An Economic Analysis of Australian Real Property Law


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The current global business climate has seen a heightened awareness of the legal framework that surrounds corporations. However, outcomes of legal decisions are not often evaluated as to their underlying economic rationale. This paper seeks to contribute to this area by attempting to explain real property law in Australia, as evidenced by native title judicial decisions, through the application of an economic analysis of the law. In analysing these theories, the paper concludes that externalities and regulation were held to be an important component for economic agents within the real property law framework.

The purpose of this paper is to explain real property law in Australia, as evidenced by native title judicial decisions, through the application of an economic analysis of the law. Native title law has revolutionised the precedent for real property law and subsequent property rights in Australia. Native title represents the acceptance of indigenous people occupying the Australian land and the further recognition of established property rights for the indigenous people, if established in the Australian law courts and their respective judicial decisions. Anderson and Grewell (1999) define the process of analysing judicial decisions as a bottom-up process that means customary, common law property rights that are formed over time when conflicts over resource use arise, whereas a top-down approach means government-mandated property rights. In discussing property rights, what is traded on the economic market is not physical entities, but the rights to perform certain actions, and the rights which individuals possess are established by the legal system (Coase, 1960).

In considering the economic underpinnings of the judicial decisions, the analysis in this paper will specifically probe at transaction cost theory and the Coase theorem as posed by Coase (1960) and the essay will also seek to address Pigou’s (1932) externality effects where the Coase theorem does not appear to apply. As a result of the economic analysis under transaction costs, rights and externalities, the paper is classified in the domain of welfare economics: welfare economics being the study of individual and group utility in an economy (Hartwick & Olewiler, 1997). The welfare economic analysis of the law has occurred in the areas of crime (e.g. Becker, 1968), tort (e.g Posner, 1992) and contract (e.g Trebilcock, 1993). In investigating the effects on individuals and groups as economic agents under the welfare paradigm, this paper will argue that the restrictions placed on proving the existence of native title is burdensome, because of the economic detriment, both negative economic returns and a high opportunity cost, associated with such a burden. Furthermore, Rubin and Bailey’s (1994) argument that special interest groups operate to influence the law to suit their own rent-seeking behaviour will not hold for the case of native title judicial decisions in Australian property law.

In considering economic detriment and individual or group utility this paper will look at a number of areas. First, there will be a discussion on the theory of economic analysis of law. Secondly, the paper will look at how the economic analysis of law in Australia has affected the burden of proof claimants must discharge to be successful in an application for native title under Australian real property law. Thirdly, the paper will examine the influence economic analysis of law has on the denial of real property rights in Australia under native title claims. Lastly, the paper will look at the method the Australian courts use to divide real property rights, as property is commonly defined as a bundle of rights (Dnes, 1996; Hartwick & Olewiler, 1997; Posner, 1992). It is the concept of rights that differs between Coase (1960) and Pigou (1932).

Literature Review

Coase (1960) and Pigou (1932) differ in their approaches to an economic market and the problem of social cost. Coase (1960) did not think in terms of externalities, but rather considered pollution and clean air (or water, forests, wildlife habitat) as conflicting or alternative resource uses for which there is competition. Generally, Coase’s (1960) approach is accepted to contain two propositions. The first proposition is that, when there are zero transactions costs and wealth effects, parties will bargain to an efficient outcome. The second proposition holds that the same outcome will occur regardless of the distribution of property rights. The latter is known as the invariance thesis (see Hylan, Lage & Treglia, 1996). Overall, Coase (1960) is proposing a free market approach that is dependent on the pricing system for appropriate distribution of rights.

Pigou (1932) essentially argues that a free market is a practical norm that is difficult to find and a regulatory framework must be utilised. Pigou (1932) states that the dominant policy approach for solving economic problems has been to use government's power to tax and regulate. Government intervention is seen as necessary when externalities exist in a market. The term externality refers to an economic concept asserting that inefficiencies result when costs incurred and benefits received by individuals involved in an economic transaction or activity do not incorporate all the costs and benefits to society (Anderson, 2000). Therefore, a transaction that seems efficient to the individual parties to a transaction may really be inefficient from the viewpoint of society because of the existence of externalities (Anderson & Grewell, 1999).
Economic Analysis of Law

The economic analysis of law is the extension and application of traditional economic theory to the law, in this case Coase (1960) and Pigou (1932), and relies heavily on microeconomic constructs (Posner, 1992; Cooter & Ulen, 1997; Wittman, 2003). Resource utilisation is an important aspect of traditional economic theory and that markets clear (Robbins, 1935). Conflicting uses, such as in the case of air pollution, can be resolved through bargaining, if well-defined property rights specify who has the right to use the resources and therein derive value from them (Coase, 1960). However in considering a legal analysis, the implication is that there are some market imperfections necessitating intervention. This means that the analysis merges into a regulatory economic paradigm (see Stigler, 1971; Peacock & Rowley, 1972; Hartwick & Olewiler, 1997), and support for Pigou’s (1932) arguments of externalities and intervention in an imperfect market need to be considered.

A leading cause of market failure is the presence of significant externalities. As a result competitive equilibrium does not exist, and the outcome is not Pareto optimal. For Pigou (1932) the typical response to this lack of optimality is for the government to step in and introduce corrective policy, usually in the form of taxes and subsidies. Coase supporters view this differently. They have contended that, despite externalities, unrestrained bargaining and contracting ought to be sufficient to generate an efficient outcome, even if formal markets fail, the invisible hand nevertheless succeeds, and outside intervention or design is not required. (Maskin, 1994)

Unrestrained bargaining by economic agents adheres to economic theory in that resources, rights, are finite and scarce (Mansfield and Yohe, 2000). Therefore, resources (renewable and non-renewable) must be used efficiently, by ensuring resource allocation is maximised. This means the person who should control the resource should be the person with the highest value for that resources use (Dnes, 1997), this is best understood and resolved in the Coase (1960) framework, wherein these concerns are viewed as a competition over conflicting uses for scarce resources (Anderson & Grewell, 1999). Furthermore in this framework a Pareto efficient outcome is sought, whereby total social welfare denotes a position on the indifference curve where it is not possible to reallocate resources and improve the welfare of any one person without making at least one other person worse off (Hartwick & Olewiler, 1997). This is different to other views (e.g Bentham) whereby utility is spread equally amongst economic agents (Hardin, 1996) and that transaction costs incorporate social costs (Coase, 1960). However if the market fails in allocating resources, then there may be a need to rely on a third party, government, and subsequently government regulations to facilitate and intervene, to obtain a more optimal allocation of resources. For the case of the paper and the analysis of Australian property law and native title claims, the resource being distributed is a right to property, either singularly or as a bundle of rights.

Under Australian law, economic agent protection is provided by two complimentary sources: the Australian law courts and the doctrine of precedent, bottom-down; or the Parliament at a Federal or State level, top-down. If the Australian law courts are the source then property law, law of contract and tortious law can afford protection (see Posner, 1998). These areas of law create, define and transfer and protect property rights (Posner, 1998). When property rights in resources and land are well defined and protected, it is presumed there is an incentive for people to exploit resources efficiently and effectively (Benkler, 2002).

Furthermore, the transaction cost of enforcing and regulating property rights is lower than the benefit gained by such a process (see Coase, 1960; Calabresi & Melamed, 1972; Hartwick & Olewiler, 1997). The implication is that, real property must be owned, transferable: to ensure the most efficient user can exploit the right or land, and exclusive, to ensure rights in the land are not interfered with (Hartwick & Olewiler, 1997), this process is sometimes referred to as inalienability of title (Calabresi & Melamed, 1972). Title rights and inalienability can vary over time. In an evolutionary economic perspective the theory of property rights is dynamic in nature, envisioning the possibility that rights can be redefined from period to period as the relative values of different economic agents have different uses of land or changes in societal values (Jackson, 2003).

Economic Analysis and Australian Common Law

The economic analysis of law is not a concept, which has been explicitly referred to by judges in native title property rights decisions in claims in Australian real property law. Posner (2003) concedes that there will be no explicit reference to the economic analysis of law; rather it will require academics to learn to seek it out below the surface. Judges in Australian law courts will try to maximise economic welfare as an implied consequence and intentional endeavour, but not as direct economic policy nor as a direct economic institution.

Strict Burden of Proof for Native Title Claims

Having competing claims on a disputed land area in Australia does not only create uncertainty, but is economically detrimental as economic agents can not make more accurate decisions about the usage of their right. The focus on competing uses rather than on social costs necessitates resolving an important question: who has the property rights to a scarce resource? While free trade and competition for resource use resolves which use is valued higher, the issue of who actually owns the property right to a scarce resource must be resolved. Thus, the Coasean perspective defines economic problems not in terms of externalities, but rather as problems brought about by ill-defined property rights (Anderson and Grewell, 1999). Demsetz (1964) notes that whether res nullius (open access) or private property governs resource use depends on the level of benefits expected from the property and the costs of monitoring and enforcing the property right by excluding others. In Members of Yorta Yorta v Victoria (2002) 194 ALR 538 (Yorta Yorta) a claim was made on 2000 square kilometres of land and water along the Murray, Ovens and Goulburn rivers in Victoria and New South Wales. The claim was opposed by nearly three hundred parties, which included the New South Wales and Victorian Governments, councils, forestry and fishery groups, farmers, beekeepers and tourist operators. The water supply to the towns of Albury, Finely, Deniliquin, Cohuna, Shepparton, Benalla and Wangaratta was threatened if native title was recognised over the rivers. Further, the claimants wanted to exclude cattle and logging. All parties faced uncertainty regarding the outcome of the claim and the effect on them. Furthermore, the transaction cost of allocation of the property rights was extremely high. Similarly legal action increased economic agent uncertainty in Wilson v Anderson 190 ALR 313 (Wilson). In Wilson a claim was lodged on behalf of the Euaylay-i people for 4107 square kilometres of land and increased the transaction cost of legal enforcement as well as uncertainty. The land claimed, Western Division, represents 42 per cent of New South Wales and consists of 4250 perpetual grazing leases.
The threat of litigation also hinders investment and threatens the transferability of land to a more efficient user (see North, 1990). The hindering effect of litigation has been referred to as the economics of precautions (Cooter, 1985; Brown, 1998). Furthermore, leaseholders may have their rights partially extinguished. This affects leaseholder’s ability to invest as their property rights may become affected. With the inability to invest, resources are not efficiently maximised. Expansion becomes impeded and new machinery and employees cannot be utilised to increase production. This results in market failure and waste. To prevent the economic turmoil the High Court in Australia has imposed a strict burden of proof on all native titleholders.

The burden of proof does impede traditional indigenous values. Traditionally, for Aboriginal and Torres Strait Islanders the enforcement of property rights was unnecessary. Land was communal and abundant. There was no need to have written records or fenced property, ownership was evidenced by possession. Acts such as cultivating the land and hunting were consistent with possession. This has led to controversy in the Australian law courts regarding native title claims in real property rights as possession alone will not be recognised by the Australian High Court at common law. As a result the application of a stricter burden of proof results in market imperfection as asymmetrical information governs the ability to hold an interest in land recognised by the Australian High Court.

In order to alleviate the uncertainty associated with asymmetrical information regarding traditional values and Australian real property law, the High Court of Australia has set a precedent of a stricter doctrine of proof. The Australian High Court in Yorta Yorta established a stricter onus of proof on indigenous claimants wishing to assert native title rights over a disputed area. The majority judgment in Yorta Yorta held that there must be substantial uninterrupted and continued observance or acknowledgement of traditional laws and customs since 1788. In addition, the laws and customs must display normative characteristics, derived from a system of norms. If there has been an interruption, then native title will become extinguished. The previous legal burden for native title property rights in Australia under De Rose v South Australia [2002] FCA 1349 (De Rose); Commonwealth v Yamirr (2001) 184 ALR 113 (Yamirr); Fejo v NT at 126, were such that it was only necessary to prove observance or acknowledgement of traditional indigenous laws and customs. A further qualification, under Mabo and De Rose, was that a static lifestyle was not required, whereby the system of norms was required to be uninterrupted since 1788, Australian sovereignty. Interruptions would cause the extinguishment of the native title property right. While the onus is strict, Yorta Yorta decided that there is allowance for some adaptation of traditions and customs.

However, in De Rose it was deemed that a tradition would not be recognised if there were a break with the past rather than maintenance of the ways of the past. Again in Yorta Yorta, native title was denied on the grounds that the society ceased to exist as group, making it impossible for members to acknowledge and observe laws and customs. Further, any attempt to resurrect the traditions would be unsuccessful, due to the interruption.

Competing Interest

The Australian High Court has been cautious in dividing property rights over competing property right claims (commonly referred to as land claims). Concurrent property rights may result in inefficient use of resources and affect economic improvements to the land (North, 1990). In considering multiple users there is still a competitive market where people bargain for the use of the rights to scarce property and competing demands for use of an asset (Anderson & Grewell, 1999). According to the logic of the Coase theorem, the important condition is that whoever these owners are, public or private, their property rights should be well specified. (Jefferson, 1998). When there are competing claims, the Australian Law Courts will not assign and protect the rights of the party who values the property the most. Rather, it will look to the most economic viable option. In most cases, the court will protect the current landholder’s property rights to exploit the land and its resources for economic gain.

In adhering to protection of current right holders it can be seen that whether property rights evolve as private or as shared common property, definition and enforcement costs are likely to be lower at the local level because those involved in the process have more incentive and greater ability to economize on expenditures (Anderson & Hill, 1983). There are numerous explanations as to this resolution. Individuals at the local level are likely to be more culturally homogeneous, and that homogeneity provides norms that can help resolve conflicts in closely knit groups (Ellickson, 1991). Such social and cultural norms develop over time as efficiency-enhancing norms replace efficiency-reducing ones and as those who disagree with norms move where the norms better fit their preferences (Anderson, 1995). Overall a significant factor is cultural homogeneity, as it reduces transaction costs through common language that can lower the costs of specifying property rights and negotiating over their use (Anderson & McChesney, 1994).

When native title has been proven it will be subject to two further qualifications. Firstly, the use of land must be related to the practising of traditional customs. Secondly, the use of land must not interfere with the exploitation of resources. The rationale behind only providing native title holders with minimal rights is that if exclusive possession was proven, they would lack the expertise and technical skills required to exploit resources, for example mining. Consequently, resources would not be allocated efficiently, and wealth would not be maximised it would be wasted.

The recognition and extent of competing rights depends on the rights granted not the particular lease granted. In a cross-section of Australian High Court decisions, Ward v Western Australia (1998) 159 ALR 483 (Ward), Wik Peoples v Queensland (1996) 141 ALR 129 (Wik) and De Rose, pastoral and mining leases can only partially extinguish native title rights, and therefore native title rights can co-exist with other rights. Conversely, perpetual leases will wholly extinguish native title rights, and the rights of lessees remain unhindered as was held in the Wilson decision by the Australian High Court.

In Ward the rationale for the co-existence of property rights, is the assertion that native title claims inevitably consists of a bundle of rights. As a result the High Court of Australia, in the law cases of Yamirr and Wik, states that native title rights can be extinguished partially, subject to the inconsistency of incidents test. Australian real property law under Wik, in consideration of native title must compare the legal nature of statutory rights granted (grant and the statute it is made under) with the native title rights being claimed. Furthermore in Mabo, native title rights will be extinguished when there is an inconsistency with the manner of occupation. The manner of occupation being closely related to the existing property right granted to the agent.

Applying inconsistency test, leaseholders proprietary rights are largely protected. This was determined in Ward where leaseholders maintain rights related to exclusive possession, occupation and use and enjoyment of the area, control of access to the area and rights to make decisions about the area. The overall trend is that native title rights are residual in nature. However, Aboriginal and Torres Strait Islanders have rights with respect to the observance of traditional laws and customs. These rights include the right to have access to the claim area; move around the area to hunt, prepare and consume food; gather plants for medicinal purposes, can access
water so-long as it is not man-made; use timber to construct shelter and make weapons and implements and the right to hold meetings for religious and ceremonial purposes.

However, the division of a bundle of property rights should be done with caution as the boundary principle represents a moral hazard to the parties. The boundary principle limits the right to subdivide private property into wasteful fragments (Heller, 1999). In the United States, the division of property rights has been unbundled in a controlled manner allowing continued productivity for the use of each right (Rose-Ackerman, 1985). The trend in Australia is towards a controlled assignment of private property rights, increasing overall fragmentation of the bundle of rights (Heller & Krier, 1999). If Australian law and policy were to divide property rights too far and by too much then this would not be economically viable as it would increase transaction costs as a result of the assignment process to parties and secondly, rights as a resource would no longer have economic value as a result of externalities.

Denial of Rights
Posner (1998) argues that the denial of a property right can be as much an economising device as the creation of one. Posner (1998) also contends that limitation of economic devices can be designed to induce the correct level of investment in the exploitation of a valuable resource. The application of Posner’s arguments is that the denial of native title rights, under real property law policy, becomes a product of economic rational practicability and not an issue of racial discrimination. Broadly, the denial of native title can be justified on two grounds: public access and structures.

Public Access
Native title will be denied, where rights claimed are over public areas, such as waterways and water resources. The binding decision for public access is in the Australian High Court decision of Yamirr. The issue in Yamirr was whether native title could exist offshore to include the resources, which were in the seabed and subsoils. The claim was for the ownership, exclusive possession, occupation, use, and enjoyment of an area of sea. In Yamirr it was held that native title exists offshore, but not exclusive title. The denial of exclusive rights was grounded on the common law public rights of navigation and fishing and innocent passage. Applying the economic analysis of law, granting an exclusive right to a valuable public resource could result into a potential quasi-monopoly and rent seeking behaviour over waters. This would lead to wasted resources and market failure. This is evidenced in His Honour Justice Kirby’s dissenting judgement in Yamirr, where he held that exclusive rights existed, and therefore the right to prevent fishing, tourism and mining activities around the island.

Structures
Operational inconsistencies are another basis for denying the recognition native title rights and were set as a precedent in De Rose. Furthermore De Rose held that native title will be extinguished where there have been improvements to the land, for example by the construction of homesteads, dams, bores and airstrips. One reason for this denial is that Aboriginal and Torres Strait Islanders are no longer able to observe traditional laws and customs if there have been improvements. However, applying an economic framework there are two additional reasons. Firstly, native title claimants would receive a benefit, without necessarily compensating the previous landholders adequately. While market value or ‘just terms’ is the basis for compensation, it does not consider the subjective value of the property. The person being dispossessed may value the property above market value. For example, in Yorta Yorta, a portion of the farmer’s descendants had occupied and worked the land continuously since the 1870s. Secondly, the land may have moved to the economic agent with the highest value for the land. Therefore if not used efficiently, resources would no longer be maximised and the creation of wealth becomes stagnant. To ensure that native title rights do not interfere with the rights of leaseholders to use structures, De Rose holds, under Australian law that the application of a buffer zone of one kilometre radius exists around the structure. However if there are improvements that can be shared, then Mabo allows for shared property rights and that native title will not be extinguished.

Still there remains the problem of common property rights. Gordon (1954), Demesetz (1964), Demesetz (1997) and Furubotn and Pejovich (1972) all agree that over exploitation results when there is common property as users ignore their impact on other users. This is commonly referred to as the tragedy of the commons. The tragedy of the commons follows Pigou’s externality in a negative aspect. In this situation Coase rights are not defined sufficiently to consider the optimum usage or marginal benefit.

Implications and Suggestions for Future Research
In considering Coase (1960) and Pigou (1932) and real property law from a bottom-up perspective in Australia a number of trends have been outlined in this paper. Pigou’s (1932) externalities and regulation were held to be an important component for economic agents within the real property law framework. Particularly in consideration of the burden of proof and certainty regarding investment of resources. Coase’s (1960) transaction costs would be burdensome in view of the actual process of the claim and the outcome of the judicial process. Furthermore, in dividing rights between parties and adhering to the notion of a bundle of rights transaction costs were also high but were reduced when a local climate of resources had been utilised and when capital investment had already occurred.

Rights would be divided when the rights of native title claimants are not inconsistent with existing rights. In this situation, the right may be considered to have transferred to the user with the highest economic value (see Coase, 1960). At first instance Pigou’s (1932) social cost approach would hold however intrinsic value of the right is considered and the native title party may move around the area to hunt, prepare and consume food; gather plants for medicinal purposes, can access water so-long as it is not man-made; use timber to construct shelter and make weapons and implements and the right to hold meetings for religious and ceremonial purposes, when these actions are consistent with traditional customs and aboriginal laws.

Outright denial of aforementioned rights will occur on two grounds. The first instance is when there is public access to consider, here exclusive native title will be denied, where rights claimed are over public areas, such as waterways and water resources. In this case a monopoly of the bundle of rights is avoided and individual rights can be utilised by more agents. The second instance occurs when there are operational inconsistencies are another basis for denying the recognition native title as it may interfere with existing investments. As a result the resource will not be used efficiently.

It can be seen that a number of perspectives can be considered in analysing native title and real property law in Australia. This paper did not consider an economic analysis of non-native title claimants. The dominant reason being that native title is changing the framework of the doctrine of precedent in Australian real property law from a bottom-up perspective. Future studies may also contribute further to the economic field of analysing the law by
investigating the role of the law courts as an economic institution or as an indirect policy maker.

**Conclusion**

This paper has discussed the important implications stemming from the economic rationale of real property law in an Australian context. This paper discussed native title judicial decisions, through the application of an economic analysis of the law. Transaction cost theory, Coase’s theorem and Pigou’s externality effect were examined through the economic law literature and Australian cases. In analysing these theories, the paper concluded that externalities and regulation were held to be an important component for economic agents within the real property law framework. Suggestions for future research were highlighted and implications stemming from this paper were stated.

**References**


