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Compensating and taxing land regulations

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COMPENSATING AND TAXING LAND REGULATIONS

Abstract

In this article, I synthesise the literature regarding the law and economics approach dealing with compulsory acquisition. Contrary to the status quo, I reason that regulations not amounting to an acquisition, but which adversely affect economic value, should also be compensable from an efficiency lens. This can be accommodated within the existing jurisprudence by recognising that acquisition 'gains' can also include environmental amenities, rather than only limiting these to land or property in specie by the acquiring authority. Similarly, where landowners enjoy an uplift in value from regulations, some part of this windfall profit should be taxable. The article takes reference from South Australia and Victoria's statutory frameworks, the latter primarily because of the commencement of the *Windfall Gains Tax and State Taxation and Other Acts Further Amendment Act 2021* (Vic) in July 2023. The broader principle advocated however is that more efficient and just outcomes would ensue if both acquisitions and regulations affecting land value are compensated on the same yardstick.

I Introduction

Compulsory acquisition is of perennial interest given the substantial number of government infrastructure projects in South Australia ('SA'),[1] and the consequential media attention this attracts.[2] Generally, the contentions raised ask whether the acquisition is premised on a legitimate basis, and how much should be paid for the acquired land. The former concerns questions of law, with

* PhD (Cantab); Associate Professor of Law, Singapore Management University. I am very grateful to the anonymous referees for their astute comments, as well as the excellent editorial work by the Review.

1 As the Deputy Premier Vickie Chapman MP noted, '[t]he *Land Acquisition Act 1969* establishes a process for the acquisition of land by acquiring authorities. Land is generally acquired to accommodate various road and infrastructure projects, and this process will continue to assist South Australia growing and our economy developing into the future': South Australia, *Parliamentary Debates*, House of Assembly, 12 December 2019, 9150 (Vickie Chapman).

2 Don Mackintosh, 'Compulsory Acquisition of Land: Navigating the Intersection between Executive Powers and Individual Property Rights' (2021) 43(8) *Bulletin: The Law Society of SA Journal* 24, 24.

local government having to satisfy the applicable statutory standard of purpose or legitimacy where challenged. The latter is a question of fact as the consensus yardstick is market-price compensation, where land is forcefully acquired by a state.

Compulsory acquisition and regulating what can be done on land are distinct but conceptually similar urban planning tools. However, while both may be regarded as justifiable incursions to property for the greater good, landowners are not compensated when their land is not physically acquired but made subject to an adverse rezoning plan or development restriction. Conversely, the principle that property should not be acquired 'without payment of compensation has emerged as a settled feature of legal doctrine in both common law and civilian systems since at least the seventeenth century'.[3] This is trite and intuitively satisfies normative legal and moral expectations. In this vein, the High Court of Australia has taken the position that the legislature would not intend to confiscate property without compensation unless their intention to do so is made absolutely clear.[4] Because regulations are largely not compensable, it is possible for a government to render a site less valuable before acquiring it at its prevailing market value. This conceptual overlap, discussed in more detail below, is observed in the recent amendments to South Australia's *Land Acquisition Act 1969* (SA) which permit the State to acquire underground land without compensation.[5] I refer to 'acquisitions' as physical takings of land by the state. Where land is not acquired but is subject to a change, restriction or enhancement in use through legislative or administrative discretion, I refer to these as 'regulations'.

This article argues that economic efficiency requires regulations and acquisitions to be treated similarly. Regulations which adversely affect land value should be compensable on the same yardstick as acquisitions. Conversely, regulations which enhance a site's value — perhaps by increasing the permitted intensity of the use of the land[6] — are equivalent to the state granting the landowner more *property*, and at least some of such windfalls should be taxed. In this vein, Victoria's *Windfall Gains Tax and State Taxation and Other Acts Further Amendment Act 2021* (Vic) is cited as a possible approach.

By synthesising the literature regarding the law and economics approach to compulsory acquisitions, the efficiency justifications regarding market-price compensation are presented. I seek to extend these reasonings to also justify the government paying compensation for regulatory incursions, as well as taxing unearned windfalls accruing to land from regulation. A necessary premise for my arguments is that accepting that compensation for compulsory acquisition is efficient provides the rationale to similarly conclude that compensation or taxation for land regulations is also efficient. This follows from the perspective that any

3 JW Harris, *Property and Justice* (Oxford University Press, 1996) 95.

4 *Commonwealth v Hazeldell Ltd* (1918) 25 CLR 552, 563 (Griffith CJ and Rich J).

5 *Land Acquisition Act 1969* (SA) pt 4A, as inserted by *Land Acquisition (Miscellaneous) Amendment Act 2019* (SA) s 22.

6 See *Planning, Development and Infrastructure Act 2016* (SA) s 4(1)(d).

restriction (or enhancement) of a particular right reduces (or enhances) the value of property proportionately and an acquisition, 'which deprives the owner of all rights, is simply one end of a continuum'.[7] This article's thesis is significant to both landowners and government and provides a governance framework for land regulations. While I refer to SA's and Victoria's legal frameworks, the principles outlined are broadly agnostic and apply, mutatis mutandis, in the Commonwealth and the Anglo-Saxon common law world.

Following this Introduction, Part II explains why regulations are generally not compensable, while Part III outlines the economic approach to law. Part IV analyses why: (1) the power of the State to acquire is efficient; and (2) why market-price compensation should be the yardstick for compensation. Part V presents Victoria's windfall gains tax ('WGT'), arguing that efficiency rightly cuts both ways and just as efficiency is promoted by taxing rezoning decisions which give landowners an uplift, compensation should ensue if planning decisions render land less valuable. Part VI concludes.

II Land Regulations Are Largely Not Compensable

Given SA's historic legacy of pioneering the Torrens system of recording land titles in the common law world, exacting land use control has long been a feature of the State's planning law landscape.[8] Thus, planning regulations, rules, decisions, or discretion dictate what can be built or done on the land.[9] It is evident that all things being equal, a site where more intensive use is permitted is worth more than a site where this is not permitted. Equally, if a site's development potential is reduced by regulation, perhaps because of a change of zoning, such property has suffered financial degradation. Despite the stark effects of such discretions, government is not obliged to compensate where planning decisions adversely affect land value. Indeed in the Commonwealth context, there is high authority that compensation is only triggered when the acquirer obtains an interest in land,[10] as '[t]he extinguishment, modification or deprivation of rights in relation to property does not of itself constitute an acquisition of property'.[11] Thus, legislation which 'adversely

7 Thomas J Miceli, *The Economic Theory of Eminent Domain: Private Property, Public Use* (Cambridge University Press, 2011) 113.

8 Anthony P Moore, 'Environmental Decision-Making: South Australia's Planning Authorities' (1975) 5(3) *Adelaide Law Review* 260, 262. Notably, SA's *Planning and Design Code* is a lengthy tome comprising some 5,000 pages: State Planning Commission, *Planning and Design Code* (No 2023.6, 27 April 2023).

9 In SA, the *Planning and Design Code* (n 8) is the single source of planning policy. It is given legal force as a public document via the *Planning, Development and Infrastructure Act 2016* (SA) s 72(3).

10 *Commonwealth v Tasmania* (1983) 158 CLR 1, 145–6 (Mason J) ('*Tasmanian Dam Case*').

11 *Mutual Pools & Staff Pty Ltd v Commonwealth* (1994) 179 CLR 155, 185 (Deane and Gaudron JJ).

affects or terminates a pre-existing right' that a landowner enjoys without an acquisition does not bring the *Australian Constitution*'s protection of the acquisition of property on other than just terms into play.[12] In SA, the regulation of land use via a Development Plan would not attract compensation.[13] Conversely, there are also no universal principles that require increases in land value to be taxed where regulation or planning permission renders a site more valuable, though additional levies are imposed when a site is rendered more valuable by the Valuer-General. One way my suggested arguments could be accommodated within the jurisprudence would be to characterise deprivation of a landowner's property rights to land as environmental amenity 'gains' on the part of society (acting through the agency of the acquiring authority).

In *Trade Practices Commission v Tooth & Co Ltd*, Stephen J noted the 'universality of the problem' in relation to distinguishing between compensable acquisitions and non-compensable regulations.[14] Academically, Rachelle Alterman presents the first large-scale comparative research devoted entirely to regulatory takings.[15] Alterman's collection reviews 14 jurisdictions across both common law and civilian jurisdictions to show that globally, compensation for regulations affecting land values is typically absent and at best minimal.[16] In the Australian context, A Lanteri similarly observes that '[i]n cases where the loss is occasioned by restrictions on the use of the claimant's land imposed by legislative controls, relief is rare'.[17] This is true as exhibited in both SA and Victoria.

A *Overview of South Australia and Victoria*

1 *South Australia*

Under South Australian law, the right to compensation is restricted to situations when the government acquires a legal or equitable estate or interest in the land, or when the government physically takes possession or occupies land.[18] As with other jurisdictions in Australia, market value is the yardstick of compensation. In interpreting the statutory phrase 'the actual value of the subject land',[19] Blue J in *Nelson v*

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12 *Tasmanian Dam Case* (n 10) 145 (Mason J), quoted in *Australian Tape Manufacturers Association Ltd v Commonwealth* (1993) 176 CLR 480, 499–500 (Mason CJ, Brennan, Deane and Gaudron JJ); *Australian Constitution* s 51(xxxi).

13 *Tavitian v City of Playford* (2014) 202 LGERA 87, 96 [26] (Kourakis CJ, Blue J agreeing at 100, Stanley J agreeing at 100).

14 (1979) 142 CLR 397, 415.

15 Rachelle Alterman (ed), *Takings International: A Comparative Perspective on Land Use Regulations and Compensation Rights* (American Bar Association, 2010).

16 Ibid ch 1.

17 A Lanteri, 'Compensation under the Town and Country Planning Act 1961 (Vic)' (Pt I) (1980) 12(3) *Melbourne University Law Review* 311, 313.

18 See *Land Acquisition Act 1969* (SA) ss 6(1) (definition of 'Authority'), 22B, 29.

19 Ibid s 25(1)(b)(i).

Commissioner of Highways (SA) held that this refers to 'its market value in accordance with the definition in *Spencer v The Commonwealth*, namely, "what would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell"'.[20] No compensation is payable where land is rendered less valuable by regulation. Unlike Victoria (from 2023),[21] there are equally no 'windfall gains' taxes or betterment levies if a site is rendered more valuable.[22] Under s 163(6)(e) and pt 13 div 1 sub-div 7 of the *Planning, Development and Infrastructure Act 2016* (SA), the costs of a defined infrastructure project may be recovered through a Ministerial charge on land within a designated growth area, without the affected landowners having to agree to the charge. Essentially, the infrastructure improvements are co-paid by landowners within the defined area. As the infrastructure improvements enhance the site's market value, these contributions are defensible. However, such charges are distinct from imposing a betterment levy on a particular site where development potential has been enhanced.

As mentioned above, amendments in July 2020 to the *Land Acquisition Act 1969* (SA) allow the government to acquire underground land without paying compensation[23] — compensations are thus limited to physical takings of the surface of the land. By essentially defining underground land to have no economic value to the landowner, the SA Government can be said to have executed a State-wide acquisition. Treasurer Rob Lucas MP candidly stated prior to the amendments taking effect:

> In South Australia, landowners also own the underground parts of their land with no limit as to depth, and therefore an acquisition needs to take place in order to tunnel under private property …
>
> The Act will be amended to provide that no compensation will be payable for underground acquisitions, as landowners will not suffer any detriment or loss of enjoyment of their land.[24]

It is difficult to see why landowners would not suffer a loss. As Tom Koutsantonis MP rightly observed, having a tunnel underneath one's property would have an

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20 [2020] SASC 109, [80] (citations omitted), quoting *Spencer v Commonwealth* (1907) 5 CLR 418, 432 (Griffith CJ). See also *Nelson v Commissioner of Highways [No 2]* [2023] SASC 7, [71] (Blue J).

21 See below nn 162–3 and accompanying text.

22 SGS Economics & Planning, *Technical Paper on Value Capture* (Final Report, Infrastructure Australia, September 2016) 49 <https://www.infrastructureaustralia.gov.au/sites/default/files/2019-06/sgs_technical_paper_on_value_capture-september_2016.pdf>.

23 *Land Acquisition Act 1969* (SA) pt 4A, as inserted by *Land Acquisition (Miscellaneous) Amendment Act 2019* (SA) s 22.

24 South Australia, *Parliamentary Debates*, Legislative Council, 31 October 2019, 4820 (Rob Lucas, Treasurer).

adverse impact on its real estate value.[25] Lucas was also inaccurate to state that the prior silence of the *Land Acquisition Act 1969* (SA) 'on the question of compensation for underground acquisitions' caused 'legal and operational confusion'.[26] It follows from his own logic that since landowners own underground parts of their land with no limit as to depth, the right to compensation would naturally have followed prior to the amendments. The quantum of compensation would then be a question of fact, and it may well be that where the underground land acquired is sufficiently deep below the surface, no economic loss to the landowner results.

As it is inaccurate to state that the loss of underground land would never cause 'detriment or loss of enjoyment'[27] to landowners, no matter how shallow below the surface such an acquisition takes place, it would be interesting if such an acquisition were governed by the *Australian Constitution*, supposing there was a sufficient nexus between the acquisition in SA and the Commonwealth.[28] Referring to the placitum under s 51(xxxi) of the *Australian Constitution* prohibiting acquisition of property other than on just terms in *Minister of State for the Army v Dalziel*, the High Court of Australia held:

> Property, in relation to land, is a bundle of rights exercisable with respect to the land. The tenant of an unencumbered estate in fee simple in possession has the largest possible bundle. But there is nothing in the placitum to suggest that the legislature was intended to be at liberty to free itself from the restrictive provisions of the placitum by taking care to seize something short of the whole bundle owned by the person whom it was expropriating.[29]

As it stands, the South Australian position is a significant derogation of the *cuius est solum* principle which, while shown to be untenable as an absolute principle, nevertheless presents the starting position of common law land rights.[30] Troublingly, the

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25 South Australia, *Parliamentary Debates*, House of Assembly, 15 October 2019, 7711 (Tom Koutsantonis). Koutsantonis was appointed Minister Infrastructure and Transport on 24 March 2022: South Australia, *Government Gazette*, No 19, 24 March 2022, 894.

26 South Australia, *Parliamentary Debates*, Legislative Council, 31 October 2019, 4820 (Rob Lucas, Treasurer).

27 Ibid.

28 Sean Brennan observes that the federal constitutional provision is engaged when the land is acquired in a state by the Commonwealth (either singly or jointly), where the Commonwealth imposes as a condition of state funding a requirement that the state acquire property compulsorily, and where the Commonwealth exercises its power to vest property in another person or entity within the state: Sean Brennan, 'Section 51(xxxi) and the Acquisition of Property under Commonwealth–State Arrangements: The Relevance to Native Title Extinguishment on Just Terms' (2011) 15(2) *Australian Indigenous Law Review* 74, 75–76.

29 (1944) 68 CLR 261, 285 (Rich J).

30 In *Bocardo SA v Star Energy UK Onshore Ltd* [2011] 1 AC 380, 398 [26], Lord Hope held that the maxim in relation to underground land rights 'still has value in English law as encapsulating, in simple language, a proposition of law which has commanded general acceptance'.

Land Acquisition Act 1969 (SA) does not define what 'underground land' is, and there is no *de minimis* provision for reasonable enjoyment of subterranean space.[31] At common law, *Bernstein of Leigh (Baron) v Skyviews & General Ltd* establishes the principle that rights over airspace extend to a height 'necessary for the ordinary use and enjoyment' of the landowner.[32] While there is no unitary position on how 'ownership and use of underground land ought to be regulated',[33] applying the rights over airspace test of 'ordinary use and enjoyment' to underground land is not unprincipled. The Australian High Court has recognised 'the elementary principle of the common law that a freeholder … is entitled to take from his land anything that is his. Except for those minerals which belong to the Crown, the soil and everything naturally contained therein is his.'[34] In this vein, the *Land Acquisition Act 1969* (SA) can be said to redefine the meaning of land, if the principle that all acquisitions of land should be compensable is maintained. This observation again demonstrates the overlap between acquisition and regulation.

2 *Victoria*

Apart from situations where land is physically acquired or occupied by the government,[35] under Victorian law, there is an additional ground when compensation arises — when the land is 'expressly'[36] stated to be reserved or gazetted for a public purpose.[37] As this provision merely accelerates compensation for landowners whose land has been identified for a public taking, regulations or planning decisions which render land less valuable per se are not compensable. Under s 98(2) of the *Planning and Environment Act 1987* (Vic), an owner or occupier of land may claim compensation from the State 'for financial loss suffered as the natural, direct and reasonable consequence of a refusal by the responsible authority to grant a permit to use or develop the land *on the ground that the land is or will be needed for a public*

31 Cf *State Lands Act 1920* (Singapore) s 9 which sets aside a depth of 30 metres below the surface for the landowner's reasonable use and enjoyment of the land. Thus, acquisitions within that depth are compensable under Singapore law. The only mention of a depth reference is found in *Land Acquisition Act 1969* (SA) s 26EA(1) where it is stated that the acquiring authority must prepare and submit to the Public Works Committee a report where the land to be acquired is for the purpose related to subterranean works less than 10 metres below the surface.

32 [1978] 1 QB 479, 488 (Griffiths J).

33 Elaine Chew, 'Digging Deep into the Ownership of Underground Space: Recent Changes in espect of Subterranean Land Use' [2017] (March) *Singapore Journal of Legal Studies* 1, 2.

34 *Wade v New South Wales Rutile Mining Co Pty Ltd* (1969) 121 CLR 177, 185 (Windeyer J).

35 *Land Acquisition and Compensation Act 1986* (Vic) s 26, 47.

36 *Planning and Environment Act 1987* (Vic) ss 98(1A)–(1B).

37 See ibid ss 98(1)–(1B).

purpose'.[38] The jurisprudence demonstrates that the italicised words are construed with exacting strictness. In *Minister for Planning v S B Partitions Pty Ltd*,[39] the Victorian Supreme Court dealt with a case where some land was proposed to be reserved for a road on the communicated basis that granting the planning permission sought by the landowner would prevent the proper future planning of the area.[40] As the plan was subject to statutory public participation procedures that had not been completed, Osborn J held that at the date of the planning refusal it was apparent that while 'the land may be required for a public purpose', it was inconclusive 'whether it was or would be so needed'.[41] Accordingly, the Court held that the refusal to grant the development permit 'did not give rise to a right to compensation under s 98(2)' of the *Planning and Environment Act 1987* (Vic).[42] A fortiori, where a height or development restriction is imposed to enhance environmental amenities but where the land itself will not be used for a public purpose, no compensation is payable.

The Victorian Supreme Court has observed that while planning control affects the use and enjoyment of land, planning matters do not amount to defects in title as planning does not affect any estate or interest in land.[43] In contrast, it has been argued that '[t]he interest that underpins the right to property is the interest we have in purposefully dealing with things'[44] as property is the interest we have in the use of things.[45] If that were true then even on a conceptual basis when land is regulated, a landowner has lost property because their interest to determine the use of their land exclusively has been reduced. Indeed, Paul Babie rightly states that 'planning law is, in *itself*, property'.[46] Regardless, it is reiterated that an efficiency rather than a conceptual lens is adopted by this article. In other words, rather than asking whether there are conceptual differences between a physical acquisition and regulatory incursions to

38 *Planning and Environment Act 1987* (Vic) s 98(2) (emphasis added). The phrase 'the natural, direct and reasonable consequence' in s 98 of the *Planning and Environment Act 1987* (Vic) was held by Batt J in *Halwood Corporation Ltd (admin apptd) v Roads Corporation* (1995) 89 LGERA 280, 302–3 ('*Halwood*') to 'connote a very close and limited connection between' the event giving rise to the compensation and the financial loss suffered. In particular, the word 'direct' stood out as being 'eloquent of the immediacy' required between the imposition of the land reservation and the financial loss suffered: *Halwood* (n 38) 303–4. *Halwood* was cited with approval by the Victorian Supreme Court in *Provans Timber Pty Ltd v Secretary, Department of Economic Development, Jobs, Transport and Resources* [2019] VSC 390, [221] (Emerton J).

39 [2009] VSC 333.

40 Ibid [10]–[14].

41 Ibid [19].

42 Ibid [54].

43 *Yammouni v Condidorio* [1959] VR 479, 487–8.

44 JE Penner, *The Idea of Property in Law* (Oxford University Press, 1997) 70–1.

45 Ibid 49.

46 Paul Babie, 'Three Tales of Property, or One?' (2016) 25(4) *Griffith Law Review* 600, 612 (emphasis in original).

land justifying their disparate treatment,[47] the question posed is whether efficiency requires both diminutions in land value to be made compensable.

B *Regulatory Land Takings in the United States — An Outlier*

It has been observed that in drafting the constitutional property clause, the Australian founders were concerned to limit the acquisition power, just as the Americans had done with their Fifth Amendment.[48] Indeed, in *Wurridjal v Commonwealth*, Kirby J stated that s 51(xxxi) was inspired by the Fifth Amendment to the *United States Constitution*.[49] This is even though the Australian acquisition clause is worded as a grant of legislative power, rather than being expressed as a specific limitation on power — the takings clause of the Fifth Amendment reads: 'nor shall private property be taken for public use, without just compensation'.[50]

Notwithstanding this, while the compensation differences between acquisitions and regulations existing in SA and Victoria are in line with other parts of the Commonwealth and the common law world, the position in the United States ('US') is a key exception to the general position that regulations affecting land value are generally not compensable. The peculiarities regarding the US law of regulatory takings have arisen because of the overly expansive yet restrictive position adopted by the US Supreme Court. In a nutshell, any regulation could qualify as a Fifth Amendment taking under the property clause, so long as the Constitutional Court considers that the effect of the regulation sufficiently constitutes a taking. Such 'regulatory takings' are only compensable if the regulation goes too far, essentially depriving the landowner of all or nearly all the land's economic benefits. The test is pragmatic rather than principled, being limited to situations where the regulation results in complete or very substantial loss in land value.

In *Palazzolo v Rhode Island* for instance,[51] even a 93.7% diminution in land value was held by the Court to be insufficient to require compensation.[52] In the US context, the government appears to compensate for physically taking land but not when regulating land because of practical considerations related to causation and administrative feasibility. Examples cited by Richard Posner include the difficulties in identifying and compensating everyone whose properties were affected by government regulation affecting the price of heating oil[53] — the rationale being that

47 See Edward SW Ti, 'Justice as Fairness: A Rawlsian Perspective in Compensating Regulatory Land Takings' (2022) 14(2–3) *Journal of Property, Planning and Environmental Law* 45.

48 Duane L Ostler, 'The Drafting of the Australian Commonwealth Acquisition Clause' (2009) 28(2) *University of Tasmania Law Review* 211, 211.

49 (2009) 237 CLR 309, 425 [306].

50 *United States Constitution* amend V.

51 533 US 606 (2001).

52 See ibid 615–6, 632.

53 Richard Posner, *Economic Analysis of Law* (Wolters Kluwer, 9th ed, 2014) 60.

higher market value would be attributable to better insulated homes if energy prices were high, and vice versa. Another example Posner gives is a zoning ordinance forbidding the development of land used exclusively for residential use to prevent, for instance, one landowner from creating a pigsty on their land.[54] Certainly, it would be going too far to argue that every regulation affecting land value should attract compensation. It would be administratively unworkable and therefore economically inefficient to isolate and quantify every state-sanctioned externality that affected land values. The legitimate concern is that in the context of determining when compensation is due, defining 'regulation' in its widest sense would indeed mean that the 'progress of civilised society would effectively grind to a halt if every minor regulatory act of the state provoked an immediate entitlement to some carefully calculated cash indemnity for the affected landowner'.[55]

Outside of the US context, these implementation problems may be resolved by properly defining what a land regulation is. Regulations may be understood to mean planning rules or discretions which directly impinge or enhance the economic value of land without involving a physical taking (or addition) of land.[56] Accordingly, regulating the price of heating oil or interest rates are not land regulations, though they certainly impact real estate values. For zoning ordinances, these should be limited to only when the regulation adversely affects the lot in question, or those lots within a statutorily defined boundary. While this is consistent with s 55(2)(a)(iii) of the *Lands Acquisition Act 1989* (Cth), which limits compensation to the value of the land taken and any reduction in value of the remaining (contiguous) property of the landowner, it would also include situations where the development potential of a site has been reduced.

There are many approaches to determine why rules operate differently in two different albeit similar contexts. The purpose of this article is not to argue for the transplantation of American takings jurisprudence to Australia. Neither am I arguing for or against either compulsory acquisition or the regulation of land. Instead, I highlight that there is a tangible outcome difference (between compensation and non-compensation) when land is acquired and when land is regulated, even where the economic loss suffered by the landowner may be the same. Second and principally, I argue that from a normative perspective, efficiency outcomes are enhanced if compulsory acquisition and adverse regulations are both compensable and, in the case where regulation enhances the value of land, there is the imposition of a land value-gain tax.

III An Economic Approach to Law

Speaking extra-curially, Kirby J has remarked that 'amongst some of those who now hold (or have held) senior judicial office, there is occasionally an uncomfortable

54 Ibid.

55 Kevin Gray, 'Land Law and Human Rights', in Louise Tee (ed), *Land Law: Issues, Debates, Policy* (Routledge, 2014) 211, 223. See also *Pennsylvania Coal Co v Mahon*, 260 US 393, 413 (Holmes J) (1922).

56 See Edward Seng Wei Ti, 'Compensating Regulation of Land: UK and Singapore Compared' (2019) 11(2) *Journal of Property, Planning and Environmental Law* 135, 135.

feeling that the economic implications of judicial decisions ought to be given more attention than they typically are'.[57] Arguing that a 'filter' of economic analysis to aid decision-making would be useful, the learned Justice laments that 'the conventional and traditional way of our system' in Australia has led to courts largely shying away from dealing with a case's economic implications.[58] David Partlett similarly notes that while '[t]he lens of economic analysis has been used extensively in the United States to examine' legal rules and doctrines, its use has been limited 'elsewhere in the common law world'.[59] Justice Kirby reminds us of the practical benefits of legal values that maximise benefits and minimise costs.[60] While these comments were made in the context of judge-made case law,[61] it is equally important to have a law and economics framework to analyse regulations, particularly those which govern something as critical as property ownership.

Legal doctrinal concepts based on justice and fairness are the traditional prisms through which law is viewed.[62] Thus, Alan must compensate Bob if Alan causes attributable harm to Bob. This traditional approach does not, however, seek to maximise net utility. The introduction of economic concepts to augment the study of jurisprudence allows rules to be constructed that seek to maximise efficiency.[63] These are not based on traditional concepts of justice and fairness *inter partes* per se, although it could be argued that efficient outcomes are ultimately what is most just and fair for society. As Kirby J notes, an important challenge facing Australian jurists is reconciling 'the universal human rights movement in the law' with law and economics.[64]

In a marked departure from the legal approach that looks at where the cause of harm runs from,[65] Ronald Coase innovatively sought the establishment of legal rules that

57 Justice Michael Kirby, 'Law and Economics — Is There Hope?' (Speech, Law School of the University of Melbourne, 4 July 1997) <https://www.hcourt.gov.au/assets/publications/speeches/former-justices/kirbyj/kirbyj_lawecon.htm>.

58 Ibid.

59 David Partlett, 'Economic Analysis and Some Problems in the Law of Torts' (1982) 13(3) *Melbourne University Law Review* 398, 398.

60 Kirby (n 57).

61 Ibid.

62 See Nicholas Mercuro and Steven G Medema, *Economics and the Law: From Posner to Post-Modernism* (Princeton University Press, 1997) 13.

63 See also ibid.

64 Kirby (n 57).

65 It is hoped that both his critics (see, eg: Richard A Posner, 'Nobel Laureate: Ronald Coase and Methodology' (1993) 7(4) *Journal of Economic Perspectives* 195; Dan Usher, 'The Coase Theorem Is Tautological, Incoherent or Wrong' (1998) 61(1) *Economics Letters* 3) and supporters alike (see, eg, Robert C Ellickson, 'The Case for Coase and against "Coaseanism"' (1989) 99(3) *Yale Law Journal* 611) will at least agree that Coase's economic analysis of law is one that seeks to promote economic efficiency.

instead encourage efficiency in the assignment of costs and liabilities.[66] He believed that economic actors that are able to minimise their transaction costs enhance efficiency.[67] To minimise transaction costs Coase argues that the assignment of liabilities should not simply be based on who harmed whom; rather, the goal is to identify and avoid the more serious harm[68] so that there is a greater net value in any exchange which, at least in theory, could be split, leaving all interested parties better off.[69] As an economic term 'efficiency' may be defined as process outcomes that tend toward maximising output for any given input.[70] The economic approach to law holds that from a societal perspective, laws that bring increased net wealth, or to use economic nomenclature, bring us closer to Pareto[71] or Kaldor–Hicks[72] improvements, are more efficient than those that do not.

Robin Paul Malloy notes, 'it is a misconception to believe that economics can help us identify the most efficient legal rule or the optimal-rule choice in a given set of circumstances', nevertheless, '[*s*]*ome choices can be shown to be suboptimal and these can be eliminated*'.[73] Thus, I synthesise the literature to evaluate the relative efficiencies pertaining to compulsory acquisitions and regulation vis-à-vis compensation. The standard law and economics assumption that deems actors to be rational *homo economicus* is adopted.

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66 See RH Coase, 'The Problem of Social Cost' (1960) 3 (October) *Journal of Law and Economics* 1, 2.

67 Ibid 27, 32–4. In referring to the costs of contracting, Coase states: 'There are negotiations to be undertaken, contracts have to be drawn up, inspections have to be made, arrangements have to be made to settle disputes, and so on': RH Coase, 'The Institutional Structure of Production' (1992) 82(4) *American Economic Review* 713, 715.

68 Coase, 'The Problem of Social Cost' (n 66) 2.

69 Kaldor–Hicks efficiency, described below n 72 (or as described by Posner (n 53) 14, wealth maximisation) is thus the goal.

70 Robert Cooter and Thomas Ulen, *Law & Economics* (Berkeley Law Books, 6th ed, 2016) 13 state that a production process is 'productively efficient if either of two conditions holds': (1) '[i]t is not possible to produce the same amount of output using a lower-cost combination of inputs'; or (2) '[i]t is not possible to produce more output using the same combination of inputs'.

71 Pareto efficiency is the allocation of resources in which it is it is impossible to make any one individual better off without making at least one individual worse off. A Pareto improvement is one where at least one individual is better off and no individual is worse off: Posner (n 53) 14.

72 The Kaldor–Hicks criterion holds that an outcome is an improvement if those that are made better off could in principle compensate those that are made worse off, so that a Pareto improving outcome could (though does not have to) be achieved. Kaldor–Hicks efficiency is achieved when no further Kaldor–Hicks improvement can be made: Posner (n 53) 14–15.

73 Robin Paul Malloy, 'Economics as a Map in Law and Market Economy' (2009) 24(1) *Research in Law and Economics* 3, 8 (emphasis added).

IV Acquisitions, Regulations and Efficiency

Many scholars have considered the issue of efficiency, or the maximisation of aggregate utilities, vis-à-vis compulsory acquisitions. A review of the literature unpacks two questions: (1) is it more efficient than not to allow the government to exercise the power of compulsory acquisition? (2) if so, should compensation be paid for compulsory acquisition — and if so — how much? In arguing that regulations, like acquisitions, should be compensable, I am thus relying on how these two questions have been answered in order to assert 'a connection between the failure to compensate landowners and the generation of some quantum of disutility that would not exist' if compensation were made.[74]

A *The Power Compulsorily To Acquire Enhances Efficiency*

To a rational landowner, the economic value of land and its utility are interchangeable and would be determined by the sum of all future income streams or rent that can be generated from the property, discounted to its present value. This is the standard approach adopted to appraise the value of investment property, which in theory would also be the market price. Ignoring transaction costs, a utility-maximising individual would sell their land if the net present value of all future income generated is matched or exceeded by the offer price. Utility from land is, however, sometimes subjective — owners may view it as a status good or attach sentimental value to their property.[75] 'Therefore, the price of land has two components: an objective component that is relatively easy to measure and a subjective component that is difficult to measure.'[76]

Compulsory acquisition assigns no value to any compensation for 'dignitary harms' suffered by property owners who feel unsettled or vulnerable in the compulsory acquisition process.[77] At common law, Lord Romer held that compensation at 'market value' is referenced on an objective basis, with the 'disinclination of the vendor to part with his land' disregarded.[78] This is largely true under both the South Australian and Victorian statutes. Section 25(1)(g) of the *Land Acquisition Act 1969* (SA) states in relation to compensation that 'no allowance shall be made on account of the fact that the acquisition is effected without the consent, or against the will, of any person'. In interpreting that subsection, a Full Court of the South Australian State Supreme Court held that psychiatric injury stemming from having one's land

74 Gregory S Alexander and Eduardo M Peñalver, *An Introduction to Property Theory* (Cambridge University Press, 2012) 162–3.

75 Sanjoy Chakravorty, *The Price of Land: Acquisition, Conflict, Consequence* (Oxford University Press, 2013) 140, 142–3.

76 Ibid 143.

77 See Nicole Stelle Garnett, 'The Neglected Political Economy of Eminent Domain' (2006) 105(1) *Michigan Law Review* 101, 109.

78 *Vyricherla Narayana Gajapatiraju v The Revenue Divisional Officer, Vizagapatam* [1939] AC 302, 312 (Lord Romer for the Court).

acquired is not compensable under this Act.[79] However since 2 July 2020, s 25A of this Act provides for a statutory solatium, albeit only for owner-occupiers whose principal place of residence is acquired.[80]

Under the Victorian statute, the general principles on which compensation for acquisition is based include not just the market value of the land,[81] but also 'any special value to the claimant on the date of acquisition'.[82] While this does not take into account any disinclination to part with the land, it nonetheless has a subjective element as 'special value' is defined to mean 'the value of any pecuniary advantage, in addition to market value, to a claimant which is incidental to his ownership or occupation'.[83] In *Spyropoulos v Commissioner of Highways*, Parker J held that 'an emotional attachment to land d[oes] not entitle a dispossessed owner to compensation under the head of special value'.[84] Nonetheless, the slight concessions in both SA and Victoria present a response to Posner's arguments that the heterogeneous nature of real estate means that a land 'parcel in the hands of a particular owner will generally yield [that owner] an idiosyncratic value that is on top of the market value'.[85] The Acts surveyed can thus be said to adopt a more nuanced approach than frameworks that look solely to market value for guidance.

Compulsory acquisition nevertheless creates disutilities as landowners may have emotional attachments to their property and no statutory scheme may be able to fully capture these sentiments. Landowners may also be disadvantaged because they not only cannot set the sale price, but they also lose the right to determine when the property should be acquired. While s 23(1) of the *Land Acquisition Act 1969* (SA) directs the acquiring authority and landowner to 'negotiate in good faith', this pertains only to the compensation payable and not whether the acquisition will take place. This may lead to compulsory acquisition inevitably taking place when property prices are suppressed. In Singapore, state planners have observed that even if not by intentional design, acquisitions 'generally occur during an economic slowdown when public [infrastructure] projects are often introduced to pump-prime the economy'.[86] Owners may thus lose out as they may be forced to relinquish their property 'when land prices are low or at a time when it is inconvenient for the owner

79 *Anderson v Commissioner of Highways* (2019) 134 SASR 543, 561 [65] (Stanley J, Kelly J agreeing at 544 [1], Blue J agreeing at 544 [2]).

80 Section 25A(4) provides for an additional payment of up to the lesser of $50,000 or 10% of the market value of the land: *Land Acquisition Act 1969* (SA) s 25A(4), as inserted by *Land Acquisition (Miscellaneous) Amendment Act 2019* (SA) s 20.

81 *Land Acquisition and Compensation Act 1986* (Vic) s 41(1)(a).

82 Ibid s 41(1)(b).

83 Ibid s 40 (definition of 'special value').

84 (2018) 234 LGERA 467, 476 [42].

85 Posner (n 53) 56.

86 Bryan Chew et al, 'Compulsory Acquisition of Land in Singapore: A Fair Regime?' (2010) 22 (Special Issue) *Singapore Academy of Law Journal* 166, 177.

to vacate [their] property'.[87] Seen in this light, the market value benchmark not only ignores sentimental value, but may lead 'to an excessive transfer of private property to public use because the government does not have to pay the true opportunity cost of the resources it acquires'[88] as the external assembly gains from joining parcels of land goes to the condemnor.[89] As Douglas J states in *United States v Causby*, '[i]t is the owner's loss, not the taker's gain, which is the measure of the value of the property taken'.[90]

Despite these inherent weaknesses, Thomas Miceli[91] and Posner[92] separately point out that the power to acquire is justified on an efficiency basis due to the problem of holdout. When the state endeavours to acquire land for a public project, 'individual owners whose land is necessary for the project acquire monopoly power in their dealing with the government'.[93] This allows them to 'hold out for prices in excess of their true (subjective) valuation of the land' since it would be too costly or even impossible for government to seek alternative locations or abandon the project.[94] Rational landowners will be reluctant to declare their true subjective valuation, and even if they did state a price, it would be impossible for the state to know if such an account were true. Therefore, Yun-chien Chang's suggestion for 'full compensation' which he defines as 'fair market value plus "(unique) subjective value" … derived from, say, the memory of growing up in the family house',[95] may prove unwieldly. Notwithstanding, while valuing an acquired property based wholly on its

87 Robin Goodchild and Richard Munton, *Development and the Landowner: An Analysis of the British Experience* (George Allen and Unwin, 1985) 35.

88 Thomas J Miceli, *Economics of the Law: Torts, Contracts, Property, Litigation* (Oxford University Press, 1997) 139 ('*Economics of the Law*').

89 In contrast to this benchmark adopted by governments, Richard Epstein discusses the possibility of using project value compensation, meaning condemnees share the enhanced value arising from the public project facilitated by eminent domain: see Richard A Epstein, *Takings: Private Property and the Power of Eminent Domain* (Harvard University Press, 1985) 3–5.

90 328 US 256, 261 (1946).

91 Miceli, *Economics of the Law* (n 88) 138.

92 Posner (n 53) 56.

93 Miceli, *Economics of the Law* (n 88) 138.

94 See ibid.

95 Yun-chien Chang, *Private Property and Takings Compensation: Theoretical Framework and Empirical Analysis* (Edward Elgar Publishing, 2013) 5, citing Lawrence Blume and Daniel L Rubinfeld, 'Compensation for Takings: An Economic Analysis' (1984) 72(4) *California Law Review* 569, 619; Lee Ann Fennell, 'Taking Eminent Domain Apart' [2004] (Winter) *Michigan State Law Review* 957, 963–5; Thomas J Miceli and Kathleen Segerson, *The Economics of Eminent Domain: Private Property, Public Use, and Just Compensation* (Now Publishers, 2007) 20; Michael Heller and Rick Hills, 'Land Assembly Districts' (2008) 121(6) *Harvard Law Review* 1465, 1475.

subjective value cannot be the guiding principle, jurisdictions such as SA provide for a solatium to partially mitigate subjective losses.[96]

Since holdouts are a form of transaction cost which could very easily spiral uncontrollably, the state's power compulsorily to acquire land at market value is the lesser evil on an efficiency scale. Thus, the metamorphosis of what is ordinarily a property rule into that of a liability rule[97] — in relation to an individual landowner's property vis-à-vis the state — is justified because of the unique location of each plot of land and the need to acquire contiguous lots for the greater good of society. In short, the transaction costs to maintain land ownership based strictly on a property rule are debilitating. Despite the subjective unfairness to individual landowners, therefore, the power of compulsory acquisition, if not wielded capriciously, enhances efficiency. To prohibit it altogether would mean that government projects would be curtailed, either by sentimental landowners who would not sell for any price, or by landowners who would set extortionate prices for their property.

B *It Is Efficient To Pay Compensation for Acquisitions*

Requiring the government to treat all land with a property entitlement and therefore compensate landowners for the entire subjective value they attribute to their property is unworkable and will lead to strategic holdouts. Market value should thus be the *upper limit* paid when a state exercises its right compulsorily to acquire property. I thus consider whether compensation could bring about greater efficiency than a no-compensation policy. If that is accepted, the contention that compensation for regulatory takings should also be paid would likewise have force.

It has been observed that '[t]yrannies sometimes finance government and enrich officials by taking property from individuals' without compensation.[98] This may be seen as a form of ad hoc, narrow base taxation.[99] Requiring compensation for compulsory acquisition can therefore be viewed as a device for channelling government finance into broad base taxation (eg income tax, consumption tax, corporate tax, etc) rather than uncompensated acquisitions.[100] No compensation or low compensation is tantamount to an arbitrary tax in respect of certain landowners. Disutility emerges because of the skewed wealth outcomes post-acquisition. As mentioned earlier, the SA statute now allows the SA Government to acquire underground land without compensation.[101] Though universally affecting all landowners in principle, only a small subsection of owners will have their property acquired.

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96 Such special concessions include moving costs, inconvenience, etc, as exhibited in SA's statutory solatium: see *Land Acquisition Act 1969* (SA) s 25A.

97 Guido Calabresi and A Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85(6) *Harvard Law Review* 1089, 1092–3.

98 Cooter and Ulen (n 70) 175.

99 See generally ibid 175–6.

100 See ibid 175.

101 See above Part II(A)(1).

The non-compensation for underground land may thus lead to economic disutilities for some landowners, especially to those who are subject to shallow subterranean takings just beneath their surface.

Robert Cooter and Thomas Ulen explain that while any kind of tax 'distorts people's incentives and causes economic inefficiency', broad base taxation 'distort[s] far less than uncompensated takings' because economic actors cannot change their behaviour to avoid such taxes.[102] In other words, 'goods should be taxed at a rate inversely proportional to their elasticity of demand and supply'.[103] Since uncompensated acquisitions have a very narrow base, landowners may go to great expense, such as engaging in protracted litigation, to prevent the government from taking away their property, with the possibility of diverting effort and resources from societal wealth production.[104] Assuming the total tax that needs to be raised is a constant, broad base taxation results in greater efficiency than uncompensated land takings.[105] Posner explains it succinctly — taxes that take 'a little bite out of many hides' are more efficient than the compulsory acquisition 'tax' that 'takes a big bite out of a few'.[106] Accordingly, small adjustments to broad based taxes such as property, income or consumption tariffs affecting a broad base of taxpayers lead to more efficient outcomes than piecemeal, uncompensated land acquisitions.

Accepting these arguments depends, at least in part, on the worldview one takes of government; in other words, what motivates government action. Like all economic models, conclusions are dependent on assumptions. As stated earlier, this article assumes that individuals act rationally. While the vast bulk of literature also assumes that individuals are *homo economicus*, the view is not unanimous. Cass Sunstein observes that some landowners could be *homo reciprocans*,[107] meaning they have a desire to act fairly 'even when it is against their financial self-interest *and no one will know*'.[108] In truth a mixture of individuals at both ends of the spectrum, and possibly many more in the middle, makes up the body of landowners and interested individuals. Posner gives a simple example of how, even though it may not be rational to feel frightened when watching a horror movie, many of us are.[109] Another well-accepted lack of rationality is loss aversion, the phenomenon

102 Cooter and Ulen (n 70) 175.

103 Ibid 175 n 63.

104 See ibid 175–6.

105 Edward SW Ti, 'Fair Differentiations or Ignominious Distinctions: Compulsory Acquisitions and Regulatory Incursions to Land' (PhD Thesis, University of Cambridge, 2017) ('Fair Differentiations or Ignominious Distinctions').

106 Posner (n 53) 57.

107 Cass R Sunstein, 'Introduction' in Cass R Sunstein (ed), *Behavioral Law and Economics* (Cambridge University Press, 2000) 1, 8.

108 See Christine Jolls, Cass R Sunstein and Richard H Thaler, 'A Behavioral Approach to Law and Economics' in Cass R Sunstein (ed), *Behavioral Law and Economics* (Cambridge University Press, 2000) 13, 23 (emphasis in original).

109 Posner (n 53) 4.

that losses loom larger in the minds of most individuals than corresponding gains. This has been identified in Amos Tversky and Daniel Kahneman's famous paper which discusses past empirical studies.[110] Notwithstanding the limitations of *homo economicus*, it remains a 'fundamental pillar … of the neoclassical paradigm' that has not been overcome.[111] Assuming that all landowners are *homo economicus* represents, therefore, a workable economic model, and one that accords more closely with reality than a model that assumes all landowners either act selflessly or irrationally. Thus, while the assumption of rational utility maximisation is not a complete description of reality, it is a useful tool of analysis with considerable truth value.

The literature is, however, more divided in its description of governments' motives to acquire and compensate for compulsory acquisition. Unsurprisingly, the assumptions built into the theoretical models that have resulted in varying conclusions therefore differ not in their assumptions of how landowners behave, but in their interpretation of government officials' incentives. Adopting Chang's framework, three assumed theories of government are discussed: the benevolent, the fiscal illusion and the political interest theories.[112]

1 *Three Theories of Government*

> 'If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controuls on government would be necessary.'[113]

(a) Benevolent Theory of Government

As its name suggests, the benevolent theory assumes a Pigovian model of government that aims to maximise social welfare.[114] This model assumes that government is unmoved by how much (or if any) compensation must be paid, as 'officials will always take into account all relevant social benefits and costs' when

110 Amos Tversky and Daniel Kahneman, 'Loss Aversion in Riskless Choice: A Reference-Dependent Model' (1991) 106(4) *Quarterly Journal of Economics* 1039.

111 Dante A Urbina and Alberto Ruiz-Villaverde, 'A Critical Review of *Homo Economicus* from Five Approaches' (2019) 78(1) *American Journal of Economics and Sociology* 63, 80.

112 Chang (n 95) 13.

113 James Madison, 'The Structure of the Government Must Furnish the Proper Checks and Balances Between the Different Departments' (Federalist No. 51) *The New York Packet* (New York, 6 February 1788) reproduced in Philip B Kurland and Ralph Lerner, *The Founders' Constitution* (University of Chicago Press, 1987) vol 1, 330, 330.

114 Chang (n 95) 13. See also William A Fischel and Perry Shapiro, 'A Constitutional Choice Model of Compensation for Takings' (1989) 9(2) *International Review of Law and Economics* 115, 120–1.

making acquisition decisions.[115] A well-cited article by Lawrence Blume, Daniel Rubinfeld and Perry Shapiro that has received much academic attention, suggesting that non-compensation brings about the greatest efficiency,[116] has been described by Chang as adhering to a benevolent theory of government.[117] Using a general equilibrium model, Blume, Rubinfeld and Shapiro found that a rule of not compensating for compulsory acquisition results in efficient investment decisions by landowners because fully compensable takings result in overinvestment on the part of the landowners ('BRS model').[118]

Miceli describes the BRS model by explaining that rational landowners would realise that they would either have to pay a tax to fund the acquisition if their land were not taken, or they would receive market value compensation if their land were taken.[119] Landowners would therefore overinvest in their property since there is a positive correlation between improvements made to their property and the amount for which they would be compensated.[120] A moral hazard is therefore created as overinvesting provides the landowner with insurance against the possibility of an acquisition vis-à-vis having to pay a higher tax.[121] Since all landowners act rationally and overinvest, the total amount of compensation (and therefore tax levied) through the remaining landowners for the land acquired is therefore higher than efficiency would demand. Because the BRS model assumes that government will not be tempted to acquire more land even if to do so were costless, it focuses on the effects of compensation on landowners. An obvious weakness of 'the benevolent theory is that we do not live in an ideal world in which government officials are omniscient angels'.[122] It also seems incongruous to hold that landowners are purely self-interested while government condemners are 'unswervingly devoted to acquiring resources only when it is efficient to do so'.[123]

(b) Fiscal Illusion Theory of Government

The model closest to *homo economicus* applicable to the behaviour of governmental officials is the fiscal illusion theory. This popular theory has wide acceptance

115 Chang (n 95) 13.

116 See Lawrence Blume, Daniel L Rubinfeld and Perry Shapiro, 'The Taking of Land: When Should Compensation Be Paid?' (1984) 99(1) *Quarterly Journal of Economics* 71, 90.

117 Chang (n 95) 13, 13 n 2.

118 See Blume, Rubinfeld and Shapiro (n 116).

119 See Miceli, *Economics of the Law* (n 88) 139–40.

120 Ti, 'Fair Differentiations or Ignominious Distinctions' (n 105).

121 Ibid.

122 Chang (n 95) 13–14.

123 Miceli, *Economics of the Law* (n 88) 141.

in the literature,[124] having 'the advantage of being easy to model mathematically because condemnors and condemnees make decisions using the same measure — the monetary value of condemned properties'.[125] Fiscal illusion theory holds that 'government officials will not internalize the costs of [land] takings unless paying compensation'[126] and will therefore tend to over acquire if this is costless. Compensation is therefore needed to enhance efficiency and prevent the 'fiscal illusion' under which governments would labour, should they be empowered to take land without cost. It does not seem unreasonable to assume that government may be expected to act like any other economic agent who responds to economic incentives. Vicki Been and Joel Beauvais describe the model as assuming governments behave like profit-maximising firms.[127] Martin Johnson suggests that if compensation is zero, then acquired resources under the control of the government will be perceived to be costless.[128] With opportunity costs ignored, compulsory acquisition and land use regulation without compensation will lead to overproduction of public goods.[129] In the absence of a compensation requirement, therefore, rational government actors may treat private property as a commons and tend to overregulate, as there is nothing to deter government from undertaking projects that are not necessarily utility-enhancing, since there would be no costs to bear.

In the context of describing the US government, Posner states that the assumption 'that the government makes its procurement decisions approximately as a private entrepreneur would do, that is, on the basis of private rather than social costs, unless forced to take social costs into account', is realistic, as the 'government is sensitive to budgetary expense'.[130] Blume, Rubinfeld and Shapiro describe such a government as suffering from 'fiscal illusion'.[131] This implies that the government, by comparing the benefit of the public good (more than zero) with the amount of compensation it must pay the owners of the land it takes (zero), would tend to over acquire. In this vein, Blume and Rubinfeld argue that the no-compensation result is

124 Abraham Bell and Gideon Parchomovsky, 'A Theory of Property' (2005) 90(3) *Cornell Law Review* 531, 605 n 386; Abraham Bell and Gideon Parchomovsky, 'Givings' (2001) 111(3) *Yale Law Journal* 547, 580–1. See also William A Fischel, *Regulatory Takings: Law, Economics, and Politics* (Harvard University Press, 1995) 61. But see Louis Kaplow, 'An Economic Analysis of Legal Transitions' (1986) 99(3) *Harvard Law Review* 509, 569.

125 Chang (n 95) 15.

126 Ibid 14.

127 Vicki Been and Joel C Beauvais, 'The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine' (2003) 78(1) *New York University Law Review* 30, 92.

128 See M Bruce Johnson, 'Planning without Prices: A Discussion of Land Use Regulation without Compensation' in Bernard H Siegan (ed), *Planning without Prices: The Taking Clause As It Relates To Land Use Regulation without Compensation* (Lexington Books, 1977) 63, 91.

129 See ibid 93.

130 Posner (n 53) 57.

131 Blume, Rubinfeld and Shapiro (n 116) 88.

bad because compensation acts as a form of public insurance for landowners against the risk of government expropriation of their property;[132] market failure would result otherwise as the private market is not able to provide such insurance.[133] The need for public rather than private insurance is clear because of moral hazard — government may be encouraged to acquire more if a private market insurance bears the cost.[134] Further, adverse selection — where only landowners with a higher risk of having their land acquired (eg properties near roads) would buy premiums — would prevent the formation of a private insurance market for hedging compulsory acquisition risk.[135] One provision in the South Australian statute may well tempt the State Government to acquire land, increase its value regulatorily and have the land resold: section 35 of the *Land Acquisition Act 1969* (SA) explicitly states that the acquiring authority 'may sell, lease, or otherwise deal with or dispose of any land acquired … that it does not require'. At the same time, the former government has also stated that the legislation 'contemplates the future use of tunnels to avoid above-ground land acquisition where possible'.[136] While Vickie Chapman's statement was made in the context of avoiding inconvenience to landowners,[137] it is worth reiterating that underground land acquisitions are costless.

(c) Political Interest Theory of Government

A forceful critic of fiscal illusion is Chang, who asserts that the model fails to clarify why money is taken as a proxy for government utility, given that governments may also weigh other more sophisticated considerations.[138] Chang thus favours the political interest theory, which 'argues that government officials make decisions according to their own calculus of personal political costs and benefits, rather than minimizing compensation payments or maximizing their agencies' budget'.[139]

While adopting a fiscal illusion theory would lead to the conclusion that only full compensation can induce efficient acquisition, political interest theory may result in different answers since it would then be accepted that government officials

132 Blume and Rubinfeld (n 95) 572.

133 Ibid 582.

134 Susan Rose-Ackerman, 'Regulatory Takings: Policy Analysis and Democratic Principles' in Nicholas Mercuro (ed), *Taking Property and Just Compensation: Law and Economics Perspectives of the Takings Issue* (Springer Science+Business Media, 1992) 25, 32.

135 Ibid.

136 South Australia, *Parliamentary Debates*, House of Assembly, 12 December 2019, 9151 (Vickie Chapman, Deputy Premier).

137 See ibid 9150.

138 See Chang (n 95) 14.

139 Ibid 16. See generally Daryl J Levinson, 'Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs' (2000) 67(2) *University of Chicago Law Review* 345.

think in political and not monetary terms.[140] This suggests that what motivates the government is the 'political opportunity cost'[141] — whether the government compensates or not (and if so, how much) is dependent on political interest maximisation.[142] The fiscal illusion and the political interest theories are similar in that both adopt a cynical view of government, while the benevolent theory believes governments always act for the benefit of society. While the fiscal illusion theory models the government as an economically rational being, political interest theorists seek to provide a more expansive description of how governments act. Heuristically, the political interest theory is attractive because it seems to accord best with reality as politicians may not always act out of concern for societal welfare, nor simply to swell government coffers, but to remain in power. Jacob Rowbottom notes that describing 'a decision as "political" is sometimes pejorative, suggesting that the decision is the product of a cynical calculation to maximise professional or partisan interests and taken with little regard for the broader public interest'.[143] The decisions whether to acquire land and if so, whether and by how much to compensate, may therefore depend on a political cost and benefit analysis.

Adopting the political opportunity cost as the model to test efficiency is, however, problematic. Tautologically, a government guided by vote maximisation or popularity in its consideration of whether and how much to compensate, is not seeking to act efficiently. Even if the outcome is efficient, this occurs by sheer chance and not design. Political interest is not measurable in the same way that rationality, proxied by prices and money, is. The law and economics query — asking whether a rule is efficient or can be made more efficient — presupposes economically, and not politically, rational actors. Notwithstanding the limitations of fiscal illusion however, this model of government is adopted as it provides the best fit to judge how to maximise efficiency through the land acquisition interactions of *homo economicus* landowners, with correspondingly rational government officials. As stated above, fiscal illusion is also adopted by a sizeable portion of the literature. Thus, while Gregory Alexander and Eduardo Peñalver note that mandating takings compensation is a blunt way to induce government officials to condemn efficiently because their political calculus seldom overlaps with an efficiency calculus, they nevertheless conclude that 'there is widespread (though not universal) agreement that compensating property owners is utility enhancing when the government expressly seizes land (or other property) for a public project'.[144]

140 See Chang (n 95) 16.

141 Ibid 16.

142 See ibid 16, 16 n 9.

143 Jacob Rowbottom, 'Political Purposes, Anti-Entrenchment and Judicial Protection of the Democratic Process' (2022) 42(2) *Oxford Journal of Legal Studies* 383, 383.

144 Alexander and Peñalver (n 74) 161.

C *Like Acquisitions, It Is Efficient To Pay Compensation for Regulations*

> 'There is nothing so dangerous as the pursuit of a rational investment policy in an irrational world.'[145]

John Maynard Keynes' statement, meant to warn investors that the market does not always behave rationally, is a fortiori applicable to a land market fuelled by uncertainty. An important conclusion drawn from Coase's work is that a clear delineation of property rights is essential to market transactions.[146] Uncertainty stifles the market because buyers and sellers who are uncertain about what they are transacting will not trade. The Australian High Court's decision in *Newcrest Mining (WA) Ltd v Commonwealth* ('*Newcrest Mining*')[147] can be said to implicitly support this proposition. There, a majority of the Court extended the law with respect to compulsory acquisition within s 51(xxxi) of the *Constitution*, which empowers the Commonwealth to make laws with respect to '[t]he acquisition of property on just terms'. In *Newcrest Mining*, mining leases were granted over Crown land which was subsequently added to Kakadu National Park.[148] The *National Parks and Wildlife Conservation Act 1975* (Cth) stated that operations for the recovery of minerals in the park were prohibited, and further that there was no liability to pay compensation for that reason.[149] Notwithstanding this, the High Court held that Newcrest was entitled to compensation on just terms for any leases which were contractually valid at the time of the park's acquisition.[150] This decision may be said to enhance efficiency because to hold otherwise would result in the investor, despite paying for such rights, having valuable property being taken away without compensation. At a macro level, this may lead to future cases of underinvestment as rational actors would consider the probability of uncompensated appropriation. To be clear, it is not argued that the government should not be entitled to regulate such environmental externalities, but simply that the owner in question should not be made to unilaterally bear the cost of the societal benefit.

The *Real Property Act 1886* (SA) embodies the original Torrens system of land registration now loyally embraced in dozens of jurisdictions across the world. One of the three key principles of the Torrens system is the mirror principle where the register effectively reflects all interests affecting land. As observed in the context of the *Land Registration Act 2002* (UK), one of the key goals of registration is to

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145 Werner De Bondt, 'Bubble Psychology' in William C Hunter, George G Kaufman and Michael Pomerleano (eds), *Asset Price Bubbles: The Implications for Monetary, Regulatory, and International Policies* (MIT Press, 2003) 205, 206 quoting John Maynard Keynes.

146 See RH Coase, 'The Problem of Social Cost' (n 66) 19–28.

147 (1997) 190 CLR 513 ('*Newcrest Mining*').

148 Ibid 525–6.

149 See ibid 530–1.

150 Ibid 635–7 (Gummow J, Toohey J agreeing at 560, Gaudron J agreeing at 561, Kirby J agreeing at 661).

ensure that the 'price paid reflects [the lot's] true economic and social value'.[151] The mirror principle thus encapsulates the idea that the register should reflect the full character of the land and the totality of rights and interests concerning title.[152] Regulating land without compensation is an affront to the mirror principle because planning decisions, changes in land use or permitted density are not reflected in the land register.[153] To that extent, registration fails in its purpose as legitimate economic expectations on the part of owners procuring land prior to adverse regulation are scuttled if no compensation is paid.

Should rational buyers assume the risk of uncompensated downzoning? Frank Michelman argues that when a buyer purchases land subject to the threat of a regulation, they paid a price that discounted the possibility of that regulation.[154] 'Consequently, the argument goes, they have already received implicit compensation.'[155] The Massachusetts Supreme Judicial Court in *Callender v Marsh* commented to this effect when it held, '[t]hose who purchase house lots … are supposed to calculate the chance of [regulations] … and as their purchase is always voluntary, they may indemnify themselves in the price of the lot which they buy'.[156] On this argument, adverse retrospective effects to purchasers are nullified by their explicit or implicit assumption of risk. Several authors have, however, pointed out that such an assertion is flawed.[157] It has been argued that 'even if the purchaser had full knowledge of the threat of a regulation when he bought the land, and therefore paid a discounted price, the threat had to arise at some previous point in time, and the owner at that point suffered a capital loss',[158] since successive buyers would demand a discount for the risk. Miceli therefore asserts that the only way to fully protect the original landowner is to provide full compensation for any decrease in value of their property brought about by regulation.[159] The risk of adverse retrospective effects cannot therefore be fully captured by the asset's market price.

The fear of landowners' jettisoning efficiency by overinvesting presupposes a utopic Pigovian government. The assumed government behaviour of fiscal illusion carries real risk of moral hazard — any government may conceivably be tempted to overregulate and hence act inefficiently, if to do so were costless. Given that regulating land and physical acquisitions are both, economically speaking, takings of property, then if it is accepted that paying compensation for compulsory acquisition is

151 Martin Dixon, *Modern Land Law* (Routledge, 10th ed, 2016) 33.

152 Ibid 34.

153 Edward SW Ti, 'An Overlooked Overriding Interest in Singapore's Torrens System?' (2018) 82(3) *Conveyancer and Property Lawyer* 280, 283.

154 Frank I Michelman, 'Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law' (1967) 80(6) *Harvard Law Review* 1165, 1238.

155 Miceli, *Economics of the Law* (n 88) 153.

156 18 Mass 418, 431 (Parker CJ for the Court) (1823).

157 Miceli, *Economics of the Law* (n 88) 153.

158 Ibid 153–4.

159 Ibid 154.

efficient, it may also be argued that, similarly, it is efficient to pay market-price compensation for regulations. Any administrative difficulties in identifying which, or indeed how regulation impacts land value can be ameliorated by adopting, as this article suggests, a more focused definition of land regulation such that it is limited to planning outcomes directly impacting the lot in question.

V Windfall Gains Tax when Regulations Enhance Value

Just as '[t]he promulgation of legal controls on land use may result in depreciation in the value of some lands', it may equally result in the 'appreciation in the value of others'.[160] In the same way that compensation for regulations adversely affecting land values should be paid, efficiency (as well as fairness) also requires that society should be compensated if planning decisions or rezoning result in additional property rights being granted to landowners. Cameron Murray and Joshua Gordon note 'that rezoning to provide [additional] rights to airspace for existing landowners is not costless. It involves transferring valuable property rights from the public to existing private landowners'.[161] The same logic dictates that where rezoning enhances environmental amenities to the public (by curtailing a landowner's development rights), this should likewise be compensable as there are 'gains' for the purposes of acquisition law in Australia.

From 1 July 2023, Victoria will apply a WGT to land that is subject to a government rezoning resulting in a value uplift to the capital improved value of the land where this exceeds $100,000.[162] The owner of the land subject to the rezoning pays the WGT, with the obligation to pay deferable until the next dutiable transaction (such as a sale).[163] The Parliamentary Secretary to the Victorian Treasurer explained that because rezoning decisions originate from the government and are premised on 'a community need or benefit', 'it stands to reason that a portion of that windfall gain … is shared with the community'.[164] Murray observes that the tax brings about community benefits because it transfers part of the (enhanced) value from the private property owner to the public.[165] Because 'the value of the property

160 Lanteri (n 17) 311.

161 Cameron K Murray and Joshua C Gordon, 'Land as Airspace: How Rezoning Privatizes Public Space (and why Governments Should Not Give It Away for Free' (Working Paper, OSF Preprints, September 2021) 1 <https://doi.org/10.31219/osf.io/v89fg>.

162 *Windfall Gains Tax and State Taxation and Other Acts Further Amendment Act 2021* (Vic) pts 2–3. For a rezoning of land that results in a taxable value uplift, a marginal rate of 62.5% will apply for value uplifts of between $100,000 and $500,000 and a rate of 50% will apply to uplifts beyond $500,000: at s 9.

163 Ibid s 8, pt 4.

164 Victoria, *Parliamentary Debates*, Legislative Assembly, 26 May 2022, 2046 (Nick Staikos).

165 Cameron K Murray, 'Explainer: Taxing Rezoning Windfalls (Betterment)' (Explainer, Henry Halloran Trust, The University of Sydney, May 2021) 3–4 <https://doi.org/10.31219/osf.io/n78m4>.

rights that are privatised via [an enhanced] rezoning are economically equivalent to government budget spending', taxing this 'betterment will reduce required tax contributions elsewhere'.[166] As enhanced land values are distributed arbitrarily — in the sense that not all landowners will benefit from uplift rezoning and such planning decisions are presumably not correlated with the identity of the landowner — taxing such windfalls smoothens out distortive, unearned gains so that the public also captures a portion of such value uplifts. The advisory body to the Government, Infrastructure Victoria, reasons that taxing windfall gains is 'much more efficient than current revenue and funding options' because a WGT can be implemented 'without distorting economic activity' as land 'cannot be relocated or reduced in supply'.[167]

While some media reports appear to have sensationalised Victoria's WGT,[168] betterment levies are not a novel concept and have historically been adopted in various forms (and rates) across multiple jurisdictions including the Australian Capital Territory,[169] New South Wales[170] and internationally in the United Kingdom[171] and Singapore.[172] The efficiency arguments in support of Victoria's WGT when land is rendered more valuable apply equally when land is rendered less valuable. As far as practicable, neither the landowner nor the community should be arbitrarily enriched through land regulations because that would be distortive. Murray is right to state that '[a] tax on the value gain from rezoning at anything less than 100% is equivalent to selling the new property rights from the community to the current property owner at a discount.'[173] However, there is wisdom in the Victorian Government taking a more centrist approach as there would be no incentives to develop or intensify land if 100% of the value gain were taxed. To encourage development, Singapore, for instance, generally applies a 70% tax rate on value uplifts.[174] Even considering the realities of not living in a frictionless world, the law and economics approach provides guidance towards enhancing efficiency.

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166 Ibid 4.

167 See Infrastructure Victoria, 'Value Capture: Options, Challenges and Opportunities for Victoria' (Policy Paper, October 2016) 20 <https://www.infrastructurevictoria.com.au/wp-content/uploads/2019/04/IV18-Value-Capture-Options_Final-web_v2_0.pdf>.

168 See, eg, Paul Sakkal and Noel Towell, 'Treasurer to Whack Landlords, High-End Property Buyers with $2.4b Tax Hike', *The Age* (online, 15 May 2021) <https://www.theage.com.au/national/victoria/treasurer-to-whack-landlords-high-end-property-buyers-with-2-7b-tax-hike-20210514-p57s4j.html>.

169 *Planning and Development Act 2007* (ACT) s 277.

170 RW Archer, 'The Sydney Betterment Levy, 1969–1973: An Experiment in Functional Funding for Metropolitan Development' (1976) 13(3) *Urban Studies* 339.

171 C Lowell Harriss, 'Land Value Increment Taxation: Demise of the British Betterment Levy' (1972) 25(4) *National Tax Journal* 567.

172 *Land Betterment Charge Act 2021* (Singapore).

173 Murray (n 165) 1.

174 *Land Betterment Charge (Table of Rates and Valuation Method) Regulations 2022* (Singapore) reg 3.

Victoria's decision to impose a windfall tax when regulation increases the value of land may thus be of interest to SA and other jurisdictions in the Commonwealth. The economic logic underpinning the tax also requires that regulations which adversely affect the value of land should be compensated on the same basis as acquisitions.

VI Conclusion

It has been argued that restrictions on the use of land may reduce its market value, and the debate regarding compensation essentially creates a tension 'between government intervention for the public good and the traditional rights associated with private property'.[175] This is not always true. Restricting land use and compulsory acquisition can both be for public benefit, but there is no utility to treat losses stemming from acquisition differently than losses stemming from regulation. Efficiency is achieved when legal rules reduce transaction costs. Murray Raff observes that the object of compensation is to determine 'where the limitations and obligations inherent in the property end and … where an uncalled for individual sacrifice is being required'.[176] Compensating for acquisitions while not compensating regulations which adversely affect land value is internally inconsistent because if it is accepted that paying compensation for acquisitions is more efficient than not, it cannot follow that not paying compensation for regulations which adversely affect land value promotes efficiency.

A crude distinction, however, now holds — one that hinges compensation upon the need to have property acquired or expressly reserved for a public purpose. As Donald Denman argues, it is flawed to think of the economic value of land as an attribute of land — its economic value is an attribute of the property rights to land.[177] Regrettably, governmental decisions that prescribe a change of use or impose other kinds of economically debilitating measures on land without compensation exist because of pedantic distinctions rather than tangible outcomes. Insofar as compensation is directed to the acquisition gains or benefits by the acquiring authority of the land or property in question rather than the deprivation of landowner's property rights,[178] regulatory land control is sub-optimal from an economic perspective. One way of accommodating the suggestions made in this article within the existing jurisprudence is to recognise that regulations restricting development, for instance a density or height restriction, can be construed as 'acquisitions' as there would be environmental amenity gains which should not be presumed to be less valuable than the loss suffered by the landowner. The identity of a landowner is arbitrary where land is selected for regulatory control. From both a justice and efficiency perspective, such

175 See Lanteri (n 17) 311.

176 Murray Raff, 'Environmental Obligations and the Western *Liberal* Property Concept' (1998) 22(3) *Melbourne University Law Review* 657, 687.

177 See DR Denman, *Land Use and the Constitution of Property: An Inaugural Lecture* (Cambridge University Press, 1969) 6.

178 See generally *Tasmanian Dam Case* (n 10) 146 (Mason J).

landowners should not be singly required to sponsor societal benefits. Indeed, given the rational adoption of taxing windfall gains in Victoria in July 2023, perhaps it is timely to consider whether compensation and taxation for land regulations should also be correspondingly expanded in SA and beyond.