



People should be compensated when government diminishes their property rights, not just when they are taken away entirely, says **John Humphreys**.

## Real Property Rights

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There has never been a successful society that was not based on a system of private property rights. The reason is that private property encourages thrift, investment, sustainable management of resources and an incentive to use property effectively. Countries that have protected private property rights have experienced strong economic growth, while those places that experimented with government control (Maoist China, North Korea, Australian aboriginal homelands) remained relatively poor, with shorter lives, worse health, and fewer life opportunities.

There is also a very powerful moral argument for private property rights. The freedom to own and trade private property is not just another freedom, but it is a necessary prerequisite for controlling your own life. If we believe in a peaceful and free society, then one of the first freedoms that must be recognised is the freedom to voluntarily trade with other people, and keep what we have fairly earned. The term 'property rights' is a misnomer, as the right to trade and acquire property is



actually a basic 'human right'.

The first and most important role of a government should be to protect private property rights from violence, theft and fraud.

Under the Australian constitution, the commonwealth government has the power to compulsorily acquire private property, but they must pay fair compensation. In contrast, when the government passes regulation that negatively impacts on private property rights (called 'regulatory taking') there is no requirement for fair compensation. For the sake of equity, efficiency and good government, the government (including commonwealth, state and local) should be required to pay fair compensation for the costs of their regulation.

This has three clear benefits:

- 1) Regulations that decrease the value of private property without compensation are effectively theft, and are a significant injustice to the victim. Under current laws there is an inconsistency: if the government takes all the value of your property they must pay full compensation, but if they take part of the value of your property they aren't required to pay partial compensation. To make our laws more equitable and consistent, the government should compensate for the negative impacts of their regulation.
- 2) More secure and stable private property rights will allow people to make better decisions about the future use of their property without fear of changing government policy. Political risk adds a political risk premium to investment and business decisions, which creates significant long-term costs. Even a minor change in the political risk premium can lead to billions in lost production. The Centre for International Economics estimated that a five basis point reduction in political 'equity risk premium' could increase GDP by 0.4 per cent (\$5.6 billion). In America, economist Mark Skousen has demonstrated that the S&P 500 Index grows slower when congress is in session because of the political risk that they may pass legislation with negative consequences. In other words, stable property rights encourage economic growth.
- 3) Requiring the government to pay fair compensation gives the government the correct incentive to only regulate when the benefits of regulation exceed the costs. Currently, the government is able to take the credit for the benefits of regulation, while making other people face the costs. Consequently, there is a strong incentive for the government to over-regulate. If the government were forced to directly face the costs of their regulation, then there would be a better incentive to only pass regulation that has more benefits than costs. This would lead to fewer bad laws and less red-tape.

Protecting private property rights does not mean that people are protected from a natural change in the value of that property. If property values fall because of market forces or decisions unrelated to your property, then obviously no compensation should be paid. Regulatory compensation is only required when the government imposes a new cost that directly damages property values.

## **AN EXAMPLE: PETER SPENCER**



In January 2010, Australian farmer Peter Spencer ended his 52 day hunger strike after gaining national media attention. Peter's concern was that the NSW government had passed legislation that restricted his right to clear his land, thereby significantly decreasing the value of his land. The government did this without paying any compensation.

For the government, this was a costless exercise to reduce carbon emissions. The government was not forced to weigh the benefits with the costs, because for them there were no costs. All the costs fell on Peter Spencer and other property owners who saw their land devalued. Not only is that outcome profoundly unfair for the innocent parties forced to suffer the losses, but it leads to worse public policy. If the NSW government had to pay compensation for their regulation then the outcome would be more equitable for the private land owners; and the government would have a better incentive to ensure they were pursuing the least cost approach to achieve their goals.

### **RICHARD EPSTEIN & AMERICA**

The concept of regulatory compensation has been promoted in America by the legal scholar Professor Richard Epstein, who highlights a similar problem in American law. In 1992 the US Supreme Court ruled that the government must pay compensation if their regulation destroys all the value of land, but no compensation if the regulation only destroys 90 per cent of the value of the land. As Epstein says:

'So what the Court did was make a rule: full compensation for full wipeouts and no compensation for partial wipeouts, no matter how large.'

Epstein goes on to identify the solution. He notes that the regulatory debate is often split between those who want unlimited power of government action, and those who want a laissez-faire attitude of no regulation. He suggests an alternative where the government is free to regulate, but that they must pay a fair compensation for their regulation. That way 'we can bring ourselves to a position in which we stop anybody from being made worse off by virtue of collective impositions'.

### **THE CANADIAN EXPERIENCE**

In Canada there have been a few cases where the courts have ruled that a regulatory taking necessitated government compensation. However, there is no legislation directly addressing regulatory compensation, there is little clarity about when compensation will be paid, and many instances of regulatory takings have not resulted in compensation.

Examining the issue, J. Bruce Melville concludes:

'Determining whether compensation will be available in any particular case is extremely difficult to predict, and this author will not attempt to advance any theory to explain why some owners succeeded and others did not. Cases like *Tener* and *Manitoba Fisheries* are illustrations where compensation was available...On the other



hand, compensation was not available in Frobeen, Canada Mortgage and Housing Corp., Rascal Trucking, Genevieve Holdings and others.'

Melville also highlights the inconsistency between a full expropriation (which requires compensation) and a regulatory taking (which does not necessarily result in compensation). He notes that the Canadian government has even tried to take advantage of this inconsistency by advising councils how to control private land without having to pay compensation. This results in outcomes that are both unfair and inefficient.

While the occasional Canadian court decision to award compensation is a good start, a better approach would be to legislate to ensure that all regulatory takings result in proper compensation being paid. Not only would that ensure fairness and lower political risk, but importantly it would improve the incentives of the government to only pass regulations that provide a clear net benefit.

## **NATURAL PROPERTY VS. GOVERNMENT LICENCES**

There is an important distinction that needs to be made with regards to property rights. The original concept for property rights was to allow the voluntary and effective management of scarce resources by giving one entity the exclusive control over that resource. These are 'natural property rights'. The important thing to note is that natural property rights are a result of natural scarcity, and includes exclusive control.

However, the government also has the power to create licences that impose artificial scarcity. These licences (such as carbon credits or import quotas) have no intrinsic value, and do not provide the 'owner' with exclusive control of any property. While these government licensing schemes may or may not be good policy, they should not be confused for natural property rights.

The management of government licensing schemes is a very important topic that deserves close attention, but it is an entirely different topic that needs to be addressed separately. Changes to government licencing systems may well be linked to compensation. However, it would not be practical or desirable to make such compensation mandatory. In any case, such considerations should be dealt with separately as it would be deeply misleading to equate natural property rights with government licences. The current suggestion for regulatory compensation is intended only to apply for natural property rights, which is the cornerstone of all successful developed countries.