



Evaluating Takings and Measure 7

By Ed Whitelaw,
Randall Pozdena,
Terry Moore,
John Tapogna, and
James Ebenhoh

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On November 7, 2000, Oregon voters passed Ballot Measure 7, which requires state and local governments to compensate a property owner if a government passes or enforces a regulation restricting the use of property, thereby reduc-

ing its value. Oregon residents and businesses will be affected by Measure 7 in two main ways: (a) directly, through compensation or reductions in regulatory requirements, and (b) indirectly, through changes that may occur in the services and costs of government if government must finance the costs of compensation.

Here, we take a broad view of the issues raised by Measure 7. We do not attempt to examine the legal details or particulars of the measure's implementation. Rather, we examine governments' larger regulatory role and the remedies available to landowners when governments enact economically unsound or unfair regulations. We also consider policies that could improve the regulatory process and reduce

the need for compensation systems like Measure 7. We conclude by detailing the principles that should underlie an efficient and fair compensation system.

Why regulation?

Measure 7 deals with the uses of land and government's right to regulate those uses. Governments occasionally need to influence the activities that take place on land because landowners can impose "externalities" on others in the economy—negative or positive effects that are not captured by market prices. For example, a noisy industrial shop imposes negative effects ("costs") on surrounding homes, but it does not have to pay the homeowners for doing so. Without some governmental action, the shop may produce



more noise than is efficient for the neighborhood as a whole. There are two main reasons why it is difficult for markets to deal with externalities, and why regulation is seen as necessary:

- **Transactions costs.** There are transaction costs associated with trying to create markets in externalities. Market dealings, and the time and money required to work out the efficient level of reconciling

externalities, can exceed the cost imposed by the inefficiency of a regulatory alternative.

- **Undefined property rights.** Many externalities are imposed on goods with undefined property rights, such as air or water. Government regulation partially addresses this problem by implicitly assuming stewardship of public goods such as air quality and water quality.

The goal of regulation is to overcome the two drawbacks of the market approach outlined above, and to promote the following:

- **Efficiency.** An efficient outcome is one that provides goods and services at the lowest net social cost or greatest net social benefit. Regulation is efficient if it leads society toward the same, or greater, economic well-being at lower cost than the alternative of no regulation.
- **Equity.** A policy is equitable if the distribution of impacts among various individuals or groups meets society's established test of fairness. The issue of fairness is largely moot if a regulation makes everyone better off without making anyone worse off. Such cases, however, are rare or non-existent. In cases where regulation leads to a reduction in property values for some owners—what they might call “takings”—and increases in property values (“givings”) for other property owners, inequitable outcomes are possible. The issue of equity is central to the debate about Measure 7, because even regulations that have a high probability of generating net benefits for society may do so by disproportionately damaging some *individuals*.

Some economists conclude that, although the regulatory approach may be imperfect, it remains the best overall approach for coping with the multiple externalities that can accompany growing populations, a fast pace of land development, and increasingly complex interactions between human activities and the natural environment.

Critiques of the Regulatory Process

Other economists accept the theory underlying government regulation, but believe that regulation as practiced delivers much less than it promises in theory. They claim that in many cases regulation leads to less efficiency and less equity. They offer the following critiques of the regulatory process:

- **Regulators have imperfect information about markets.** Because government does not know exactly how much society is willing to pay to prevent negative externalities, it may either over-regulate or under-regulate activities that cause externalities. Zoning regulations, for example, deal with externalities like noise fairly crudely—industrial land uses are simply banned from proximity to noise-sensitive land uses such as housing.
- **Regulators have imperfect information about the effects of regulations.** Because government often lacks information on the effects of its regulation, it often cannot adequately evaluate and, if necessary, alter its regulatory policies. There may also be scientific or empirical uncertainty on the human health effects of the regulated activities (for example, development in riparian areas). Therefore the beneficial impact of regulations on those activities (for example, riparian buffers) is unclear.
- **Special interests may dominate the regulatory process.** There is a belief that the bureaucracy sometimes can become “captured” by special


interests and act on their behalf rather than on society's behalf.

- **Regulation may result in selective taxation.** The main risk of inequity with regulation is that there will be selective taxation, where certain property owners will bear more than similarly situated property owners bear in support of public-policy goals. In such cases, certain property owners are singled out, either because of their perceived ability-to-pay, or their ownership of particular parcels that have value for some public use. If costs are borne selectively by those owners (with little benefit to them) and not by the

Legal Remedies for Inefficient or Inequitable Regulations

Measure 7 was designed to address regulations that are inefficient, inequitable, or both. When government enacts an inefficient regulation, society as a whole loses and property values, on balance, fall. Other regulations may be efficient and make society better off, but they do so in an inequitable way, creating winners and losers.

Through the enactment of an inefficient or inequitable regulation, a government may restrict the use of private property in such a way that its value is lowered and at least part of the property is effectively “taken”



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larger population of beneficiaries of the policy, the policy will be seen by many as unfair. Even if a regulation is universally applied, it might impact certain properties so severely in relation to the benefit received that it would be considered unfair.

by the government action. The debate over reform centers on deciding at what point a case of diminished value should be classified as a “regulatory taking,” and whether or not, and in what amount, compensation is due.

Both law and economics are ambiguous about the appropriate remedy for an alleged regulatory

taking. The options include (1) doing nothing, under the presumption that the loss of value is either non-existent, relatively small, or not required by law to be compensated, (2) removing the regulation from the property in question, or (3) paying “just compensation.” But neither the U.S. nor Oregon Constitutions define “just compensation,” so the valuation of the property that is allegedly taken has typically occurred on a case-by-case basis.

The body of case law that has evolved in the courts tolerates government actions that promote the common good, and establishes a high burden of proof for a property owner who claims a “taking.” Most regulatory takings cases fail unless the property owner can prove that all or nearly all of the value of the affected property is eliminated by the government action, or the government action meets one of the courts’ specific criteria for determining a taking. Indeed, one study of takings cases found that federal courts were unlikely

to find a taking if a regulation reduced a property’s value by less than 80 percent¹.

Property-rights advocates criticize the existing legal system because of the difficulty that property owners have in establishing a case for regulatory takings and ensuing compensation. They point to two main hurdles: (1) the high costs and time spent in legal action; and (2) the high threshold of the loss in value that

must be proven for a regulatory taking to be found. Regarding the first hurdle, litigating takings and other property rights cases are very expensive, and often cost more than the property at issue is worth. Moreover, the legal doctrine of “ripeness” requires that courts hear no case “before its time,” i.e., before all administrative steps affecting the land use decision have been taken and finalized. Because of the many administrative processes and appeals that a property owner is required to go through to demonstrate ripeness, the costs of even getting a court to hear a case can be extensive. When added to the cost of litigation itself, the cost of seeking compensation for a regulatory taking can be very high. While property owners who win their cases are usually entitled to some compensation for legal expenses,

owners who do not win their cases bear their own legal costs.

Regarding the second hurdle, the case law described above shows that, as long as there is some connection and proportionality between the effect of the property use and the burden of the regulation, there must be a near-total loss in the

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value of property for the courts to find that a taking has occurred. Property rights advocates disagree with this high threshold. Some advocates argue that any diminution of private wealth for public purposes constitutes unlawful, selective taxation unless the property owner himself receives at least equivalent benefit from the regulation.

The Need for Change

Reasonable parties can disagree—as do the authors of this essay—on how often regulators miss their mark, and by how much. Regardless of our personal views, Oregon voters, by passing Measure 7, seemed to express a view that the courts do not always provide adequate relief when regulators enact rules that are either inefficient or unfair. We generally agree with the voters: some property owners bear a disproportionate share of the costs of regulations that strive to benefit the public.

Prior to Measure 7, the court systems provided the only formal avenue to redress the inefficiencies or inequities created by regulation. We generally agree that the remedies of the existing court system are inadequate, first and foremost, because of the high costs involved. The costs of litigation present a barrier to many property owners, and the level of these costs, from an economic standpoint, is arbitrary.

Options for Regulatory Change

Land transactions take place in an environment that is a mix of markets and regulations. Regulations on land use in the U.S. and Oregon have grown substantially over the last 25 years. One should expect to find that some of the rules are inefficient—either as written or as implemented, either individually or when coupled with other conflicting regulations. Thus, some aspects of the current regulatory system can probably be improved.

These problems motivate and are used to justify a compensation system like Measure 7. Measure 7 itself, however, has several problems. We see two courses of action for policymakers in Oregon:

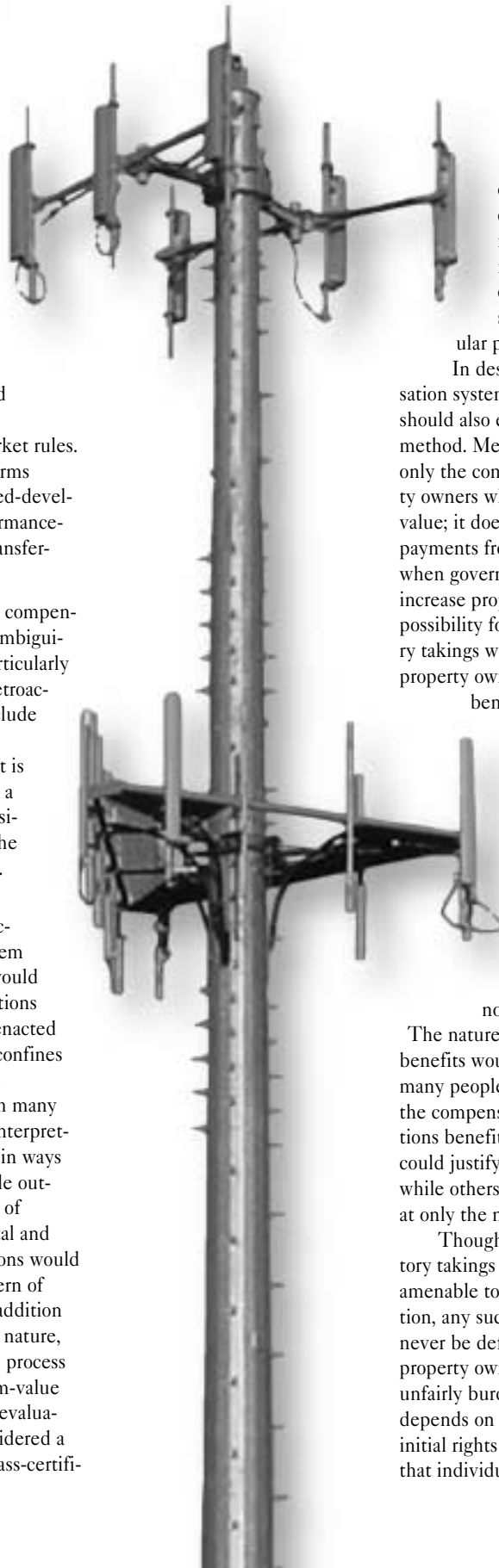
- Reform the regulatory process to limit instances of regulatory takings. State and local governments could reform the regulatory process with the goals of limiting economically inefficient or unfair rules. If they are successful in their reforms, they could reduce, perhaps largely eliminate, the need for a compensation system. We have identified a number of candidate policies, including replacing regulations with market-based transactions wherever feasible. For example, state and local governments could adopt the principles embedded in the purchase of development rights (PDR) method, where government simply buys property on the open market that it wishes to protect from market use. Alternatively, governments could replace some land use regulation with bidding

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schemes, similar to those used by companies bidding for other companies in merger and acquisition transactions. Government's role would be limited to establishing and defining the market rules. Other candidate reforms include limited-vested-development rights, performance-based zoning, and transfer-development rights.

- Establish a workable compensation system. The ambiguities of Measure 7—particularly those related to its retroactivity—lead us to conclude that this law's best chance for enactment is to be reincarnated as a similar, but more feasible, amendment to the Oregon Constitution.

In our view, a prospective (not retroactive) compensation system would work best. We would exempt existing regulations because governments enacted those rules within the confines of the U.S. and Oregon Constitutions. Although many now agree that courts interpreted these Constitutions in ways that fostered inequitable outcomes, the overturning of decades of governmental and judicial land use decisions would create an arbitrary pattern of winners and losers. In addition to being prospective in nature, the ideal compensation process incorporates a minimum-value threshold over which devaluation of property is considered a "taking"; reform the class-certifi-



cation process for claimants; and recognize the overall market conditions in considering compensation for any particular property owner.

In designing the compensation system, policymakers should also establish a financing method. Measure 7 addresses only the compensation of property owners who lose property value; it does not discuss getting payments from property owners when government actions increase property values. One possibility for financing regulatory takings would be to target property owners who directly benefit from regulatory

policies that generate takings. For example, if a regulation limits development to preserve a view, those who enjoy the view would compensate those who cannot build on their land.

The nature and scope of the benefits would determine how many people would underwrite the compensation. Some regulations benefit all Oregonians and could justify a statewide tax, while others may extend benefits at only the neighborhood level.

Though the issue of regulatory takings is one that is amenable to economic evaluation, any such evaluation can never be definitive. Whether property owners have been unfairly burdened by regulation depends on assumptions about initial rights and expectations that individuals disagree on and

that societies define politically. We assume one thing—supportable, but no doubt also a subject of future policymaker debate—in these plans for the best implementation of Measure 7: some regulations unfairly harm some property owners, and these property owners deserve a speedier and less expensive way to seek compensation than those currently provided by the courts.



The authors of this article are all associated with the economic consulting firm ECONorthwest. www.econw.com

Footnote:

1. U.S. Congressional Budget Office. December 1998. Regulatory Takings and Proposals for Change. Page 22. The CBO Study cites William S. Walter, "Appraisal Methods and Regulatory Takings: New Directions for Appraisers, Judges, and Economists," *Appraisal Journal*. (July 1995), p. 338