

# AN ECONOMIC ANALYSIS OF THE COMPETING VIEWPOINTS IN OREGON LAND-USE REGULATION

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*Oregon's comprehensive land-use planning program has been in effect system and property rights advocates continues. Driven by both economic and social incentives, groups on both sides of the issue continue to push their agendas. Property rights advocates fight for reduced regulation and claim that comprehensive land-use regulation hurts property values and slows development activity. Planning advocates argue that the benefits of comprehensive planning outweigh the burdens, and that smart planning actually increases property values and protects the environment. This article explores both sides of the comprehensive land-use planning debate through the unbiased lens of economic analysis. We conclude that while the Oregon system is not perfect, Oregon's experiment with comprehensive planning regulation has been a success. Property values in Oregon have risen steadily, and in general, have outperformed neighboring states, which have been slower to adopt comprehensive planning regulation.*

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## INTRODUCTION

For over a century now, the state of Oregon has regulated the way private landowners may use their land.<sup>1</sup> From the first Beach Bill in 1899, to the adoption of comprehensive statewide planning in 1973, to the most recent battles over measures 37 and 49, Oregonians have been divided over exactly how much, and what kind of regulation the state should be allowed to place on the use of private land.<sup>2</sup> A general history of the various laws and court decisions that have shaped Oregon's current scheme of land-use regulation would ignore some of the economic context of these changes. This paper explores those connections at the crossroads of law and economics, to uncover some of the deeper motivations for many of the developments in Oregon land-use regulation. Ultimately, the thesis is that the economic effects of land-use regulation are commonly misinterpreted and politicized to serve the desires of a few, without a complete understanding of the results.<sup>3</sup> To truly understand where we are, and how we got here, we must understand the perceived incentives that motivated those who have shaped, and continue to shape our current system of land-use regulation in Oregon. This paper will focus mainly on the need for, and result of regulation, from an economic perspective.

## I. A BRIEF HISTORY OF OREGON'S LAND-USE REGULATION SYSTEM

The rulings in *Kroner vs. City of Portland*<sup>4</sup>, and later, *Village of Euclid vs. Ambler Realty*<sup>5</sup>, established that cities could regulate specific land uses through the state's police power. Portland was the first city in Oregon to enact a zoning ordinance, but others soon followed. In 1947, the state legislature extended the state's police power to allow counties to zone lands outside the city. By the early 1960s, Oregon had established special tax treatment for farmland, and had established the exclusive farm use (EFU) zone. These were important developments in Oregon land-use planning, which showed the state's commitment to the environment and the farm and forest economies. The true starting point for this analysis, however, is 1973

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<sup>1</sup> History of Oregon Land Use Planning, <http://www.oregon.gov/LCD/history.shtml> (Accessed March 10, 2012).

<sup>2</sup> William K. Jaeger, *The Effects of Land-Use Regulations on Property Values*, <http://crag.org/documents/jc/Exhibit%20104%20%20Jaeger%20Article.pdf> (Accessed March 10, 2012) (See discussion at 105 about public misinterpretation of the effects of land use regulation on property values).

<sup>3</sup> *Id.* Supra note 2.

<sup>4</sup> See Supra note 29.

<sup>5</sup> *Village of Euclid vs. Ambler Realty Co.*, 272 US 365 (1926).

and the passage of Senate Bill 100.<sup>6</sup> This was the birth of Oregon land-use planning, as we know it today.<sup>7</sup> With the passage of Senate Bill 100 in 1973, Oregon became one of only a few states to enact comprehensive, statewide land-use planning regulation. The bill wasn't popular with all Oregonians, but eventually it "overcame fearsome difficulties and survived intense floor debate in the Senate to become the foundation of the country's leading land-use planning program." *Id.* Oregon adopted the law to abate concerns that unchecked urban sprawl would degrade both agricultural production and pristine natural areas.<sup>8</sup> At the heart of the opposition was the fear that comprehensive, statewide planning would severely reduce property rights and devalue property now subject to regulation. Property rights advocates immediately mounted challenges to the newly passed legislation. The opponents' claims initially appeared to fall on deaf ears, as voters repeatedly rejected ballot initiatives to overturn Oregon's land-use laws.<sup>9</sup>

The new legislation established the Land Conservation and Development Commission (LCDC) as the center of the Oregon planning program.<sup>10</sup> Implementation of the program would be accomplished through a series of goals, each addressing a key area of concern for Oregon.<sup>11</sup> Soon after passage of Senate Bill 100, the Department of Land Conservation and Development (DLCD) was formed to implement the administrative rules and the day-to-day work of the Oregon planning process.<sup>12</sup> LCDC promulgated 19 goals, which "establish[ed.] binding land-use policies that attempt to strike a balance between development and conservation". *Id.* Oregon's land-use regulations quickly earned the praise of many for their success in preventing sub-urban sprawl and preserving prime agricultural land and open spaces.<sup>13</sup> Others, however, regarded Oregon's laws as heavy-handed, inflexible, and possibly unconstitutional controls that impeded economic development and unduly restricted landowners' rights.<sup>14</sup> These opponents never succeeded in their efforts to directly overturn Oregon's

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<sup>6</sup> S. B. 100, 57th Leg., Reg. Sess. (Or. 1973).

<sup>7</sup> Edward J. Sullivan, *Year Zero: The Aftermath of Measure 37*, 36 ENVTL. L. 131 at 134.

<sup>8</sup> M.C. Blumm & E. Grafe, *Enacting Libertarian Property: Oregon's Measure 37 and Its Implications*, 2007 DENV. U. L. REV. Vol. 85, No. 2, pp. 279, 286.

<sup>9</sup> See Blumm and Grafe, *supra* note 34 pp. 296-297

<sup>10</sup> See ORS 197.030 (2003) (establishing a seven member commission appointed by the governor subject to confirmation by the Senate).

<sup>11</sup> See *Supra* note 33 at 134-135.

<sup>12</sup> *Id.* at 135.

<sup>13</sup> *Land Use Regulation versus Property Rights: What Oregon's Recent Battles Could Mean for Sustainable Governance*, Melissa Powers, <http://data.iucn.org/dbtw-wpd/html/EPLP-070/section22.html> (accessed March 13, 2012)

<sup>14</sup> Hunnicutt, D. J., *Oregon Land-Use Regulation and Ballot Measure 37: Newton's Third Law at Work*, 2006, *Envtl. L. Vol. 36, No. 1*, pp. 33-34.

land-use laws.<sup>15</sup> They did, however, convince Oregon voters to adopt Measure 37, which afford[ed] private property owners extraordinary rights to compensation for any economic losses resulting from a land-use regulation. Much of the support for Measure 37 was arguably garnered through the misleading “just compensation” requirement in the bill. Though the purpose of Measure 37 was compensation, “[t]he Measure says very little on the subject (aside from creating a statutory right to “just compensation” if the fair market value of land is devalued by a land-use regulation).<sup>16</sup> Its discussion of valuation is largely confined to the following statement found in subsection (2):

Just compensation shall be equal to the reduction in the fair market value of the affected property interest resulting from enactment or enforcement of the land use regulation as of the date the owner makes written demand for compensation under this section.<sup>17</sup>

While Oregon voters later withdrew support for many of its aspects, Measure 37 will have lasting effects on Oregon’s land-use laws.<sup>18</sup> Through Measure 37, Oregon had seemingly changed its opinion on comprehensive land-use planning. So what exactly would compel Oregon voters to allow the enactment of comprehensive land-use regulation, then only about 30 years later, vote to essentially eviscerate the program? The answer lies in perceived incentives.

## II. THE ECONOMICS OF LAND USE

### A. *Basic Economic Theory*

Before delving in to the evolution of land-use regulation, it is first necessary to understand basic economic theory as it relates to the supply, regulation and cost of land. “Economics is the study of the rational behavior of individuals when choices are limited or constrained in relation to human desires.”<sup>19</sup> Private property is, by nature, a limited resource. This is the reason economics is such an effective tool for analyzing incentives in land-use regulation. “[E]conomics is not simply about money—it is about how incentives influence behavior.” *Id.* Economic theory presumes that all actors

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<sup>15</sup> See *Supra* note 34 at 296-299.

<sup>16</sup> OR. REV. STAT. § 197.352(1) (2005)

<sup>17</sup> Edward J. Sullivan, *Through a Glass Darkly: Measuring Loss Under Oregon’s Measure 37*, 16 SE ENV. L. J. 113, 115 (2008) (Citing: OR. REV. STAT. § 197.352(2) (2005)).

<sup>18</sup> See note 40.

<sup>19</sup> HENRY N. BUTLER & CHRISTOPHER R. DRAHOZAL, *ECONOMIC ANALYSIS FOR LAWYERS*, at 3 (Second Edition, Carolina Academic Press).

within a market will behave rationally. When presented with choices, the rational self-maximizer will always make the choice that provides the most benefit, or utility, for themselves. “We don’t always seek to maximize our utility, and we all certainly have our irrational moments. But that is the idea of a model—it is a simplified version of reality that generates predictions about behavior”. *Id.*

In the land-use regulation context, each distinct party to an issue has its own set of incentives. For example, property owners generally want to maximize the value of their property.<sup>20</sup> Some advocacy groups, like 1000 Friends of Oregon, want to prevent unchecked growth, and provide for the orderly use of land.<sup>21</sup> Their incentive is more indirect, but generally, they want to protect the state in which they live from urban sprawl and unworkable land use regulation. Other advocacy groups, like Oregonians in Action, want to reduce regulation because they believe that will enhance the value of property. Their stated mission is “to defend the right of private property owners to make use of their property”.<sup>22</sup> Oregonians in Action claims “our planning system lowers the value of private property in Oregon by \$5.4 billion a year”.<sup>23</sup> Even politicians and legislators have incentives to gain support from voters, as well as wealthy donors, so that they can win in election season and push their agendas.<sup>24</sup> Similarly, voters have incentives to further their own interests. Those incentives could compel voters to vote for eased restrictions because they believe that their property values might increase, or to tighten restrictions to ensure that Oregon continues to “grow smart” and avoids the problems of urban sprawl experienced by other states, such as California.<sup>25</sup>

#### B. Externalities and Market Failures

“Externalities exist when the actions of one party affect the utility or production possibilities of another party outside the exchange

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<sup>20</sup> See note 4 at 5.

<sup>21</sup> See 1000 Friends website, *Our Focus*, <http://www.friends.org/about/our-focus> (Accessed March 10, 2012)

<sup>22</sup> See mission statement at bottom of website homepage, Oregonians In Action, <http://www.oia.org/> (Accessed March 10, 2012).

<sup>23</sup> David Hunnicutt, Executive Director, Oregonians in Action, in LOOKING FORWARD, OREGONIANS IN ACTION EDUCATION CENTER, September-October 2004 (<http://oia.org/ec.html>)

<sup>24</sup> Claudio Ferraz & Frederico Finan, *Motivating Politicians: The Impacts of Monetary Incentives on Quality and Performance*, March 2008, [http://www.gsb.stanford.edu/facseminars/events/political\\_economy/documents/pe\\_04\\_08\\_ferraz.pdf](http://www.gsb.stanford.edu/facseminars/events/political_economy/documents/pe_04_08_ferraz.pdf). See discussion of politician’s motivation on pg. 1 and 2.

<sup>25</sup> Ed Bolen, Kara Brown, David Kiernan & Kate Konschnik, *Smart Growth: State by State*, <http://www.uchastings.edu/public-law/docs/smartgrowth.pdf> (Accessed March 12, 2012)

relationship”.<sup>26</sup> A classic example of an externality is when a neighboring property owner constructs a building that blocks the view of an adjacent property owner. With no legal method to stop the construction, the adjacent property owner bears the cost of the devaluation of his land, even though he was not a party to the transaction. This is an example of a negative externality.<sup>27</sup> If, for example, the neighboring property owner built a fancy golf course and resort, this could be a positive externality. Some economists have described positive externalities as “amenities”, which can actually increase the value of neighboring property.<sup>28</sup>

The tort theory of nuisance could provide relief for negative externalities, but most jurisdictions have chosen to codify these nuisance-based rules in what we know today as land-use regulation. Government intervention is necessary because “totally private ordering of land use decision making through market mechanisms is not a realistic option”.<sup>29</sup> We now have local ordinances to protect view sheds and restrictions on building height and even design and color. When a neighboring property owner puts his land into an incompatible use, such as a feedlot, or a heavy industrial use in a residential area, he is imposing a negative externality on adjacent landowners. Before land-use restrictions, the residential landowners were forced to sue in tort under a nuisance theory.

### C. *Why Do We Regulate?*

In economic terms, the reason we regulate these negative externalities is to prevent market failures. “A market failure is a situation where the private market fails to produce the optimal level of a particular good.”<sup>30</sup> An externality is a form of market failure, because it represents the costs to a third party that were not considered in a private transaction. *Id.* In our previous transaction, one property owner constructed a home, presumably because it was in his best interest to do so. The adjacent property owner, however, had no choice in the matter and lost value in his property as a result. Economic theory presumes that market failures are a net loss for the market as a whole, and for that reason, government intervention is proper, and can benefit the market. *Id.* It can be very difficult, however, to create a

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<sup>26</sup> See Supra note 4 at page 15.

<sup>27</sup> *Id.*, at 26, 27.

<sup>28</sup> William K. Jaeger, *How Have Land-Use Regulations Affected Property Values in Oregon?*, June 2007, <http://extension.oregonstate.edu/catalog/pdf/sr/sr1077.pdf> (Accessed March 10, 2012)

<sup>29</sup> MANDELKER, BROWN, MECK, MERRIAM, SALSICH, JR., STROUD & TAPPENDORF, *PLANNING AND CONTROL OF LAND DEVELOPMENT: CASES AND MATERIALS*, Eighth Edition, 30.

<sup>30</sup> See Supra note 4 at 120.

regulation that prevents only negative externalities, without also prohibiting some positive externalities.

American capitalism as an economic system is based on the principle of laissez-faire (from the French, meaning, roughly, “let simply to do”).<sup>31</sup> The theory is that the free market, or the “invisible hand,” as described by Adam Smith, will regulate the economy in a way that maximizes production and utility for all. The reality, however, is that “no society has ever conformed to the laissez-faire ideal.” *Id.*

Oregon found its authority to regulate the use of land after the Supreme Court’s decision in *Village of Euclid v. Ambler Realty Co.*, 272 US 365 (1926), which held that the power to regulate land was part of the state’s police power. The Oregon Supreme Court had already upheld the validity of city zoning laws in *Kroner v. City of Portland* one year earlier, but this ruling was bolstered by the *Euclid* ruling.<sup>32</sup> So Oregon now had the legal power to regulate land use, but what was the purpose, and where were the incentives? Cities certainly had an incentive to control growth, as provision of public services becomes more expensive with spread out development. Farmers would enter in to the equation later on as urban sprawl threatened their farming way of life. Environmentalists liked the idea of limiting the unnecessary growth in valuable ecosystems. Even homeowners within the city generally liked the assurance that the vacant lot next door would not become a feedlot. These concepts will be covered in detail in this analysis.

#### D. *The Coase Theorem*

The Coase theorem provides that, with well-defined property rights, “the same property rights assignment will emerge regardless of the initial assignment of ownership rights, when the costs of negotiation are non-existent or trivial”.<sup>33</sup> Individuals may be unhappy with the allocation of resources, but regardless of the initial allocation property rights, property will be put to its most beneficial use.

##### 1. *The Coase Theorem—An Economic Revolution*

Before Ronald Coase proposed his theorem in the article “The Problem

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<sup>31</sup> *Id.* at 119.

<sup>32</sup> *Kroner vs. City of Portland*, 116 Or. 141, (1925). (Upholding the City of Portland’s right to use zoning ordinances under the police power).

<sup>33</sup> See *Supra* note 4 at 27.

of Social Cost” in 1960<sup>34</sup>, the generally accepted theory was that articulated by Arthur C. Pigou.<sup>35</sup> Pigou advocated subsidies for activities that created positive externalities and taxes for activities that created negative externalities. These are now called Pigovian taxes and subsidies, respectively. *Id.* Pigou’s analysis was accepted until 1960, when Ronald Coase showed that taxes and subsidies were not necessary if the people affected by the externality and the people creating it can easily get together and bargain. *Id.* As a result of Coase’s work, the “Law and Economics” movement was born and Coase was awarded the Nobel Prize.<sup>36</sup>

As a general explanation of the Coase Theorem, suppose that property owner A owns a rock pit, and property owner B owns a golf course. The noise and dust from the rock pit is a negative externality placed on B’s property. Now suppose that B would earn \$400,000 per year from his golf course if the mine shuts down, but is currently earning nothing because nobody wants to play golf next to a fully operational rock pit. Additionally, suppose that the rock pit makes a net profit of \$200,000 per year. If the rock pit shuts down, A will generate \$0 per year, and B’s golf course will generate \$400,000 per year. If the rock pit doesn’t shut down, A will generate \$200,000 per year and B’s golf course will generate \$0 per year in net profits. There are essentially two scenarios; the first produces a net gain of \$200,000, the second produces a net gain of \$400,000. From an economic perspective, the \$400,000 scenario is preferred. A regulation that prohibits golf courses, however, would produce a net result of \$200,000. The Coase Theorem predicts that with well-defined property rights and no transaction costs, A and B will bargain for the arrangement that provides the maximum economic benefit, regardless of who is initially given the property right to continue their operation. For example, if A is given the right to operate his rock pit, B will pay A not to operate the rock pit. B will do this because it still makes economic sense to operate the golf course and make a \$200,000 profit, rather than shut down the golf course and make \$0. The net result will be that A is paid \$200,000 not to operate, and B earns a net profit of \$200,000 after paying A, making the overall net benefit to the economy \$400,000. The same is true if B has the right to operate his golf course and A does not have the right to operate the rock pit. In this case, A does not stand to gain enough to pay B for the right to operate the rock pit. B will

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<sup>34</sup> See R. H. Coase, *The Problem of Social Cost*, JOURNAL OF LAW AND ECONOMICS, Vol. 3, Oct., 1960, pp. 1-44.

<sup>35</sup> *The Concise Encyclopedia of Economics*, Biography of Arthur C. Pigou, <http://www.econlib.org/library/Enc/bios/Pigou.html> (Accessed March 11, 2012)

<sup>36</sup> *The Concise Encyclopedia of Economics*, Biography of Ronald H. Coase, <http://www.econlib.org/library/Enc/bios/Coase.html> (Accessed March 11, 2012)

continue to operate his golf course and A will shut down his pit. The overall net benefit to the economy is still \$400,000. Obviously, the problem with this analysis is that in the real world, there are transaction costs and property rights are regulated by the state. It is still important, however, to understand exactly what is being regulated, and what would theoretically happen in a cost-free world without that regulation.

## *2. The Law and Economics Movement*

Three premises underlie the Law and Economics argument:

(1) that rational individuals pursue preference—maximizing actions and exchanges;

(2) that rules of law impose prices on (or subsidize) individual action, such that those rules alter the nature and amount of activity;

(3) that common law rules are efficient, in that they reach the results that rational actors would reach through a process of free exchange.<sup>37</sup>

On the basis of these premises, advocates of Law and Economics contend that efforts to regulate individual behavior through the law are likely to be futile or have perverse or dangerous consequences.<sup>38</sup> The argument against regulation is twofold: first, the costs (anticipated and unanticipated) of regulation often outweigh its benefits;<sup>39</sup> second, regulation is a form of rent-seeking behavior by cartelizing groups seeking to gain a premium over the market price for their activity.<sup>40</sup> This argument, however, is based on a world that does not truly exist. In the real world, there are transaction costs, and the common law rules are not efficient, due to costs of litigation. This analysis is helpful, however, in understanding the property rights movement and the theory that regulation is an overall negative for the economy and property values.

### *E. Effects of Regulation*

#### *1. New Regulations Create New Incentives*

Many laws and regulations have unintended consequences. “It is important in designing laws and regulations to consider how rational

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<sup>37</sup> Richard Posner, *The Law and Economics Movement*, AM. ECON. REV., May 1987, at 1.

<sup>38</sup> Cf. ALBERT O. HIRSCHMAN, *THE RHETORIC OF REACTION: PERVERSITY, FUTILITY, JEOPARDY*, (Harvard University Press, 1991).

<sup>39</sup> Richard A. Epstein, *Products Liability as an Insurance Market*, 14 J. LEGAL STUD. 645, 653, 664-69 (1985)

<sup>40</sup> Mark Kelman, *On Democracy-Bashing: A Skeptical Look at the Theoretical and “Empirical” Practice of the Public Choice Movement*, 74 Va. L. Rev. 199 (1988).

economic actors are likely to respond to new constraints on their behavior”.<sup>41</sup> Many believe that increased regulation generally limits the uses of land, thereby reducing the utility, or value of that land.<sup>42</sup> Owners of land subject to new regulation may perceive a loss of value, or utility, and are not happy about the new limitations on their land. The result is an incentive for property owners to oppose regulation that may reduce the value of their land. Of course, not every landowner will oppose new regulations—some will even see them as a good thing. Those property owners who experience “amenity effects” will likely be in favor of new regulation. If an owner planned to build a standard single—family dwelling and a new regulation prohibited all landowners in the area from building manufacturing facilities, the residential homeowner might be happy. This does not mean that the homeowner is not a rational actor. The homeowner had already predicted that he would derive the most utility from building a home. If his land were actually worth double if used as a manufacturing site, he may have different incentives, and likely, would not be in favor of the new regulations. Economic models are not perfect, but seek to predict the behavior of rational actors on a large scale. There will always be those who act irrationally and won’t sell the farm no matter how much they are offered. The purpose of this economic analysis is to give some perspective, at the state level, on why people are either for, or are opposed to land-use regulation.

## 2. *New Incentives Create Unexpected Strategies*

People are generally very resourceful and adaptive when it comes to finding alternatives to regulation that negatively affects them. In the article *The Nature of Man*<sup>43</sup>, the authors propose a model to predict the ability of people to find a way around onerous regulation. In their example, the authors speak of a “Resourceful, Evaluative, Maximizing Model” or REMM as a predictive model for human behavior. “REMM’s response to a new constraint is to begin searching for substitutes for what is now constrained, a search that is not restricted to existing alternatives. REMMs will invent alternatives that did not previously exist”. *Id.* The authors give an example of the 1974 federal imposition of a nationwide 55-mile-per-hour speed limit. The REMM model predicts that people will find alternatives, which they did. Some people chose to fly, instead of drive. Others choose to simply

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<sup>41</sup> Michael C. Jensen & William H. Meckling, *The Nature of Man*, 7 JOURNAL OF APPLIED CORPORATE FINANCE 4-19, Summer, 1994.

<sup>42</sup> See *Supra* note 8 for a property rights perspective on land-use regulation.

<sup>43</sup> See *Supra* note 26.

break the law and risk the fine. Some even choose to install citizens' band (CB) radios in their cars so they could warn and be warned of speed traps. The unforeseen consequences of this new federal law took decades to unfold, and included a new industry in radar detectors, which spawned even more technological advancement on the part of the police, and in turn, even more sophisticated radar technology to avoid being caught. What this proves is that people valued their time more than they valued the cost of avoiding fines. After all, time is a valuable resource, and "an hour of time consumed is just as irreplaceable as—and generally more valuable than—the gallon of gasoline consumed". *Id.* The drivers were willing to pay a premium to be able to drive faster, and they came up with very creative ways to make that happen. In the land-use context, those who are subject to new regulation, which they believe devalues their property, will presumably be just as innovative as the REMM model suggests. Property owners evaluate their options and may respond by litigating, forming property rights groups, petitioning the government, proposing voter initiatives, or even ignoring the regulations all together.

### *3. Incentive to Fight Regulation*

Property rights groups like Oregonians in Action continue to fight for reduced regulation, even though the majority of Oregonians are in favor of comprehensive land-use regulation. Their incentive is simple—the potential increase in value from an individual exemption to the current scheme of land-use regulation. According to this economic analysis though, a complete elimination of the land-use regulation system would actually have negative effects on property values as a whole, though there would be increases in the value of some individual parcels. However, since its inception with Senate Bill 100 in 1973, property rights advocates have been fighting to overturn or limit land-use regulation in Oregon. "Land-use planning opponents initially launched direct challenges to Oregon's land-use laws through citizen initiatives seeking to rescind the laws. Three separate measures brought between 1976 and 1982 all failed".<sup>44</sup> Oregon Voters didn't agree with property rights activists, who claimed that the land-use regulation system was unfair or bad for Oregon. As a whole, people in Oregon viewed comprehensive regulation as a positive, and were not willing to trade the benefits gained through property regulation for the individual property owner's right to develop land without restrictions.

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<sup>44</sup> Blumm, M. C. & Grafe E., *Enacting Libertarian Property: Oregon's Measure 37 and Its Implications*, 2007 DENV. U. L. REV., Vol. 85, No. 2, pp. 279, 286.

### III. ECONOMIC EFFECTS OF COMPREHENSIVE LAND-USE LEGISLATION

#### A. *Senate Bill 100 and the Beginning of the Oregon Planning Program*

Senate Bill 100 required the support of many interested parties, but “[t]he movement for state mandated planning originated in efforts by Willamette Valley farmers to protect their livelihoods and communities from urban engulfment and scattershot subdivisions, with their disruptive effects on agricultural practices”.<sup>45</sup> Greatest credit for the passage of Senate Bill 100 went to Senator Hector Macpherson, a Linn County dairy farmer who articulated the importance of statewide planning in protecting and enhancing Oregon’s agricultural economy.<sup>46</sup>

The idea of preserving farmland for the future sounds appealing, but was it really in the farmers’ best interests? Presumably, farmers are rational economic actors, so what benefit did they see in a reduction of their property rights? Wouldn’t it be better to retain those property rights and have the chance to develop or sell their land at a higher price once demand increased for residential development? As a farmer, several factors contributed to the decision to support comprehensive land-use planning. First, farmers placed a high value on their agricultural way of life. For many farmers, selling their land is not a preferred option. Second, as urban sprawl began to interface with agricultural uses, conflicts arose, and inevitably, lawsuits followed. This legislation was seen as a way to avoid those conflicts. Third, and probably most important, farmers had limited information and understanding of the potential effects of comprehensive land-use regulation. They relied in large part on Hector Macpherson’s charismatic message, which resonated with farmers, who generally supported his vision of the Willamette Valley, and bought in to the idea of comprehensive land-use planning for protection of farmland. Macpherson’s message served to dampen the demands of some farmers, who wanted to preserve property rights that would enable them to sell out to developers. *Id.*

Senate Bill 100 was seen by farmers as an extension of the favorable treatment they had been given in the past by the Oregon legislature. Beyond zoning and land-use restrictions, farmers had enjoyed favorable treatment through the property tax system.<sup>47</sup> “In [1961], the state legislature offered a

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<sup>45</sup> *A Quiet Counterrevolution in Land Use Regulation: The Origins and Impacts of Oregon’s Measure 7*, [http://www.upa.pdx.edu/IMS/currentprojects/TAHv3/Content/PDFs/Impact\\_OR\\_Measure\\_7.pdf](http://www.upa.pdx.edu/IMS/currentprojects/TAHv3/Content/PDFs/Impact_OR_Measure_7.pdf), (Accessed March, 24, 2012).

<sup>46</sup> *Id.* at 389

<sup>47</sup> See EDWARD J. SULLIVAN & RONALD EBER, *Generally: The Long and Winding Road: Farmland Protection In Oregon 1961-2009*, 18 SAN JOAQUIN AG. L. REV. 1, 2009.

preferential property tax assessment for land in ‘farm use’ and ‘zoned exclusively for farm use’ (‘EFU zone’).<sup>48</sup> In addition to the protection of farmland through favorable tax treatment, Oregon also created Urban Growth Boundaries to prevent urban sprawl and encourage resource use on EFU zoned lands.<sup>49</sup> Farmers enjoyed these protections and did not want to see urban sprawl and development encroach on to their farmland.

Eventually, “49 out of 60 legislators from Willamette Valley districts voted in favor of Senate Bill 100”. *Id.* The message did not carry as well outside the Willamette Valley though, with only nine out of 30 legislators from coastal and eastern counties voting in favor of the bill—a fact that created much controversy in the decades after passage of Senate Bill 100. *Id.*

Despite its legislative support, comprehensive planning has always had strong opposition. Critics contend that the system has had “tremendously negative economic consequences on property owners, especially those in the rural areas”.<sup>50</sup> The opposition focuses on the effects of regulation on individual landowners, but what, exactly, have those effects been?

*B. The Economic Effects of Senate Bill 100 on Rural Landowners*

In a 2007 report, entitled “How Have Land-use Regulations Affected Property Values in Oregon?”, William Jaeger explored the economic effects of regulation in great detail.<sup>51</sup> Jaeger’s work focused on land values in Oregon, both before and after comprehensive planning legislation. *Id.* The goal of the report was to determine whether land-use regulations had a net positive or negative effect on land values. As a control, the report also considered land in neighboring Washington State, which was not subject to comprehensive land-use legislation until 1990.<sup>52</sup> The results of Jaeger’s report serve to confirm much of the economic theory relied upon in this paper. Jaeger found that land values did not necessarily decline after the imposition of restrictive land-use regulation. On the contrary, values actually increased at rates similar to the rates before regulation. Jaeger’s

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<sup>48</sup> EDWARD J. SULLIVAN & RONALD EBER, *The Long and Winding Road: Farmland Protection In Oregon 1961-2009*, 18 SAN JOAQUIN AG. L. REV. 1, 2009 (Citing Act of May 13, 1961, ch. 695, 1961 Or. Laws 1428).

<sup>49</sup> See Supra note 47.

<sup>50</sup> See Supra note 2, (Citing David Hunnicutt, President, Oregonians in Action, KLCC Radio, Eugene, OR, February 25, 2007.)

<sup>51</sup> See Supra note 2.

<sup>52</sup> *Growth Management, Washington State Department of Community, Trade and Economic Development*, [http://www.commerce.wa.gov/\\_cted/documents/id\\_892\\_publications.pdf](http://www.commerce.wa.gov/_cted/documents/id_892_publications.pdf) (Accessed March 25, 2012).

study concluded; “Oregon land value data finds no evidence of a generalized reduction in value caused by Oregon’s land-use regulations, a result that is consistent with economic theory and with other research in the economics field”. *Id.*

“Economists recognize three potential effects of land-use regulations on land values: restriction effects, amenity effects, and scarcity effects”.<sup>53</sup>

### *1. Restriction Effects*

a. Effects on Oregon’s Rural Lands. Restriction effects are just as they sound—limitations on the uses to which a land may be put. When a regulation restricts the use of a particular piece of land so that its “highest and best use” is prevented, it can be expected to decrease the property’s value. If, however, the prohibited use would not be chosen because it is not the “highest and best use” of that piece of land, then the regulation will have no effect on the property’s value. *Id.* Much of Oregon’s rural lands are farmland and forestland, so it is likely that their “highest and best use” was not prevented by the legislation. *Id.* The Coase Theorem predicts that lands will be put to their highest and best use in the absence of regulation, but in this case, the regulation doesn’t limit the highest and best use for the vast majority of parcels, so it has little even no effect on the value of land. Similarly, the regulation prevents market failures by preventing the negative externalities associated with the urban/rural interface. Oregon’s comprehensive land-use planning scheme is, therefore, not a restrictive effect in the traditional sense for most parcels of rural land.

b. Property Rights Argument That Senate Bill 100 Has Restrictive Effects The counterargument, posited by property rights groups, is that property value is reduced when land is limited to its current highest and best use instead of its potential highest and best use. Opponents to regulation argue that land-use regulation unfairly restricts a property owner from taking advantage of the changes in Oregon’s real estate market to create real value from their land. This argument fails to recognize that all land in Oregon is currently subject to land-use regulation. Of course the value of one single parcel would increase, relative to those around it if regulations were lifted. For example, if a parcel of EFU zoned property in the Willamette Valley were suddenly free of all restrictions, it would likely be worth a great deal more as a subdivision, or commercial center, than as farmland. This ignores the potential effect of all lands becoming available for such development at the same time. In that situation, supply of land

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<sup>53</sup> See *Supra* note 2 at i.

would greatly exceed demand, making it relatively plentiful. Developers would choose to focus their efforts on those lands that are closer to public utilities and currently established communities. The result would be exactly the situation Oregon was trying to avoid by enacting comprehensive land-use regulation. Urban sprawl would cause provision of public services to become more costly, and we would lose the amenity effects that come with comprehensive land-use regulation.

## 2. *Amenity Effects*

A simple example of an amenity effect can be seen in the result of a property tax. Properties subject to higher taxes, all else being equal, should be worth less due to their higher cost of ownership. Services provided to the property by those taxes however, can actually increase its value.<sup>54</sup> Similarly, a land-use regulation that prevents nuisance causing uses, and protects more desirable uses, will generally improve property values, as long as that desirable use is also the highest and best use of the particular land. Property owners can feel confident that their investment won't be devalued by conditions on neighboring properties. Additional examples of amenity effects include land-use regulations to protect environmental quality, open space, groundwater availability and quality, or to reduce noise, congestion, or pollution, as well as agricultural lands and lands with historical significance. *Id.* It is not hard to see the value of amenity effects in "nice" neighborhoods. Houses have a similar appearance, and public services, such as roads and schools, are higher quality than those in other neighborhoods. The result is higher property value for the same acreage.

"This characterization of amenity benefits in economic terminology is similar to the legal concept of 'average reciprocity of advantage' that has been noted in federal takings cases".<sup>55</sup> Justice Holmes identified reciprocity of advantage in *Pennsylvania Coal Co. v. Mahon* as a justification for denying compensation for takings.<sup>56</sup> Essentially, courts have often held that when the benefits of a regulation accrue to the regulated party, there is no taking.

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<sup>54</sup> See GORDON C. BJORK, *GENERALLY LIFE, LIBERTY AND PROPERTY*, 85-86 (1990) (discussing the argument that services provided by property taxes increase the value of the real estate to which they are applied).

<sup>55</sup> William K. Jaeger, *The Effects of Land-Use Regulation on Property Values*, <http://arec.oregonstate.edu/jaeger/land/ELJaegerfinal.pdf> (Accessed March 25, 2012)

<sup>56</sup> 260 U.S. 393, 415 (1922).

In Oregon, comprehensive land-use regulation is responsible for many of the amenity effects enjoyed by property owners. Without the statewide regulation of land-use, there would be less security in the value of property.

### *3. Scarcity Effects*

Scarcity effects result from use limitations imposed on certain lands. In Oregon, for example, much of the rural land is zoned for either timber or agricultural uses. This classification prohibits, or at least limits, the potential for development on those lands. As a result, lands available for development are in limited supply, and therefore, in a higher demand. As discussed earlier, the value of timberland and agricultural land, assuming that it is being put to its highest and best use, is relatively unaffected, or even positively affected. The net result, according to William Jaeger's work, is an overall increase in the value of land.<sup>57</sup> As applied to a single property however, regulation that limits development can seem very unfair. In an environment of comprehensive regulation, it is very easy for a landowner to see the financial incentive to develop their property. That incentive, however, is predicated upon the value of developable land, which is a direct result of the scarcity effect created by the limiting regulation. Regardless of whether this incentive is logical, or good for Oregon, it is very real for property owners. The potential financial gain from an individual exemption to the land-use regulation scheme is a powerful motivating force of the property rights movement.

#### *C. Common Misinterpretations and Misrepresentations*

The economic effects of land-use regulations on property values are commonly misinterpreted because two very different economic concepts are being confused and used interchangeably. The first concept is the effect of a land-use regulation on property values, which focuses on the change in value when a comprehensive regulation is applied over a large area. The second concept is the effect of an individual exemption, or variance, to an existing land-use regulation, which measures the change in value when a regulation is removed from only one parcel.<sup>58</sup> Evidence that an individual exemption would increase a property's value has been widely interpreted as evidence—or even proof—that the land-use regulation had reduced the property's value in the first place. This is erroneous, however. Indeed, an

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<sup>57</sup> See Supra note 50 at 108.

<sup>58</sup> See Supra note 51 at 109.

exemption to a binding land-use regulation can be expected to increase a property's value even in cases where the regulation has raised property values. *Id.* When property rights groups argue for fewer restrictions, it is likely that they are playing off of this misunderstanding to garner support. One only needs to look at the campaign for Measure 37 in 2004 to see exactly how the public's perceived incentives can be manipulated.

The Oregon Planning System survived several challenges, remaining relatively unchanged until November of 2004. There had always been opposition to comprehensive planning, but this time, opponents found a way to convince voters to pass a bill that would have nearly destroyed the Oregon land-use planning system had it remained in force. The measure was officially titled: "Governments must pay owners, or forgo enforcement, when certain land-use restrictions reduce property value". The measure included in its explanatory statement that :

the owner of private real property is entitled to receive just compensation when a land use regulation is enacted after the owner or a family member became the owner of the property if the regulation restricts the use of the property and reduces its fair market value.<sup>59</sup>

This seemingly fair bill was appealing to voters, passing easily with 61% of the vote. *Id.* As additional support for the bill, property rights groups mounted a powerful advertising campaign, featuring Dorothy English, a widow whose heartfelt story resonated with voters. English's wish was to allow each of her children to build homes on their individual portion of the family farm, but the restrictive system of land-use regulation wouldn't allow it.<sup>60</sup> What was not explained in the ballot measure was just how unfair this type of individual exemption from land-use regulation would really be for some Oregonians. Under Measure 37, property owners would be given compensation for any regulation that devalued their property. If the local government didn't want to pay the compensation, it could waive the restriction. In either case, the result would be a different treatment for property owners, depending on when they bought their property. The amenity effects, created by smart planning, could now be exploited by a select group of property owners. Those who received waivers could develop rural lands, imposing externalities on their neighbors, who were not free to develop. Scarcity effects were less powerful because supply of developable

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<sup>59</sup> *Information About the Election*, DLCD Measure 37, Oregon.gov, [http://www.oregon.gov/LCD/MEASURE37/legal\\_information.shtml](http://www.oregon.gov/LCD/MEASURE37/legal_information.shtml) (Accessed March 25, 2012)

<sup>60</sup> See PETER A. WALKER & PATRICK T. HURLEY, *PLANNING PARADISE: POLITICS AND VISIONING OF LAND USE IN OREGON*, 76-94 (The University of Arizona Press, 2011) (Read for extensive discussion of social and political climate that led to Measure 37 campaign for property rights)

land suddenly increased to include all land owned prior to the restrictive regulation, so long as the property owner had a valid Measure 37 claim. Rather than eliminating the comprehensive land-use system and resorting to common law methods of land-use control, Measure 37 produced a set of winners and losers. The winners reaped huge rewards by taking advantage of the economic effects of scarcity and amenity, while still being compensated for their alleged loss in property value. The losers suffered the loss associated with diminished scarcity and amenity effects.

A system of exemptions based on length of ownership creates a checkerboard pattern of land-use regulations.<sup>61</sup> Eventually, Oregon voters came to their senses and approved Measure 49, which sharply curtailed the broad exemptions allowed by Measure 37, but still left plenty of room for individual exemptions to land-use regulation. This brief summary of the effects of Measures 37 and 49 is in no way intended to be exhaustive, as volumes of work have been written on the subject alone. The important lesson to take from this discussion of the Measures 37 and 49 is that the true economic effects of legislation often play a much smaller role than they should in the minds of voters.

#### CONCLUSION

Despite the uproar from property rights groups and landowners wishing to make their millions in the real estate market, Oregon's land-use planning system appears to have accomplished many of its originally stated goals. Property values in Oregon are higher than those in Washington, and those who are truly hurt by comprehensive planning regulation are in the minority.<sup>62</sup> In general, the benefits of smart planning outweigh the burdens. If our experiences with Measures 37 and 49 have taught us anything though, it is that Oregon's planning system is not invulnerable to attack. Those who wish to influence the masses need only to appeal to voter's economic incentives and craft a message that Oregon voters want to hear. The battle over Oregon's land-use regulation system continues, even today. Those in favor of comprehensive planning regulation must continue to educate the public and expose misleading information if we are to avoid another Measure 37 style campaign. The opposition to comprehensive planning is a small, but at times, powerful group. Understanding their motivations and

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<sup>61</sup> Edward J. Sullivan, *Through a Glass Darkly: Measuring Loss Under Oregon's Measure 37*, 16 SE ENV. L. J. 113, 114 (2008).

<sup>62</sup> See Generally Supra note 50.

incentives will help to preserve Oregon's planning program and continue to let Oregon "twinkle from afar."<sup>63</sup>

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<sup>63</sup> Comment by former Governor Tom McCall, as cited in *PLANNING PARADISE*, *See Supra* note 55 at 79.