filth, fumes, odours, pollutants or electrical charges onto property of a neighbour. Indeed any non-trespassory invasion will do. This restriction is perfectly reciprocal in that each landowner has the same level of protection against all neighbours. In general, we can be confident that the value of all parcels of land are increased relative to a legal system that allows any landowner to do whatever they see fit on their property. Accordingly there is no reason to afford any compensation in cash for demanding all owners respect these restrictions. The regulation provides its own compensation to both landowners, wholly without regard to any further form of state action.

One easy social experiment serves to verify this general conclusion. In modern times many current landowners derive their titles from a single person who owned some large parcel from which smaller parcels were carved. That owner had the right set of incentives to include those restrictions on land use that would maximise their return from selling off all the pieces. As such that party would take into account all the pluses and minuses to all purchasers of the property, and would impose that set of burdens and benefits that imposes the best relationships among the parties in order to maximise their own gain. The system of recordation allows these benefits and burdens to be transferred with notice to subsequent buyers of all parcels. One can scour the landscape for a subdivision agreement that allows landowners to commit actions that would be actionable nuisances at common law. The private actions therefore provide strong confirmation that this first cut in the common law of nuisance is welfare-enhancing for the parties. That result is further confirmed by the simple observation that no known planning code has ever thought to relax the prohibitions of this body of law. The nuisance law is by any measure a clear improvement over a supposed system of ownership that lets any owner do anything they want. The gains are shared both by the parties to the transaction and, by derivation, by the rest of the world. We have in effect started a modest environmental movement on a sensible instalment plan.

It is, however, important to remember that this first move is just that – a first cut, and nothing more. The question is whether additional steps that can increase the gains are possible. It turns out that they are, and in two forms. The first of the common law

approximations is that some nuisances are too small to worry about. Hence the live-and-let-live rule gives these kinds of nuisance a general benediction. Everyone has to tolerate low-level nuisances in exchange for having the right to commit them on others. What counts as low is subject to some interpretation, but ordinary speaking during the day counts as a low-level nuisance even if – and the point is critical – only lower levels of noise are tolerated after dark when people are sleeping. These rules again require no explicit compensation because their uniform enforcement typically produces gains for all parties. And the same principle of external verification is available. It is commonplace in residence halls to place more stringent noise restrictions late at night than it is in the middle of the day. As the relative value of liberty of action and tranquillity changes, the legal rules should move in response, which is just what they do.

The second variation from the basic theme comes from the law of covenants. This body of law is in perfect conformity with classical liberal principles of land use management. In effect, the origin of a covenant starts in a contractual relationship among two or more landowners. The content of the covenant is a restriction on land use that is not required by the law of nuisance. It covers height restrictions, set back restrictions, exterior design restrictions, sign restrictions and the like. One salient feature of these restrictions is that they tend to be most severe in subdivisions intended for wealthier clients, who quite simply are prepared to pay greater sums for the amenities thus supplied. Once again there should be no serious objections if the public system imitates this set of restrictions in homogenous communities, so long as there is some reason to believe that they work to the long-term average advantage of its members. Typically that condition is satisfied when communities separate out in accordance with wealth and tastes. Quite simply it is easier to supply public goods, including regulations, to groups that are fundamentally of the same mind than it is for groups that have very different expectations of what they hope to gain from public regulation.

Modern land use planning

There are clear policy implications from blending these three elements – basic nuisance law, live-and-let-live exceptions, and covenants – together in one whole. The acid test for all systems of land use restrictions that are imposed by central planners is whether they result in uniform increases in value to the owners of the regulated parcels. If they do, then we can say that each owner receives implicit in-kind compensation in the form of the parallel regulation that is imposed on their neighbours. Unfortunately this test is met by virtually none of the challenged restrictions that are championed by modern land-use planning authorities. Here are the salient distinctions. In the typical case of comprehensive restrictions, property values tend uniformly downward, often by large amounts. There is in effect no implicit in-kind compensation that satisfies the traditional requirement of just compensation of which this report speaks. In addition, most of the restrictions in question are consciously skewed so that people who are lucky enough to have built escape the brunt of the regulation – and see their property values increase in consequence of the land-use restrictions from which their neighbours suffer. In other cases, everyone loses: the gains in question are said to flow from some community-wide environmental benefit that extends to individuals outside the regulated environment.

Yet we know that this environmental claim too is inevitably over-inflated. The key issue here is the form in which the social calculations are made. In a world in which no compensation is provided for loss of use value, the state is spared the clumsy business of making a land-use valuation. That is surely a plus but it is not a dispositive argument. It is much like the proposition that we should allow the government to seize land without compensation because it knows how to balance the benefits and costs of its intervention. In truth the absence of eminent domain is worse than a social system that allows exchanges but prohibits the use of prices. In that unwise universe, at least barter remains an unhappy alternative.

In contrast, under modern regulation the refusal to require compensation leaves property owners without any line of resistance, for now the law gives the state authority the right to force an alteration in existing property rights at zero cost to those who benefit. We know that the supply of property rights at this level will be close to zero. The demand for land use restrictions at zero price will be very high. The small administrative advantage that comes from the absence of prices is thus more than offset by the massive over-claiming that regulatory bodies do in light of the fundamental imbalance of supply and demand.

The separation of regulation from compensation has profound implications for the operation of public institutions. In particular, it means that key agencies, often populated by ardent environmentalists, can continue to press their demands without having any taxpayer input that acts as a restraint on the overall system. Yet at the same time it hardly defuses the heavy opposition by those targeted individuals – often a local political minority – to those restrictions that reduce the value of their land.

The key point here is that the resisters are right. We know instantly that we have a social loss equal to the land-use values lost. The question is at the very least whether there is any offsetting gain. Claims of large environmental benefits can be loosely asserted but they are rarely justified. Given that the large-scale nuisances are already subject to proper social control, it is highly unlikely that the proposed restrictions offer additional benefits of any real size. The law of diminishing returns applies to environmental regulation as much as it does to anything else. And in those cases where the regulations have a sensible target, it usually makes far more sense for the state to either buy or condemn the use rights it needs in order to advance its interest. If the government, for example, wants habitat for certain species, it either buys land suitable for that purpose or gets a set of grazing rights that leaves landowners free to make other consistent uses of their lands. The bargaining process should get us to the right equilibrium. Moreover, it will encourage landowners to think of valuable habitat as an asset they can sell, rather than as a liability that they should avoid. The political process and the discovery process both work better if compensation obligations are imposed on the state.

Thus far the modern system of regulation without compensation has little to commend it. But it gets worse.

Exactions

There is another strong sign of the pathologies that arise when all use rights are in essence placed in the public domain. The state often sells them back to the original owners by

playing the exaction game. Thus suppose that a landowner has the right to build on a field that is, or might be, occupied by some rare species. Under the current law the government has the right to stop all building to permit the grazing of the species to take place, even if the gains to the government are, by its own calculations, small and the losses to the landowner are large. To illustrate, treat the state gains as equal to 100 and the private losses equal to 500. No responsible state would purchase grazing rights that cost more than they are worth. It would look elsewhere for land that is more suitable for this task. But it hardly follows that once the regulations are imposed the state is unwise to sell back the grazing rights to the original owner.

There are of course complications. Taking cash for this indelicate transaction reveals the arbitrary use of state power behind the situation. The risks are so great that the state can mint money by first imposing restrictions on land use, and then lifting them for a fee. So the basic transaction has to be duly disguised and, if the American precedents are any evidence on the point, it frequently is. The rule is that we will let you build on half your land if you deed to us the other half for use as a game preserve; or if you purchase land dedicated to that purpose elsewhere in the community; or contribute money to a land preservation fund and so on. All of these gimmicks cannot conceal the extortion that started the transaction. It is of course a matter of short-term relief if the thief sells back the watch that he or she stole from its owner. That transaction increases value by putting the watch in the hands of the person who attaches to it a higher-valued use. But by the same token everyone understands that this form of property ransom only encourages the initial theft.

And so it is with these exactions. The more that planning agencies can enter into these deals, the more willing they are to impose regulations that they don't want to enforce. They can come to landowners and say, "Let's talk about some way to ease the burden through a new deal." Who could resist? No one. And thus the scope of these restrictions continues to grow, while their benefits continue to plummet.

Summing up

Clearly there is much room for improvement which initially involves stripping away persistent illusions. It is commonly thought that those who defend strong institutions of private property have narrow parochial issues in mind. One of the great services of this report is that it reminds us that this proposition is incurably false. The realities are otherwise. States without a robust, just compensation requirement will invest in bad environmental projects, and do so by political processes that are an affront to the sound operation of democratic institutions. In so doing, they will reduce the other use values that contribute to a prosperous and well-governed society.

Given the sorry state of the law in both New Zealand and the United States, we can expect an improvement in environmental policy, land-use development and political accountability simultaneously by following this clear rule: **pay for those land use restrictions that are not justified under the private law framework of nuisance and covenant sketched earlier.** These systems are efficient. The government substitute for them is wasteful at best and should be scrapped, now and forever more.

PROPERTY

(‘Thou shalt not steal’ vs ‘Property is theft’)

What is property?

Property is generally thought of as something that is owned or possessed to the exclusion of others. The Property Law Act 2007 defines property, *inter alia*, to mean “everything that is capable of being owned, whether it is real or personal property, and whether it is tangible or intangible property”. The New Zealand Law Society considers a useful definition of property to be a thing protected by, or assumed by, legal rules as to trespass, exclusivity or alienation. Both these definitions embrace tangible items of value, such as real estate and chattels, and intangible sources of income or wealth, such as ownership of shares, bonds or loans.

On 31 March 2007 in a paper reviewing the issue of including a right to property in the New Zealand Bill of Rights Act 1990, the Ministry of Justice summarised the current accepted position as to what constitutes property, internationally and domestically, as follows:

Unfortunately international treaties and constitutional texts offer little guidance as to the definition of the term ‘property’. This task has been left to the Courts, and so by determining the scope of property they have determined the extent of the protection provided by the right to property.

For the purpose of the constitutional right to property, overseas Courts have given the term ‘property’ a wide and liberal construction to include both real and personal property ... personal property means property other than land but excludes leaseholds. This term is extremely wide and includes tangible things and intangible things. [Intangible things include the right to sue.]

The Courts have held that the constitutional right to property covers – in addition to private property – communal property ... This means that corporations can bring constitutional claims for the loss of corporate property. In addition, customary interests in land can be treated as property worthy of constitutional protection.

Public property is any property controlled by a state or by a whole community. Open access property (eg the atmosphere) is not controlled by anyone. Private property is remaining property. It includes property owned individually and in common. Which form of control is likely to best benefit the community depends on the circumstances.

People own themselves. John Locke wrote that “every man has a property in his own person. This nobody has a right to but himself.” It follows that the fruits of one’s labour are one’s exclusive property. (If one contracts to supply one’s labour in return for a wage, the wage is the tangible fruit of that labour.) There is no tension between this concept and the principles of consent to taxation and the non-violation of the like rights of others. The self-ownership principle is also reflected in the fundamental common law principle

that governments will pay compensation if they take someone's property without their consent. Taxation without genuine consent or commensurate benefits truly alienates workers from the fruits of their labour.

Government-issued transferable permits, such as individual transferable rights to fish, are property. Section 122 of the Resource Management Act 1991 states that, while a resource consent is neither real nor personal property, it is property for the purposes of the Protection of Personal and Property Rights Act 1988.

The sea in which we swim and fish and the air we breathe are not property because no one has an exclusive right to them. Wild animals, such as fish, become the property of anyone who secures them but, if they escape, that property right is lost.

New technologies can alter what is capable of being possessed to the exclusion of others. So some things may be property today, but not in the future. For example, the ability to copy digital information is undermining the exclusivity of some property rights in music. Conversely, new technologies can make it easier to exclude others, and thereby create property.

What is a property right?

The ... absolute right inherent in every Englishman, is that of property: which consists in a free use, enjoyment and disposal of his acquisition, without any control or diminution, save only the laws of the land.

William Blackstone (1768)¹

Property is one thing; rights in property are another. Property rights are the formal and informal rules that govern access to and use of property. Rights in property can be bundled and unbundled and exchanged separately or together, independently of the thing that is property.

Current scholarship considers rights in property to be a bundle of rights that are defined and protected by the domestic sovereign power. Ownership of title is only one aspect of property rights. Important categories include the rights to:

- determine the *use* of the property;
- any *income* from the property (eg rent or sale of crops);
- *dispose of* the property (eg destroy, sell or otherwise alienate it); and
- *exclude* others, thus permitting the quiet enjoyment of one's property.

It follows that government regulations imposed without consent that reduce the domain for legal freedom of action in any of these respects are a taking of property rights, in whole or in part, even if ownership of title is unchanged. Such takings invoke the issue of compensation that is addressed below.

¹ Cited by Norman Barry (2003) who added that Blackstone would have been referring to controls or diminutions arising from judge-made laws as distinct from parliamentary laws.

Obviously property rights entail an obligation on others to respect those rights. However, this obligation is reciprocal. Exercising one's own property rights must preserve the like rights of others. As a result, a rich body of case law limits the *nuisances* that use of one's own property might impose on others. Private nuisances (eg those caused to the owner of an adjoining property) are distinguished from public nuisances, such as threats to the public peace or community health or safety.

Desirable nuisance limitations provide mutual benefits for property owners (eg peaceful enjoyment) that are worth more than the costs caused by the reciprocal obligations. As a general proposition, the broader the definition of a nuisance, the less the freedom of action in respect of property and the more likely it is that the costs of the obligations will exceed any benefits. In the Introduction, Epstein observes that the acid test for a nuisance is whether its prevention would uniformly raise the value of the regulated land.

Property rights are different from property values. Property rights expose owners to the risks associated with those rights. Commonly, for example, they expose the owner to the risk that some event or act of nature will increase or decrease the value of the property. Such events alter property values but not property rights. Of course, government actions that reduce property values by restricting the legal use of property without the consent of the property owner are takings.

Welfare entitlements are not property rights. Entitlements to cheap housing, free education or state health care are not excludable or transferable and these programmes do not legally bind future parliaments. A future government can change welfare benefits that are not binding contracts without violating any property right. Similarly, in the absence of any contrary legal undertakings, a government that issues transferable taxi or import licences would be entitled to make them worthless overnight, simply by making future licences freely available. Market expectations would be dashed but there would be no change in the rights of ownership, use or disposal of existing taxi or import licences.

As the supreme law-making body, parliament can pass laws that change property rights for better or for worse. As the example of the Resource Management Act 1991 illustrates (see below), it is not fanciful to observe that parliament could largely negate property rights in land simply by passing a law that gives open-ended legal rights to strangers to block changes in land use.

Courts must use their discretion to embed each new parliamentary law into the existing laws. This necessity is another source of uncertainty as to future property rights. Independently the courts may also change property rights by novel rulings that overturn earlier precedents or views about what constitute sound rules for an orderly and civil society. A New Zealand Law Society submission on the New Zealand Bill of Rights (Private Property Rights) Amendment Bill observed that the European Convention on Human Rights jurisprudence has deemed pension entitlements to be possessions in "certain circumstances". It speculated that the generalised incorporation of protection for property rights in the New Zealand Bill of Rights Act might widen the opportunity for some future New Zealand court to rule similarly. However, some pensions, such as state servants' government superannuation, are not welfare payments; they are

legally enforceable contractual entitlements. The submission arguably confused the understanding of property rights by failing to distinguish between binding contractual agreements and welfare benefits.

It follows that the ongoing legal security of rights in property depends on the quality of future decisions of parliament and the courts, and in particular their respect for precedent. Security in property rights is protected to the degree that the constitution limits unprincipled or predatory government actions (see the sections below on takings and compensation).

Why are property rights important?

The right to life is the source of all rights – and the right to property is their only implementation. Without property rights, no other rights are possible. Since man has to sustain his life by his own effort, the man who has no right to the product of his effort has no means to sustain his life. The man who produces while others dispose of his product is a slave.

Ayn Rand, *The Virtue of Selfishness*

The biblical commandment, ‘Thou shalt not steal’, is testimony of the longstanding acceptance of the importance of property rights. Well-assigned and enforced property rights provide the basis for:

- the sense of self;
- peaceful cooperative coexistence;
- liberty;
- prosperity; and
- conservation.

A *sense of self* is an innate human need. Ownership of treasured possessions is part of that need. It is evident in the strong sense for ‘mine’ in young children (they need to be taught to share rather than to exclude); the home-making impulses of adults, including the deep personal violation some feel when their homes are burgled; the ‘sentimental values’ attached to some personal possessions; and the feeling of dislocation the infirm elderly may feel when moved from their homes to an institutional setting.

Property rights facilitate *peaceful order and coexistence* by providing a basis for sharing and exchanging resources peaceably for mutual benefit. These benefits are illustrated in Box 1.

Private property rights permit *liberty* by limiting the actions of those who control military power. John Adams observed that “[p]roperty must be secured or liberty cannot exist”. Arthur Lee of Virginia declared that property “is the guardian of every other right”; to deprive the people of property would be to deprive them of liberty. Without well-assigned, stable, secure private property rights that are widely held, a government that controlled the army could simply confiscate all the wealth of any disaffected citizens. With

Box 1: Property rights for Sesame Street

Ever seen two children quarrelling over a toy? Such squabbles had been commonplace in Katherine Hussman Klemp's household. But in the Sesame Street Parent's Guide she tells how she created peace in her family of eight children by assigning property rights to toys.

As a young mother, Klemp often brought home games and toys from garage sales. "I rarely matched a particular item with a particular child", she says. "Upon reflection, I could see how the fuzziness of ownership easily led to arguments. If everything belonged to everyone, then each child felt he had a right to use anything."

To solve the problem, Klemp introduced two simple rules. First, never bring anything into the house without assigning clear ownership to one child. The owner has ultimate authority over the use of the property. Second, the owner is not required to share. Before the rules were in place, Klemp recalls, "I suspected that much of the drama often centered less on who got the item in dispute and more on whom Mom would side with." Now property rights, not parents, settle the arguments.

Instead of teaching selfishness, the introduction of property rights actually promoted sharing. The children were secure in their ownership and knew they could always get their toys back. Adds Klemp, "'Sharing' raised their self-esteem to see themselves as generous persons."

Not only do her children value their own property rights, they extend that respect to the property of others. "Rarely do our children use each other's things without asking first, and they respect a 'No' when they get one. Best of all, when someone who has every right to say 'No' to a request says 'Yes', the borrower sees the gift for what it is and says 'Thanks' more often than not", says Klemp.

Janet Beales

<http://www.econlib.org/library/Enc/PropertyRights.html>

all opposition suppressed, whether it permitted people to vote or not would be irrelevant. People would depend on the government's favour for the necessities of life.

Private property rights facilitate *prosperity* by reducing waste from over- and under-exploitation and for other reasons. More importantly, without property rights, individuals could not trade for mutual benefit. No trade means no ability to specialise. Without trade, there would be no process for discovering prices. If there is no price discovery, no one can be sure which uses of resources represent the best value for money. Widely dispersed information and 'know-how' could not be effectively harnessed. Governments would have to determine in great detail the allocation and use of scarce resources on the basis of flawed incentives and very limited information. Destructive lobbying for political power would displace cooperative, mutually beneficial deal-making.

In contrast, allowing individuals to own property provides them with an incentive to borrow, lend, save and invest. Economist Hernando de Soto has demonstrated how securing property rights in housing or land allows poor squatters or slum dwellers to

borrow ('micro-finance').² Securing such rights facilitates investment and advancement. More generally, extensive empirical studies in recent years have found (unsurprisingly) that the prosperity of a country is positively and strongly correlated with indicators of the robustness of its institutions, including its system of property rights. (For a useful overview of this literature, see chapter 3 in the International Monetary Fund's April 2003 *World Economic Outlook*.³)

Private property rights facilitate *conservation* by providing incentives to protect and enhance the value of property. In particular, they can reduce the harm that arises in their absence due to:

- over-exploitation – as in situations involving the *tragedy of the commons*;
- neglect or under-exploitation – as in situations involving the *tragedy of the anti-commons*;
- an inability to get a court injunction to stop an illegal nuisance, perhaps because government polluters have set themselves above the law; and
- an inability to afford a better environment.

Over-exploitation occurs when none can exclude other harvesters. The inability to exclude removes the incentive to preserve today in order to harvest more tomorrow. In New Zealand, transferable fishing quotas have proven to be an effective property rights response to this problem, at least in respect of non-coastal fisheries.

Neglect arises where no one invests adequately to preserve or enhance the value of a property because none has an adequate property right. Much Maori-owned land, particularly in North Auckland, suffers from this problem. It is also illustrated by the widespread problems of pests and weeds in the 'conservation estate' in New Zealand. Governments often have only a limited interest in preserving or enhancing property values. There may be more votes, for example, in spending money on competing in the America's Cup than on the conservation estate. Similarly the lack of private property rights in endangered species can turn potential gamekeepers into poachers and make it harder for preservationists to achieve their goals by private initiatives. The Resource Management Act also creates this under-utilisation problem by allowing changes in land use to be blocked by those who are not confronted with the costs to the community of their land use preferences (see below).

Court injunctions can stop owners of property from using it illegally. This legal action can help protect against pollution of water, the air, or damage caused to others from noxious weeds or uncontrolled animals. (For a detailed discussion of the scope for common law actions to protect the environment, refer to the References and Suggestions for Further Reading, particularly Brubaker 1995 and Eagle 2008.) The pollution by the state in the old Soviet Union illustrates the problems that arise when citizens have no effective legal

² Wikipedia provides a more detailed summary of his thesis at [http://en.wikipedia.org/wiki/Hernando_de_Soto_\(economist\)](http://en.wikipedia.org/wiki/Hernando_de_Soto_(economist)).

³ A copy of this chapter can be downloaded from <http://www.imf.org/External/Pubs/FT/weo/2003/01/pdf/chapter3.pdf>.

remedy to stop government-caused nuisances. The longstanding problem in some parts of New Zealand of unsafe municipal drinking water also illustrates the difficulties citizens face in holding governments to account when there is a conflict between the government's role as a provider and its obligation to citizens.

Of course, a system of private property rights also permits controversial environmental uses, destruction, folly and waste. For example, an owner (public or private) might demolish a building or destroy a habitat that others would like preserved. However, there are at least four of setting considerations in the case of private ownership. They are: (1) the rightful owner has an incentive to replace an asset with something that has a higher market value (ie something that *others* value more highly); (2) those who wish to have something preserved can hope to achieve their objective by making the owner sufficiently reactive to their; (3) informal social sanctions constrain all forms of behaviour that violate commonly agreed norms, including what is regarded as acceptable use of property; and (4) any other system for allocating scarce resources will give rise to controversial uses and outcomes. Of course, any use of property rights will be unstable in practice if the outcomes are not politically acceptable. Politics and property are not strictly separable.

Under the alternative of a highly politicised system of property rights, mechanisms (1) and (2) above might not be available. Also government waste or destruction may occur on a grander scale than private waste or destruction given that the state owns so much more than a private person does and the time horizon of governments (often the next election) is typically short. Past government subsidies for fertilisers and pesticides and current government subsidies for biofuels in the United States demonstrate the potential for wasteful and destructive government actions.

Although greater reliance on private property rights would reduce many environmental problems, it could not be expected to solve them all. Non-point source pollution can present problems for private arrangements (but see the discussion in Box 3 below on the problem of water quality in Lake Taupo) and border security requires government action (to keep out unwanted persons and pests).

Well-defined property rights also facilitate the greater prosperity that makes a cleaner environment more *affordable*.

Those who see property rights as theft (eg Pierre-Joseph Proudhon, 1840) object to the right to exclude those with little or no property. However, it does not follow that those who are currently penniless would be better off without such a system of property rights. Refugees and other penniless migrants arriving in a well-ordered society that allows upwards mobility can hope, through hard work and thrift, to put their children, if not themselves, on the path to a relatively prosperous property-owning future. Barriers to obtaining property may arise from poor quality education systems, limits on access to productive work, oppressive tax systems, or other regulations that reward privilege and penalise upward mobility, effort and merit.

Another common complaint about systems of property rights is that private wealth is always distributed unequally. This inequality of ends egalitarian principles. However,

any ‘winner takes all’ public reallocation of property will have this result. Moreover, it does not follow that people will receive fairer treatment if governments with coercive powers determine how resources will be distributed. Any existing allocation of property rights, while inevitably unequal, will pass a test of fairness if it is the outcome of fair rules and processes for accumulating property. That is why reallocations drawn under proper supervision are accepted. The major enduring problems with any allocation of property rights usually come from past unfair uncompensated appropriations, as happened, for example, with some of the Crown’s dealings in Maori land in the nineteenth century.

In any case, to observe that private property rights lead to uncomfortable outcomes is not so much an argument against private property rights but a question as to whether a mixed system might do better. Certainly there is nothing in a system of private property rights that precludes people from voting to be taxed in order for the state to play a role in alleviating poverty or assisting those who cannot look after themselves and lack family support.

Where do property rights come from?

Those who have observed infants demanding, with all the power their lungs can muster, the restoration of a precious ‘cuddly’ blanket or toy can be left in little doubt about the existence of an innate human need for personal possessions. Indeed, there is a strong philosophical tradition that property rights have their origins in human nature and the natural course of things more generally. This tradition is illustrated by the natural right and natural law philosophies.

Without security in property there can be no security in person. The seventeenth century philosopher John Locke considered that property rights are derived from one’s rights to one’s own person and therefore to the products of one’s labour. Trespass laws reflect social recognition of the importance of personal privacy. This recognition is embodied in the notion that an Englishman’s home is his castle. The moral and social roles of property rights in helping to maintain peaceful order in society are also illustrated by the common sayings, ‘Keep your hands to yourself’ and ‘Good fences make good neighbours’.

Even basic human acts of compassion and generosity require the possession of something of value to give – property or time. The biblical dictum that it is more blessed to give than to receive assumes the existence of personal possessions.

In the English legal tradition, the *legal* origins of property rights primarily reside in the common law. Common law is sometimes called judge-made law. It has evolved over the millennia, and its development was informed by earlier Roman law. Customary rights (such as claims to ownership of the foreshore and seabed) are recognised in the common law.

Common law determinations depend on the application of a complex body of existing law to the facts of a particular case. New information might lead to a court ruling (or to a government regulation) that certain previously legal uses of a product would now be illegal. For example, asbestos was eventually shown to be harmful. In principle such rulings *clarify* the nature of *existing* property rights. They are arguably not a taking of property rights (see below) if no new interpretation of what constitutes a nuisance has been invoked.

The common law is subservient to parliamentary law because parliament is the supreme law-making body. Legal property rights in New Zealand are determined by statutes and judges' interpretations that mesh these statutes with the common law.

An entirely different view of the origins of property rights is that individuals have no innate or natural rights in property (or self). Instead, all rights are social and the government has unlimited despotic power to change property or other rights as it pleases. Timothy Sandefur traces this view about government power back to Blackstone and attributes its influence today to the rise of the Progressive Movement around 1900.⁴ He considers that the following statement, in a dissenting opinion in 1929 by US Supreme Court judge Louis Brandeis, exemplifies this view:

[I]n the interest of the public and in order to preserve the liberty and the property of the great majority of the citizens of a state, rights to property and the liberty of the individual must be remodelled, from time to time, to meet the changing needs of society.

Sandefur (2006 p 68)

In this unqualified form the 'greatest-good-for-the-greatest-number' vision of a majoritarian democracy denies sanctity for the individual citizen in self or in property. A political majority has the right to take what it wants and its victims have no legitimate basis for complaining that any property rights have been taken. If slavery of a minority meets a "changing need", so be it.

The enduring influence of the Progressive Movement's benign view of such government power is evident in New Zealand legal circles:

The balances in society are constantly changing and the legal rules, therefore, are in need of constant review and adjustment. At any time the bulk of the law will remain constant. But the Government of the day must assume responsibility for assessing changes in the political, economic and social environment and for determining whether adjustments to the law are needed in response to those changes.

Legislation Advisory Committee (2007, p 9)

Note here the presumption in favour of "constant" review and adjustment rather than the traditional reliance on the robustness of private laws that may have endured since Roman times to accommodate changes in society. Government must take responsibility because, by assumption, there are no other options.

This is arguably the dominant viewpoint in New Zealand today. Its influence is also evident in: the Treasury Working Papers cited in the References and Suggestions for Further Reading; the opposition by the Ministry of Justice and a majority of government agencies in 2007 to amending the New Zealand Bill of Rights Act to include protection for private property rights; the lack of active support by the Treasury, the Law Commission and the New Zealand Law Society for this proposal; and the Ministry of Economic Development's opposition, with the acquiescence of Treasury, the Law Commission and

⁴ Wikipedia contains a discussion of the Progressive Era and Movement at http://en.wikipedia.org/wiki/Progressive_Era. Richard Epstein analyses its influence on the US Supreme Court in *How the Progressives Rewrote the Constitution*.

the Law Society, to ‘elevating’ property rights by providing greater legal protection for them in a private member’s Regulatory Responsibility Bill. In all these cases the dominant concern was apparently to avoid constraining regulatory agencies and politicians, rather than to protect individual rights.

Nevertheless, constitutional protections for property rights of various sorts abound internationally. Major examples include Magna Carta, the fifth amendment of the US Constitution, the United Nations Universal Declaration of Human Rights (Article 17), the French Declaration of the Rights of Man and of the Citizen (Article XVII) and the European Convention on Human Rights (Protocol 1).

Independently of legal limits, the exercise of property rights is also moulded by informal social rules. Indeed, many people do not comply with parliamentary laws that violate accepted practices. Conversely, unwritten social norms will see informal sanctions imposed on property owners who fail to exercise their property rights in accordance with accepted practices, customs or ethical beliefs, even if their actions are legal.

There is little agreement concerning the efficiency of an existing set of legal rules. One consequentialist proposition is that common law rights are what they are because their current form is an efficient response to human needs and current conditions. Another view is that the common law does not evolve efficiently, either because it is excessively bound by anachronistic precedents or because some judges have unduly taken it upon themselves to invent new law rather than to content themselves with applying the law of the land to the cases before them.

Views differ similarly about the efficiency of parliamentary laws. Those who consider parliament to be a wise and benign body and the common law to be defective will incline to the view that parliamentary laws on the whole make the overall legal system more efficient. Those who consider that politicians must generally respond to partisan political pressures to get re-elected may take the opposite view. Both groups may generally agree that many parliamentary laws (eg those providing for general elections) are desirable and necessary and also that parliaments all too often legislate in haste and repent at leisure.

Even so, human nature and the enduring need to protect the individual citizen from the abuse of state power do not change with the political winds. In 1850 the French economist and politician Frédéric Bastiat warned of the dangers in the notion that the law of the land should change with a change in the balance of political power:

As long as it is admitted that the law may be diverted from its true purpose – that it may violate property instead of protecting it – then everyone will want to participate in making the law, either to protect himself against plunder or to use it for plunder.

Frédéric Bastiat, 1850

The worldwide growth in regulation of land use for ‘environmental’ reasons in recent decades illustrates the tension between these two views. Again New Zealand’s experience is no exception. Box 2 uses the example of the landowners’ historic right to cut down native trees and convert land to pasture to illustrate the tension between a modern, reasoned, environmentalist view and a traditional property rights view.

Box 2: 'Evolving' property rights and environmental 'bottom lines'

In 1998 environmentalist Guy Salmon, who is more respectful of property rights than many environmentalists, argued that the farming community should stop “dreaming” about returning to the exploitative rights of “pioneer” farmers who cut down native bush and converted it to pasture at will.

“Society” has taken away such exploitative rights, Salmon argued, and farmers needed to get over it. Yet “society” in this context means a political majority, and farmers are a minority. New Zealand’s experience with the taking of Maori land rights in the nineteenth century indicates that a minority may not readily ‘get over’ seeing its longstanding legal rights taken without consent or compensation. Instead, departures from the principles of consent and compensation are sure-fire recipes for enduring grievances.

In a 1999 submission on behalf of the Maruia Society, Salmon also criticised the Ministry of Agriculture for treating farmers as if they had the right to decide how much of their own money to spend on erosion control and reducing discharges. He was not arguing that they were legally required to spend more. He asserted instead that the ministry should be supporting a new legal system of “sustainable property rights” that would force farmers to spend more, apparently regardless of cost-benefit considerations.

However, under the benefit principle those who derive a benefit from seeing less erosion or more native trees should be confronted with the cost to the community of providing that benefit. Indeed, this is exactly what could occur under a system of “pioneer” property rights – those who want less erosion or less farm run-off than is legally required could buy the land themselves and alter its use to achieve their goal. Alternatively, they could pay the farmer to spend more. To argue that they could not afford to do this but the existing farmer could is to argue for a gain at the farmer’s expense. It also suggests that the benefits they hope to derive will be less than the costs.

Moreover, there is a fundamental conflict between a property rights approach that allows outcomes to be determined by voluntary processes of negotiation and consent, and an environmental ‘bottom line’ approach that seeks to impose a predetermined outcome (eg more spending on erosion control) without the consent of those who would bear the cost and regardless of trading opportunities.

In short, the ‘environmental bottom line’ approach fails to confront those who want a benefit with the costs to the community of achieving it, and it thereby fails to provide a mechanism for ensuring that benefits are commensurate with the costs.

Salmon’s line of argument is further evidence of the influence in New Zealand of the Progressive Movement’s view of property rights and benign government.

Voluntary dispute resolution processes involving property

Because property is a scarce resource, non-owners always have an interest in benefiting from someone else’s property. Non-owners might not like to see native trees cut down or

the landscape altered by a wind farm, or it might be more convenient for them to trespass than to respect the owner's privacy.

The civil process for resolving disputes about how property should be used or who should derive the benefits is provided by the system of voluntary exchange and contract. Non-owners can negotiate to buy the property or to pay the property owner to put it to the use they desire or to provide the benefits that they desire. This process of mutual exchange for mutual benefit is also a mechanism for finding the use value for the property that the community values most highly. The market value of a property is not the value that the owner puts on it; rather it is the value that a non-owner is prepared to pay for it. An owner who refuses to sell at that value is thereby confronted with the opportunity loss of that value. This prospect forces the owner to consider whether the benefits from not selling exceed the gains to the community from selling. Conversely, the same process confronts the non-owner with the costs to the owner (and thereby the community) of relinquishing the required rights. In economic terms, a system of voluntary exchange based on respect for private property rights imposes a market-based cost-benefit test on those who wish dictate the use to which a property will be put.

Because it is a prime role of government to protect private property rights, a government should prefer to act as a private buyer when seeking to use private property in whole or in part for a public or private purpose. Acting in this role means paying consideration and achieving the uncoerced consent of the seller.

Proximity always creates interference effects. Well over a thousand years of judge-made law have largely established which interferences are actionable and which are not. For example, your freedom to swing your arm stops before your fist hits someone else's nose. However, that limitation may not apply if the two parties have agreed to spar. A neighbour's motor mower disturbs the peaceful enjoyment of those occupying an adjoining property, and vice versa. However, the benefits from the freedom to mow one's own lawn are mutual and the obligation to respect the other's freedom to make *some* noise is reciprocal. A 'live-and-let-live' approach to many interferences is optimal. If you can't abide your neighbour you can move or seek to buy the property.

None of this is to argue that there is any fully satisfactory solution to all disputes between neighbours. Better disputes from proximity are as old as humanity itself. Moving to a more

socially optimal.⁵ This approach typically leads to the conclusion that, in the absence of explicit corrective government action, people probably produce more negative (and fewer positive) effects for others than is socially optimal. This is because they do not appear to be fully confronted with the costs that their actions are imposing on others. This approach fails to put any value on the mutual benefit from freedom of action in return for reciprocal obligations to respect the like freedoms of others.

There has been intensive debate in the economics literature in recent decades over whether externalities generally constitute a market failure that warrants government action.⁶ Although the point is commonly overlooked in public debate, the economics literature now generally accepts that many apparently 'unpriced' interaction effects are intermediated indirectly through the price system, for example through their effects on land values. The general case for government action is now thought to be much weaker than was proposed in the earlier literature (associated particularly with Arthur Pigou, 1877–1959).⁷ Nevertheless, the case for government action on account of some interference effects (eg serious communicable diseases) remains intact.

Box 3 illustrates these debates by applying a property rights perspective to the issue of the adverse effects of farm run-off on the quality of water in Lake Taupo.

⁵ See <http://en.wikipedia.org/wiki/Externality>.

⁶ For a general discussion of the concept of market failure and its limitations see http://en.wikipedia.org/wiki/Market_failure. For further analysis, see Tyler Cowen at <http://www.econlib.org/library/Enc/PublicGoodsandExternalities.html> or Richard Zerbe and Howard McCurdy at <http://www.cato.org/pubs/regulation/regv23n2/zerbe.pdf>.

⁷ See http://en.wikipedia.org/wiki/Pigovian_tax.

Box 3: Lake Taupo water quality issue

Cleaning up a polluted lake, for instance, involves a free-rider problem if no one owns the lake. The benefits of a clean lake are enjoyed by many people, and no one can be charged for these benefits. Once there is an owner, however, that person can charge higher prices to fishermen, boaters, recreational users, and others who benefit from the lake. Privately owned bodies of water are common in the British Isles, where, not surprisingly, lake owners maintain quality.

Tyler Cowen, 2002

The fundamental conflict over land use. Existing land use practices (run-off from adjacent farms) are believed to be reducing the quality of the water in Lake Taupo. The poorer water quality reduces the amenity benefits (eg fishing or swimming) that the community derives from the lake. This problem might be alleviated by a change in land use and/or farming practices. However, it would be costly for the community to change existing practices. There is thus scope for conflict concerning the optimal land use.

Central planning framework for analysing the problem. From a central planning perspective, the question is whether the benefits to the community from better water quality in the lake would exceed the costs to the community of changing land use. Once this question is determined, the Crown might seek to negotiate or impose the preferred land use on the community, addressing or neglecting the issues of compensation and property rights as it wishes. It may use command and control regulations or tax/subsidy 'market mechanisms'.

Property rights framework for analysing the problem. From a property rights perspective, whoever owns the property determines the land use – as long as the chosen use is legal. So those who want to change an existing legal land use should either buy the property or induce the owner to change land use willingly, perhaps for a side payment. If they buy the property and can preserve the preferred land use by way of covenant, they do not have to keep owning that property. If those wanting to effect change are not prepared to pay for the costs to the community of achieving it, the presumption is that the benefits of the change are less than the costs. (Witness the unquestioned acceptance that none of us is obliged to sell anything we own to someone who refuses to meet the asking price.)

Complication 1: *Doubts about the legality of an existing use.* Is an existing level of pollution legal? If there is doubt about the answer, it is hard to achieve mutually beneficial transactions. The courts are the proper party to determine disputes as to what is illegal under existing law. Politicians lack the time, expertise and incentive to conduct impartial legal hearings and determine fine matters of law. However, if parliament does not like a court's determination, it has the sovereign right to change the law by passing a new one.

Complication 2: *The need to confront the parties with the costs to the community of the forgone alternative.* Under a central planning framework, if an existing use is illegal, either it is stopped, or the law is changed to make it legal. No satisfactory mechanism might exist for confronting those lobbying for a law change with the opportunity cost to the community of the forgone land use. In contrast, under a property rights framework, an illegal use must be stopped unless the consent is gained of those who would otherwise have legal standing to take out an injunction preventing the continuation of that use. Under a system of riparian rights, for example, a downstream landowner might have a common law right to fishable waters. By purchasing downstream land, an angler or environmental society could give itself standing to

bring a court action to stop the upstream pollution. Conversely, a polluting upstream owner might seek to prevent such actions by buying all the downstream land, or doing deals with all remaining downstream owners. Such contests confront each party with the costs their preferences would impose on the other.

Complication 3 *Inadequately specified property rights may prevent mutually beneficial exchanges.* The Resource Management Act could have been purpose-built for preventing mutually beneficial exchanges by undermining private property rights and imposing unduly high transaction costs by giving standing to a vast potential number of objectors who do not have to prove a common law harm, satisfy a common law test of standing, or risk being confronted with costs. Perhaps riparian rights in respect of lakes are also somewhat deficient in New Zealand.

Another potential problem under this heading might arise from incomplete ownership rights in respect of Lake Taupo itself. A brief history is that in 1926 the bed of Lake Taupo was vested in the Crown by statute. In return the Tuwharetoa Maori Trust Board received an annual payment and a half share of revenue generated from the lake by the Crown through fishing, boating and harbour services. In 1992 the Crown vested the bed of Lake Taupo back to the Tuwharetoa Maori Trust Board, with all the rights, responsibilities and restrictions of a landowner (subject to the restrictions of the deed). In September 2007 the Crown and the trust board signed a new deed that revokes and replaces the arrangement under the 1992 deed. The deed provides that the lake shall be managed as a reserve for recreational purposes in partnership between the Crown and the trust board. Under the new agreement the Crown retains the rights to control and manage the Lake Taupo fishing and all the boating and harbour services in the lake. The Crown also retains the right to set user fees without prior agreement with the trust board. The deed provides for continued free public access to Lake Taupo for non-exclusive, non-commercial recreational use and enjoyment.⁸ Whether these arrangements unduly raise the costs of achieving changes in surrounding land use through voluntary mechanisms appears to be an open question.

It is relevant (and encouraging in respect of this problem) that Ngati Tuwharetoa does have an increasing role in surrounding land use, for example by way of the Lake Taupo Forest, which is a joint venture between Ngati Tuwharetoa and the Crown. Single ownership of the lake and surrounding land would confront the single owner with the costs of changes in land use decisions that improve or reduce lake water quality.

As it happens, ownership of the Lake Taupo catchment area is highly concentrated: Maori reportedly own 45 percent, the Department of Conservation 28 percent, and other government agencies 7 percent. This large-scale ownership leaves only 20 percent (49,000 hectares) as private freehold.

Complication 4 *Prohibitively high transaction costs even if property rights are well-defined.* It is conceivable that even if government laws that impair private actions with respect to water quality were optimal, mutually beneficial exchanges could not take place because transaction costs remain too high. The classic textbook example is non-point source pollution where

⁸ The source for this information is: <http://www.tpk.govt.nz/government/reforms/trustboards.asp>. The source is silent as to who owns the column of water above the lake bed.

private actions might fail because it is impossible to prove which polluter actually caused the harm to the complainant. If so, illegal pollution could then persist without any compensation being paid to the victims of the pollution. Whether this problem exists in this case is a matter for further research. If it does, solutions might be found if the courts permitted an action against the upstream farmers as a group or if the state regulated against the otherwise illegal polluting activities, perhaps allowing them to continue where the consent of downstream parties has been obtained. Even if the owners of the lake and others with an interest in protecting or improving its water quality cannot succeed in the courts or in bringing down state regulation, they could still achieve changes in surrounding land use in other ways (eg by purchasing the land or negotiating changes in land use). If the transaction costs of these other ways are too high, the Public Works Act provides a model for changing a legal land use in a principled manner. This model provides for full compensation for the affected landowners as the existing land use is not illegal. It is desirable that the compensation be funded by those who stand to benefit, in order to confront them with the opportunity cost to the community of giving them what they want.

Concluding observations. From a community perspective, the Lake Taupo water quality problem is a conflict over land use. Is the optimal land use one that enhances or degrades water quality in the lake at the margin? In principle, a well-defined system of private property rights produces an answer to this question that confronts the successful parties (the landowners who determine land use) with the costs to the community of the forgone alternative. However, in practice, private property rights might not be well-defined or well-enforced. This may be for reasons of market failure or government failure, or some combination of the two. In the case of Lake Taupo, government failure seems likely and market failure seems possible. As a result, the observed outcomes might be less beneficial than is potentially achievable. Whether there are potential gains from improving the ability of a system of private property rights to allocate resources by reducing existing undue impediments or by adopting a central planning approach is a matter for analysis and debate. As illustrated here, any such analysis should be far-ranging and intensive and any conclusions should be based on a rich understanding of the existing law.

TAKINGS

(‘I’m taking it whether it is yours or not’)

Today it is generally accepted that in a limited range of exceptionally important circumstances it is necessary in the public interest for the government to force an owner to relinquish all or some rights in a particular property. Cases in which rights in property are taken by governments without the owner’s consent are known as *takings*.

Property may be taken physically, depriving the owner of possession and all other rights, as in the case of private land taken for a public road, or flooded for water storage for a hydro-electric power station. Alternatively, and much more commonly, government laws and regulations may leave possession unchanged but restrict an owner’s use or disposal rights. Such cases are called *regulatory takings*. Telecom unbundling, health and safety, product liability and labour market laws may all have this at ribute.

The Public Works Act 1981 ensures compensation in the case of land physically taken, but no general legislation ensures that the question of compensation is addressed in the case of regulatory takings of property rights that leave possession intact. Uncompensated regulatory takings are discriminatory taxes. They often occur without proper examination of whether they conform with sound taxation principles. Moreover, the special interest groups that lobby for these takings achieve benefits without being confronted with the costs to the community of providing them. (For example, if land values fall as a result, the cost to the community is the fall in the land value. Note that the fall in land value is determined by community valuations, not by the owner’s valuation.)

Typical situations in which the power to compulsorily acquire or restrict use or disposition is considered to be necessary are those in which unreasonable hold-out by an owner or prohibitively high transaction costs might otherwise thwart the provision of some essential part of the region’s infrastructure, such as an airport or food control scheme, or the achievement of necessary locational links for a network industry, such as public roads, piped water and sewage, or an electricity grid. The construction of such assets traditionally came under the heading of ‘public works’. Other, less common, situations include matters of urgent public necessity, such as the forced destruction of an entire herd, with or without the owner’s consent, in the event of a foot and mouth disease outbreak.

Whatever the range of acceptable circumstances, taking should be a last resort. In all situations the preferred option is to achieve the public interest by obtaining the consent of the rightful owners. This stricture is necessary if the government is to deliver on its key role of ensuring that citizens are secure in person and property. After all, this behaviour is exactly what the law of the land requires from every citizen and private organisation.

It is not easy to specify all the situations that might arise in which the taking of private property is justified, but it is clear that the burden of proof needs to favour voluntary

uncoerced acquisitions so that a test of necessity should apply to a taking – as indeed it did in the 1981 version of the Public Works Act in New Zealand (see below). That version provided that the power to take should be used only when it is *necessary* to do so for an *essential* public work (although the act also provided anachronistically for taking for purposes that did not obviously require unique geographic locations, such as land for police stations or schools). A more general principle would be to provide that property should only be taken when it is necessary to do so for an essential *public interest*.

Rules of due process ensure that consideration is given to satisfying such requirements before a decision is taken. The “due process” clause in the fifth amendment of the US Constitution states:

... nor shall any person ... be deprived of ... life, liberty, or property without due process of law.

In New Zealand the Legislation Advisory Committee (LAC) guidelines set out a process that the *Cabinet Manual* requires the executive to follow when making new laws or regulations. The guidelines ask if the legislation complies with fundamental common law principles and specifies that one of them is the principle of compensation.

Governments can show great ingenuity in taking by stealth in non-transparent ways. The inflation tax is a textbook example, but the threat to regulate or prosecute unless the individual citizen complies with some unconstitutional demand is much less transparent. In the hands of a regulator, this form of abuse arises because parliament has essentially delegated the power to tax arbitrarily. Epstein has written extensively about this problem in *Bargaining with the State* (1993).

COMPENSATION

(‘OK, it was yours so you have a claim, but I am not returning it’)

Where it is necessary in the public interest for the government to take private property rights without the owner’s consent, the issue of compensation needs to be addressed, even if this has to be done after the event. Otherwise incentives to preserve, create or enhance private property will be impaired, perhaps seriously. This requirement is acknowledged in the LAC guidelines as a fundamental common law principle. The LAC guidelines ask:

Have vested rights been altered? If so, is that essential? If so, have compensation mechanisms been included?

The takings clause in the fifth amendment of the US Constitution states:

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

Such general statements of principle are accepted practice in modern written constitutions. They do not attempt to spell out what is meant by property or vested rights. Nor have they ‘frozen’ the allocation of property rights or prevented intrusive governments from regulating property.

In a system of voluntary exchange, compensation takes the form of an agreed price between an uncoerced buyer and an uncoerced seller. This element of consent implies that the exchange is mutually beneficial. How any surplus between the seller’s willingness to sell and the buyer’s willingness to pay is shared is a matter for negotiation.

Just compensation might require more than the payment of market value. Prices are determined at the margin and most property owners are not willing sellers (or buyers) at today’s market prices. The Public Works Act 1981 recognises the need to compensate above market value through provisions that allow for relocation assistance and a modest solarium in the case of residences that are taken. Epstein notes that in the United States some state statutes set compensation at 150 percent of market value. On the other hand governments have a responsibility to taxpayers not to pay too much. Epstein suggests that a reasonable option might be to pay a fixed proportion, say 10 or 20 percent, above market value without accepting individual evidence on the matter (Epstein 2008 pp 79 and 91). Of course, paying compensation above market value is not desirable where the owner can do something that necessitates the taking (eg illegally introduces foot-and-mouth disease on to their property). The difficulties with determining what level of compensation is just in a particular case serve to emphasise the need to limit takings to cases of public interest necessity.

In a situation of private involuntary exchange, compensation commonly takes the form of restitution, perhaps achieved through tort action. Such compensation might apply, for example, to the use of someone else’s land without their consent in an emergency or in the case of a mistaken use of someone else’s property.

In a situation of involuntary exchange due to government takings, the analogous situation would be that compensation would be paid by those who benefit from the forced exchange. The principle that those who benefit should pay is known as the *benefit principle*. The term was originally a principle of taxation but it is now widely applied in situations involving government user charges. Of course, where the general public is the beneficiary, as in the case of national defence, funding from general taxation is indicated.

Where the benefits from a forced exchange exceed the cost, a rule that compensation should be based on cost would penalise the original owner if they were not a willing seller at that value. A rule favouring proportionate sharing of surpluses might help guard against rent-seeking lobbying in such situations.

There is a countervailing argument (Guerin 2002) that full compensation creates moral hazard. The concern is that full compensation could cause owners to put expensive improvements on their land partly in order to make it cheaper for utilities to take someone else's land for a public purpose. This feared 'not-in-my-backyard' investment motivation is arguably socially unproductive. Yet it implies that the expected compensation from taking the unimproved land would leave the owner worse off – that is, that the expected compensation is less than full compensation. If so, the argument is self-contradictory because it started by assuming full compensation. However, if compensation for an unwilling seller is only at market value, such an incentive could arise. New Zealand's experience to date with privatised utilities that are permitted to pay above assessed market value, like any other business, in order to secure a willing seller indicates that the adverse publicity from recourse to the power of compulsory acquisition is so powerful a consideration as to make recourse to it very rare indeed. In short, it appears that the argument that this is a significant consideration in the current New Zealand context has yet to be made.

Where those who benefit from a forced exchange are those whose property is being taken, the compensation is paid in kind. This *betterment principle* is incorporated in New Zealand's Public Works Act. The Act permits the amount of cash compensation to be reduced where the taking of part of someone's land to build a road increases the value of the remaining parcel of land.

Epstein has made the point that changes in the use of property within the state sector can also benefit one faction at the expense of another. To ask whether there is a net overall benefit is to ask whether this exchange has the potential to raise the welfare of both groups. If there is no overall benefit, the change in use may reduce the community's welfare overall. One test of this outcome is whether those who benefit would be prepared to compensate the losers.

It is not practical to pay compensation in all circumstances. There will be occasions in which the transaction costs associated with identifying winners and losers and paying compensation would be so large as to make compensation funded by beneficiaries grossly uneconomic or absurdly impractical. In such cases the options are funding by taxpayers, not paying compensation, or not proceeding with the forced exchange. Either of the first two options would provide incentives for rent-seeking lobbying, raising the likelihood

that the net benefits from the forced exchange would be negative. On the other hand, the third option may look even worse when considering the national interest. There is a saying that ‘hard cases make bad law’. Laws of general application, such as the common law principle that the issue of compensation must be addressed when there is a taking, cannot be successfully written so as to dictate the ‘right’ answer regardless of the circumstances. Such cases illustrate the need for due process requirements and rights of appeal.

Guerin (2002) attributes to Michelman the view that it is only clear that governments should pay compensation “when settlement costs are low, the efficiency gains are dubious and when the harm concentrated on one individual is unusually great”. The first element of this proposition, on a charitable reading, accommodates the above transaction cost problem. However, the notion that no compensation should be paid if the taking is efficient (ie the efficiency gains are not dubious) has no parallel with a system of voluntary exchange, where the supplier is paid regardless. Such a view appears to propose that the Crown has no legal obligation to pay. Such a reversal of the standard constitutional presumption to the contrary would be revolutionary. The LAC guidelines, for example, make it clear that the courts will interpret parliamentary laws as providing for compensation unless the language of the statute makes it absolutely clear that no compensation is intended.

Guerin (2002, p 15) also expresses the view that the vagueness and “evolving” nature of property rights may be a major conceptual barrier to extending the obligation to compensate for the use of regulations to take property rights, other than as provided for in the Public Works Act (see below). However, no one is entitled under the common law to assume ownership rights unilaterally on the basis that their ownership is vague (which must mean in practice that it is disputed). Instead the customary recourse in the event of a failure of parties to agree about the allocation of property rights is for the injured party to ask the appropriate court to make a determination. In a constitutional democracy the Crown should be subject to the law like anyone else. The argument that the evolving nature of property rights might be a barrier to compensation is similarly puzzling, unless it is motivated by the Progressive Movement’s proposition that people have no property rights except at the pleasure of the state. Otherwise, if there is doubt as to whether an ‘evolution’ in a property right is a taking, a court could be asked to make a determination.

Finally Guerin (2002) expresses the fear that a general compensation requirement might “freeze” property rights where they stand, or prohibit much state regulation. Yet the compensation requirement is ubiquitous in a system of voluntary exchange and markets based on this system are commonly known for their dynamism and flexibility. Furthermore, the many countries with written constitutions that formally protect property rights do not seem to suffer from the problem of unduly “frozen” property rights or a deficiency of state regulation. For example, the secretariat of the Organisation for Economic Cooperation and Development (OECD) has focused its regulatory work on tackling the opposite problem of an excess of ill-justified regulatory burdens.⁹

⁹ A copy of the OECD’s guiding principles for regulatory quality and performance can be downloaded from <http://www.oecd.org/dataoecd/19/51/37318586.pdf>.

IMPLICATIONS FOR MAJOR CURRENT AND PROPOSED STATUTES

This section analyses, from a property rights perspective, three major pieces of New Zealand legislation: the Public Works Act 1981, the New Zealand Bill of Rights Act 1990 and the Resource Management Act 1991 (RMA). It then considers how a Regulatory Responsibility Act might encourage a more principled and consistent approach to property rights. This discussion reviews concerns expressed about this approach during the 2007 and 2008 parliamentary select committee examination of a private member's Regulatory Responsibility Bill.

Public Works Act 1981

The Public Works Act 1981, prior to its amendment in 1987, provided that the Crown could only take land if it was required for *essential* public works. An objection to a proposed taking would be heard by an independent body, the Planning Tribunal. It was required to determine whether the taking was “fair, sound and essential” for achieving the objectives of the minister or local authority. Its reports and recommendations were binding on a local authority, but not on a minister.

The 1987 amending legislation deleted the essentiality restriction, allowing land to be compulsorily acquired if it was required for a public work. Objections are now heard by the Environment Court which must investigate alternatives and determine whether the proposed taking is “fair, sound, and reasonably necessary for achieving the objectives of the Minister or local authority”. Section 24(10) provides that its findings are binding on the minister or local authority. Section 24(11) decrees that “no appeal shall lie” from its recommendations, except in some contexts related to the Resource Management Act.

Full compensation is due for land compulsorily acquired and for an injurious affection or damage arising from a public work. There are provisions for disturbance payments; a \$2000 solatium to alleviate grief, suffering and anxiety resulting from the loss of a private residence; and assistance with purchasing a replacement property.

Claims are filed in the District Court and are heard by the Land Valuation Tribunal. Section 95(1) provides that the amount awarded is final.

Where land compulsorily acquired is no longer needed for a public work, it must be offered back to the original owner at no more than the current market value if it is reasonable, practical and fair to do so.

Compensation may be paid in cash or in kind. The quantum might be reduced where the public work increased the value of the claimant's remaining land (betterment). Compensation might not be paid for belated improvements whose purpose or effect was to increase the compensation that would otherwise be due.

The principle that those who gain ownership rights should be confronted with the costs is also preserved. For example, under the Resource Management Act, where the land that is taken is vested in a network utility operator, all costs incurred by the Minister of Lands, including compensation costs, are recoverable from the network utility.

These principled safeguards are clearly intended to protect the domain for voluntary exchange by imposing an onus of proof on the need for any taking and ensuring that the costs of the taking fall on the same party that would incur those costs if the exchange were voluntary. Such safeguards also reflect the strength of the English legal tradition that people should be secure in their homes and property. Similar provisions for full compensation for takings or losses caused by public works could be found in part VII of the Town and Country Planning Act 1977 and section 145 of the Soil Conservation and Rivers Control Act 1941.

Takings provisions for land arose historically because of the unique need for particular parcels of land for public works such as roads, railroads and canals. This may explain why these takings provisions focus on takings of land.

From an economic and constitutional perspective, the same protections and presumptions should protect all property. Indeed, the LAC guidelines (Legislation Advisory Committee 2007) are explicit that fundamental common law presumptions protect all property and its step-by-step guide specifies that where vested rights are taken, the issue of compensation must be addressed.

New Zealand Bill of Rights Act 1990

The New Zealand Bill of Rights Act 1990 states that its purpose is to “affirm, protect, and promote human rights and fundamental freedoms in New Zealand”.

Yet the tradition that an Englishman’s home is his castle does not inform this act. It does not affirm that property rights are a human right whose protection is fundamental to freedom. It does not acknowledge any human right to the quiet enjoyment of one’s possessions, secure from unwanted trespass.

Far from explicitly assuring security in property, it veers in the opposition direction. Section 21 permits the state to invade and seize a person’s property at its pleasure – as long as the actions are deemed to be not “unreasonable”.

No human right to compensation for a ‘reasonable’ seizure is acknowledged. Consistently (given that the right to take without compensation is the right to tax without consent) the act fails to address the concept of consent to taxation. Yet this fundamental human right or freedom dates back at least to Magna Carta. Through this omission, it implicitly rejects the notion that the right to the fruits of one’s own labour is a fundamental human right.

Perhaps the only saving grace from a property rights perspective is that the act states that its provisions do not override unenumerated human rights, or contrary provisions in other statutes.

The New Zealand Bill of Rights Act’s implied downgrading of the human need for security in property is not an aberration. As mentioned above, in 2007 a member’s bill

that sought to include protection for private property rights was rejected by parliament's Justice and Electoral Committee. Representatives of both the major parliamentary parties voted against the bill. They did so for various "practical" reasons, while not "fundamentally" opposing the principle.

Resource Management Act 1991

Sections 9(1) and 9(3) of the Resource Management Act 1991 prohibit any land use that contravenes a rule in a district or regional plan, or in a proposed district or regional plan, unless it is a permitted existing use or is expressly allowed by a resource consent. Although the common interpretation of these provisions is that they allow any land use that is not prohibited, the lack of adequate safeguards against what can be prohibited effectively denies security in property rights in relation to land use. Indeed, section 96 allows *anyone* to object to the granting of a notified resource consent. This section, in conjunction with administrative discretion as to which applications for consents should be notified, considerably undermines the right of a property owner to determine land use.

Further, section 85 explicitly decrees that compensation is not payable for controls on land. (The fine print in this section specifies that no provision in a plan can be deemed to be a taking or injurious affection unless otherwise provided for in the act. It permits someone whose interest in land is thereby rendered incapable of "reasonable" use to appeal, but denies the Environment Court the ability to provide a remedy unless it also deems that it places an "unfair and unreasonable" burden on the objector.) Section 284A invites malicious, anti-competitive, opportunistic or frivolous objectors by depriving the Environment Court of the ability to require a party to give security for costs. Section 108 potentially allows onerous, wide-ranging conditions to be attached to a resource consent, although case law has narrowed its application. Such provisions give rise to the problems of exactions that Epstein identifies in his introduction to this primer. Section 36, and user charge provisions in other legislation, also privilege objectors relative to applicants.

Clearly this legislation denies that owners of land are free to change its use or to dispose of it as they see fit, subject to respecting the like rights of others as defined by longstanding common law precedents. Instead it adopts the 'tragedy of the anti-commons' philosophy that anyone has a legal right to object to any use of someone else's property that they do not like. Moreover, whereas the property rights approach confronts the owner with the costs of their land use decisions (through changes in the value of their land), the RMA seeks to ensure that objectors are not confronted with the costs that their preferences seek to impose on the community.

Section 6 requires councils to "protect" things like significant indigenous vegetation, outstanding landscapes, cultural values and heritage. Section 7 obliges authorities to have regard to "intrinsic values of ecosystems". The effect is to restrict the land use, without compensation, of farmers whose efforts have preserved such features on their properties.

The implicit philosophy is that the landowner has no land use rights in such cases, but must meet all the costs of achieving this 'protection'. The effect is to turn such assets into

*Box 4: 'Property rights: do you have any?'**

Live-and-let-live: "You can do what you like with your property as long as you don't harm others, and you respect my like right."

Busybody: "Sure, but you harm me if you do something I don't like."

* This heading is the title of a 1996 paper on the Resource Management Act by David Kirkpatrick, a partner at Simpson Grierson.

liabilities from the farmer's perspective, contrary to the aims of the RMA. Constitutional lawyer Suri Ratnapala has pointed out that these sections depart from the reasonable principle that those who want a landowner to sacrifice some land use in order to derive a pleasure or benefit for themselves should compensate the landowner for that sacrifice.

In short, the RMA and the Public Works Act represent opposing views about the sanctity of private property rights. The RMA fundamentally sees the owners of land as holding it in the public interest, as determined by political processes. The restrictions it imposes on land use by some may be deemed to merely stop owners from doing what they had no prior legal right to do. If so, there is no legal case for compensation. There is even a view that the rightful owner of the land has no right to any of the benefit from a change in land use (on the grounds that the benefit is conferred by 'the community' when it approves the changed use). In contrast, the Public Works Act acknowledges the lawful existence of property rights and provides that when they are taken in the public interest (under the compulsory acquisition power) it must be for a good reason and the question of compensation must be addressed.

The RMA's weakening of property rights has predictable adverse consequences. To make it harder for people to remove trees is to discourage them from planting trees in the first place. Compared with a system that respects property rights, and confronts those who want something with the social costs of meeting those wants, we would expect to see greater divisiveness and extortion, anti-social or anti-competitive behaviour, greater waste from over-exploitation or under-exploitation of resources, and reduced incentives to invest in conserving or enhancing natural resources.

One compilation of actual cases of such adverse consequences is contained in the discussion document *Constraining Government Regulation* (Wilkinson, 2001). The problems arise over small issues – where disquieting if relatively petty bureaucratic impositions and costs are imposed on individuals – and over large ones, where the public interest cannot be well served because critical infrastructural projects such as roads and hydro-electric schemes can be delayed inordinately by mischievous, irresponsible or extortionate objectors.

More recently Federated Farmers produced a concise booklet that systematically identifies and analyses the practical adverse consequences that are occurring as a result of six major features of the RMA.

Writing from an academic and constitutional perspective, Ratnapala fails the RMA against the test of four clearly reasonable requirements. He finds that the RMA has granted virtually unconstrained discretionary power to executive government. He considers that it has failed New Zealanders by replacing the principle of freedom of action, when no harm is caused to others, with an inherently arbitrary system of environmental management that will accelerate the erosion of the rule of law in this country. Remedies include restoring basic safeguards of natural justice for landowners, reducing delegated authority and restoring the supremacy of the law over policy so that the people can know what the law is and be governed by it rather than by extemporaneous decrees.

Other more recent legislation reflects the RMA's anti-property philosophy. The Forests Amendment Act 1993 unilaterally removed without compensation certain property rights in the harvesting of indigenous forests on private land. Such actions effectively deny security in property. Local government legislation is rife with provisions for drains and watercourses that do not respect property interests in land. The Historic Places Act 1993 limits activity in relation to historic places that are defined so broadly as to apply potentially to the whole country. The Foreshore and Seabed Act 2004 (section 38) denies a right to legal redress for the taking of customary rights (replacing it with a limited right to seek redress at the disposition of the Crown). The legislation that deprived Telecom of property rights in its copper wires without compensation or conviction for wrongdoing is also consistent with an opportunistic, anti-property philosophy. Early climate change initiatives proposed to take property rights in forestry without consent or compensation. The perverse effects on deforestation and new plantings have forced some changes, but the no-compensation philosophy is still evident in the determination to tax changes in land use from forestry to dairying.

Proposals for improving the RMA depend on whether the objective is to ameliorate its effects at the margin in a piecemeal manner or to address its fundamental problems directly. Federated Farmers rightly put the principle of compensation for regulatory takings at the top of its 'six pack' list of remedies in the brochure mentioned above. The problems with the RMA are fundamentally property rights issues.

A Regulatory Responsibility Act

In 2001 a discussion document commissioned by the New Zealand Business Roundtable, Federated Farmers and the Auckland and Wellington Chambers of Commerce (Wilkinson, 2001) contained an illustrative Regulatory Responsibility Act. This act would extend to property generally the principles and philosophy underlying the Public Works Act 1981 that apply to land. It would permit the taking of property rights in the public interest (implying that taking is not permitted otherwise). When the public interest test has been satisfied, it would require that the question of compensation be addressed. It would also emphasise the importance of due process and a thoroughgoing examination of the benefits and costs of a proposed regulation.

The proposed Regulatory Responsibility Act would require that compensation be funded where practicable by those who would have paid if the exchange of property rights

had been negotiated voluntarily. This 'benefit principle' is desirable in order to reduce incentives to abuse the state's coercive powers. It is a longstanding principle of taxation and a key principle for determining who should pay government user charges. (The other key principle is that the 'risk exacerbator' should pay.)

By potentially imposing the costs of compensation on the party that is lobbying for a regulatory taking, the proposed act aims to make it easier for politicians to resist self-serving lobbyists, while reducing the incentives of special interests to lobby for regulatory advantages.

Box 5 uses the Telecom unbundling decision to illustrate the difference between current practice and the more principled approach of the proposed Act.

A version of the proposed Regulatory Responsibility Act was developed by Rodney Hide MP as a member's bill. The bill passed its first reading in parliament and was referred to a select committee. The committee gave it serious consideration and received many well-informed submissions. There was widespread agreement that current arrangements are inadequate and the committee recommended that a high-level expert task force should be established to conduct a deeper examination of the proposal and other options.

One erroneous argument against the Regulatory Responsibility Bill was that paying compensation raises the cost of regulatory initiatives. Compensation payments transfer income, neither increasing nor decreasing national income. The cost to the community of regulation is measured instead by the real resources that are not thereby available to produce something else of value for the community. This mistaken argument is sometimes known as *fiscal illusion*.

The prevalence of fiscal illusion actually strengthens the case for a compensation requirement. To the extent that governments or bureaucrats consider their own budgets and not the costs to others, a compensation requirement would force them to take a wider view.

Another argument against the bill was that respecting property rights would create obstacles for regulators and bureaucrats. However, it is in the public interest that regulators and bureaucrats are required to comply with sound principles. Private citizens have to respect the property rights of others for good reasons. The same reasons apply, if anything with greater force, to those who can exercise discretion in wielding state power.

A third argument against the bill was that it might allow the courts to impede proper government or the development of public policy. However, this fear appears to lack context given that all of the following conditions apply:

- (1) The bill explicitly provided that its provisions do not infringe on a government's ability to legislate for necessary revenues and essential public interests.
- (2) Existing case law suggests that someone attempting to use an injunction to stop policy development would be unsuccessful and likely to face a charge of being in contempt of parliament.

Box 5: Telecom unbundling

But national interest must prevail. We cannot afford to be a barely middle range performer in telecommunications as a result of allowing the incumbent to continue to play a long defensive game.

Minister of finance, 2006 budget speech

In May 2006 secret government plans to take some of Telecom's property rights in its network without compensation were leaked. The announcement triggered a fall in the share price that reduced shareholder wealth by around \$3 billion in six weeks.

The government's action was immediately popular, and Telecom decided against fighting it in the courts. Yet the taking lacked key features of sound decision making.

- No due process was followed. There was no proof of wrongdoing by Telecom and it was given no opportunity to defend itself. Indeed an earlier long inquiry by the Telecommunications Commissioner into the public interest case for forced unbundling had rejected this proposition. The Commissioner's estimates of the benefits to customers (increases in consumer surplus) from forced unbundling were inconsequential compared with the losses to Telecom shareholders that actually occurred as a result of the announcement effect alone (which indicate a loss of producers' surplus). There is no evidence that the loss incurred by Telecom shareholders was offset by a compensating gain for shareholders in competing firms, such as TelstraClear. An increase in total consumer and producer surplus would be necessary to justify the decision.
- No cost-benefit assessment supported the government's decision, notwithstanding the Cabinet Manual requirement for regulatory proposals to be accompanied by such an assessment. The supporting argument did not even predict that there would be a fall in Telecom's share price.
- Inadequate consideration was given to the disincentive to invest as a result of the failure to follow due process and the measure itself.
- There was no acknowledgement that it was a taking and no consideration of the issue of compensation.

In contrast, under the proposed Regulatory Responsibility Act, the responsible minister would have had to report to parliament, inter alia, on whether unbundling was a taking and to address the issue of compensation. Budgetary provision for the payment of compensation might have been required. If similar provisions to those in the Public Works Act applied, Telecom shareholders would have had the right to have a court determine whether the taking was necessary for an essential public interest and determine the issue of compensation.

- (3) All private parties have to conduct their affairs with full exposure to the risks of court action, raising the question of why principled government policy development should be different. If government regulations really are in the national interest, it is hard to see why regulatory activity would be affected.
- (4) Many of the principles in the bill, including the compensation principle, are already Cabinet Manual requirements, so it is not obvious why they would be problematic.

- (5) Many wealthier countries have long had written constitutions that embody such principles without producing paralysing results.
- (6) It should not be a difficult task to draft in other provisions that may be necessary to alleviate any remaining concerns.

An additional point is that governments cannot act as judge and jury in their own cause in assessing whether a law complies with sound principles and whether it does or does not take vested rights. There needs to be an independent check, and the only point of debate is whether this check should be made by the courts or some other independent agency. An independent agency that upsets the government of the day is likely to get its budget cut, have a new chief executive appointed, or find its functions allocated to a tamer government agency. The courts are less vulnerable to such interference. The point made earlier that in Public Works Act situations the Environment Court alone determines whether a taking has occurred and the quantum of compensation is relevant here.

A fourth argument against the bill was that its full implications were unclear. Because they depend on what decisions future governments will take when confronted with the need to have greater respect for property rights, it is impossible to respond to this argument with any precision. But by the same token, no one could identify the full future implications of inserting Treaty of Waitangi principles into legislation, legislating for the New Zealand Bill of Rights Act or abolishing the right of appeal to the Privy Council when these decisions were taken.

The more conventional standard for a proposed law change is whether its expected benefits would exceed the costs. Given that it is widely agreed that there is currently far too much ill-justified legislation, and that existing sound principles are all too frequently ignored, there is an obvious case for introducing stronger disciplines while guarding against overkill.

A related argument against extending the compensation principle beyond real estate to all property was that it would leave too much in doubt concerning such matters as takings processes, valuation methodologies, determination of sets, identification of beneficiaries, and the criteria to be used to determine whether the payment of compensation by beneficiaries or taxpayers would be so costly as to be unreasonable or impractical. Guidance could be developed on such matters, but the multitude of precedents in written constitutions and other documents (such as the LAC guidelines) demonstrates that it is practicable to require governments to conform to the compensation principle without spelling out the detail in the same document. New Zealand could develop guidance derived from the best overseas practices, adjusted to domestic conditions.

By potentially imposing the costs of compensation on the party that is lobbying for a regulatory taking, such legislation should make it easier for politicians to resist self-serving lobbyists and harder for special interests to benefit from lobbying for regulatory advantages.

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