

Professor Allan Fels, Dr Stephen Beare and Stephanie Szakiel

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Urban Taskforce AUSTRALIA concept economics



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FOREWORD



The Urban Taskforce is an industry organisation representing Australia's most prominent property developers and equity financiers. Our membership also includes key infrastructure providers, economists, planners, architects and lawyers involved in property development. We provide a forum for people involved in the development and planning of the urban environment to engage in constructive dialogue with both government and the community.

The Urban Taskforce commissioned Professor Allan Fels and the staff of Concept Economics to prepare this report for two key reasons.

Firstly, the cost of groceries and basic household goods has been a significant topic of public debate over the last 12 months. So much so, that the Australian Competition and Consumer Commission is undertaking a broad ranging inquiry into the grocery industry, including any potential barriers to competition at the retail level.

Secondly, the NSW Government has announced that it will prepare a centres/retail State environmental planning policy later this year. This policy will have an enormous potential to impact on retail competition – either for the better or for the worse.

This report provides the most detailed analysis of the impact of planning policies on retail competition ever produced in Australia.

It shows that the potential gains of more competition-friendly planning could add up to \$78 billion in extra income for the NSW economy and \$296 billion for the national economy.

Reform could deliver 147,000 extra jobs Australia wide and 47,000 new jobs in NSW.

Lifting the competitive restrictions imposed by planning policies will result in groceries at a lower cost with more stores offering better prices. As this report shows, consumers can expect to pay up to 18 per cent less for food staples and up to 28 per cent less for other household products in the most price-competitive retail formats.

The necessary planning reforms are about stimulating investment and innovation in the urban environment. The proposed reforms will increase the ability of the planning system to respond to changes in the marketplace. The reforms will allow the planning system to focus on its core business – minimising the costs of congestion, reducing noise impacts and protecting cultural and environmental assets.

On behalf of the Urban Taskforce I would like to acknowledge the work of Professor Fels and his expert team on this report. I would also like to recognise the valuable information provided by the members of the Taskforce, including our Secretary/Treasurer, David Tanevski.

Aaron Gadiel
Chief Executive
Urban Taskforce Australia
May 2008

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Professor Allan Fels, AO is Dean of the Australia and New Zealand School of Government (ANZSOG). Professor Fels was Chairman of the Australian Competition and Consumer Commission from 1995 until 30 June 2003 and prior to that he was Chairman of the Trade Practices Commission from 1991 to 1995 and Chairman of the Prices Surveillance Authority from 1989 to 1992. He was Chair of the OECD Trade and Competition Committee from 1996 to 2003.

Professor Fels was previously Dean of the Graduate School of Management of Monash University. He was appointed a Professor of Administration at Monash University in 1984. He has been an Honorary Professor in the Faculty of Economics and Business at Monash University since 1996, a Professorial Fellow in the Department of Political Science at the University of Melbourne since 2003 and was recently awarded an Honorary Doctorate of Economics, University of Western Australia. He is a Fellow of the Australian Academy of Social Science.

Professor Fels was awarded The Order of Australia (AO) in 2001.

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Stephanie is an economist at Concept Economics with background in economic theory. Stephanie's previous work experience in the field of regulatory and competition economics includes analysis of the competitiveness of the Australian retail sector and development and analysis of spatial competition models of Australian shopping centres and major retailers.

Stephanie also has experience in conducting geo-statistical analysis and developing regional demographic projections. Her work has been applied to a broad range of sectors including retail competition, water resources, minerals and energy industries, and oil and gas commodity price forecasts.

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1. EXECUTIVE SUMMARY

In most cities around the world, planning controls or regulations of some form have been implemented to attempt to ensure that development is achieved at socially desirable levels. However, when such restrictions are put in place, it is important that the impacts of these policies are entirely understood. Such restrictions raise a risk of unintended consequences and potentially misdirected incentives may be provided to developers. This may impede the ability of the policy to achieve the socially desired planning outcomes and deprive the community of efficiently priced goods and services and other benefits associated with increased competition.

Most of the literature on indirect effects of urban planning has been focused on the affordability and choice of housing. The focus of this report is on retail development with reference to land use planning in New South Wales. Constraints on shopping locations and formats in Australia were cited by Moran as a source of higher prices, reduced choice and diminished services. However, the effect of planning restrictions on the cost of provision and quality of retail services has not received much critical attention to date.

These issues are likely to become increasingly important. Hill PDA has projected that the Sydney metropolitan area (excluding the Central Coast) will need an additional four million square metres of occupied retail space by 2031;¹ a 50 per cent increase over current levels. The NSW government makes a more conservative estimate of an additional 3.7 million square metres, which includes the Central Coast, made in its Metropolitan Strategy. This lower estimate still represents a very substantial increase in commercial real-estate demand and does not take into account the need for commercial demands outside the retail sector.

The central issue for this study is whether the planning system, as it currently exists, can adequately and efficiently accommodate this expanding community need. The *Environmental Planning and Assessment Act 1979 (NSW)* provides a legal basis for the planning system but the processes are aligned to government policy. Government planning policies have been focused on a narrow view of urban consolidation since the Sydney region outlook plan was realised in 1968. The strategy released by the NSW government in December 2005 was based on a metropolitan region with 5 "cities"

- The Sydney CBD;
- North Sydney;
- Parramatta
- Penrith; and
- Liverpool.

A further 27 "strategic centres" are identified, which include Chatswood, Bondi Junction and Burwood.

The centres policy has directed retail development to concentrate a high proportion of retail services in a limited number of established centres. These centres are already highly congested, and the costs of expanding transport infrastructure, including roads and rail, are extremely high. An alternative directed at the same basic planning

¹ Hill PDA (2008) *Demand for retailing floorspace*, Report for the Urban Taskforce.

goals would be to encourage retail developments that take the pressure off these highly congested areas and promote more pedestrian friendly communities while still facilitating the use of public transport.

Moreover, the way in which the centres policy is given effect is through highly prescriptive regulations that exclude specific retail services and formats. In NSW this pattern appears to be continuing with foreshadowed and ongoing policies aimed at rationing retail development by capping the number of full-line supermarkets and other larger format retail facilities in most suburbs of Sydney. Clothing and food sales are also excluded from some commercial precincts.

The planning process has become reactive and focused on micro-level intervention in a complex and highly interdependent environment. A planning process that provides strategic direction for development in terms of public infrastructure investment in transport and other services is likely to be more cost effective and generate development that is more responsive to community demands.

Planning reform requires a change in perspective. With the recognition that markets or commercial incentives may fail to lead to socially desired outcomes there also comes the unfortunate belief that any attempt to address this failure is in the public interest.² Urban development should be seen in the context of planning failure as well as market failure. Planning failure is not simply the potential for planners to make mistakes, but the inability of a planning policy to deliver benefits that would justify its implementation.

“[I]n the planning sector, governments appear to be upholding anti-competitive processes that elsewhere would potentially be considered to be contravening the Trade Practices Act”

The ability of land use planning restrictions to alter economic incentives to develop and/or expand new businesses and promote or hinder retail competition means that close scrutiny must be paid to the system and its ability to achieve desired goals.

Important issues that need to be considered include:

- Are the land use regulations actually achieving their stated objectives and improving community welfare?
- Where does the burden of proof lie when negotiations are being undertaken? Is it the responsibility of applicant developers to show that it is in the community's interest to have the development proceed, or is it the responsibility of the prevailing authority to demonstrate that the planning instrument blocking the proposal is in the broader interests of the community?
- Are developers and authorities able to negotiate a development solution that maximises community welfare? This requires low levels of transactions costs for all parties, and that authorities are negotiating in a neutral manner with the broader community interests in mind, not merely the property value interests of incumbent land owners.
- What factors are taken into account when economic test are undertaken in planning assessments?

² Coase, R. (1960) *The problem of social cost*, Journal of Law and Economics 3: 1-44

This last point is pertinent when discussing the efficiency of land use regulations. Economic, or community, welfare encompasses all aspects of the collective welfare of all parties in the community, in a dynamic, forward looking and flexible manner. In NSW, section 79C of the *Environmental Planning and Assessment Act* outlines the requirement for consent authorities to consider the economic impacts of a proposed development through the approval process. However, there is limited discussion on how these benefits are to be measured

“[T]he potential gains to retail productivity growth from a more flexible planning system in Australia could ... equate to between \$52-\$78 billion of NSW Gross State Product, and \$197-\$296 billion in Australian Gross Domestic Product.”

That lack of specificity notwithstanding, the legislation and the way it has been interpreted give rise not to an economic welfare or efficiency test but rather to what seems to be a test regarding the number of facilities. For example, in *Kentucky Fried Chicken Pty Ltd v Gantidis* (1978) 140 CLR 675, it was stated that “the mere threat of competition to existing businesses, *if not accompanied by a prospect of a resultant overall adverse effect upon the extent and adequacy of facilities available to the local community if the development be proceeded with*, will not be a relevant town planning consideration.”

The approach appears immediately problematic, for at least three reasons:

- Firstly, the test can only be interpreted as an economic welfare (or efficiency) test insofar as the number of facilities is a proxy for welfare. However, it is not clear why the number of facilities would make a good proxy for welfare. The number of facilities could diminish but welfare increase: for example, if in the absence of zoning or format restrictions the facilities ultimately emerging offer higher levels of customer service and competition or lower prices. This can occur, for example, when larger formats provide returns to scope and scale.
- Secondly, the test does not take into consideration the alternate uses of land or property that may evolve in the event that current services do leave the market in response to increased competition. It is unlikely to be the case that a current centre is going to face complete abandonment and more likely, service provision in the area will evolve and adapt to the ultimate benefit of residents and consumers. Therefore, the test overstates the economic costs that would fall on the area, by taking into consideration only the first round effects of any proposed development, without accounting for new sources of benefits that may be established as adjustment proceeds.
- Thirdly, the requirement for projection and forecasts of future impacts on the number of facilities appears to place a high burden on decision-makers and potentially opens the debate as to what constitutes a reduction in facilities in contrast to a readjustment in facilities. The error rate from the application of this flawed test could be very high (that is, some developments that would have improved community welfare would be disallowed), imposing economic costs, including the curtailment of competition.

There are a number of examples presented where the application of tests for economic welfare have been misused and therefore, have resulted in the refusal of developments that may have improved economic and community welfare.

Where there are strong actions being taken toward increasing competition and reducing the influence monopolies and duopolies have in other areas of the economy, in the planning sector, governments appear to be upholding anti-competitive processes that elsewhere would potentially be considered to be contravening the *Trade Practices Act*.³

"The full impact of a 10 per cent increase in retail floor space on employment could then be 147,000 jobs Australia wide, 47,000 jobs in NSW and 16,500 jobs in metropolitan Sydney."

Land use regulations, inefficient zoning requirements and restrictions on store formats can have wide ranging impacts on economic output and productivity. By altering or restricting the location of retail outlets or store formats, such regulations can have an influence on productivity growth. Examples include restrictions on:

- an existing store's ability to alter its format in response to changing technology;
- to expand its retail offer due to land use restrictions; or
- the ability of new stores to open in certain areas that would generate these productivity gains.

Land use planning reform should seek to match urban development with community demands. It is important to recognise that community demands are not all commonly shared and can be quite diverse. Future demands are highly uncertain with growing populations, shifting social demographics and the development of information and other technologies. A complex regulatory environment is likely to inhibit adaptation and innovation in urban design and the provision of retail services.

Exclusionary regulations are those regulations that prohibit one or more land uses from being undertaken on a particular site, or that may limit the size or format of a permitted use. Exclusionary regulations create incentive for avoidance, largely through artificial differences in pre and post development property values, a major problem in political governance of urban planning.⁴

The misalignment of commercial incentives and planning objectives should in itself be seen as cause to review the planning process and its objectives. Commercial incentives do carry a clear message regarding business demands for retail space. The misalignment also provides good cause to publicly articulate why restrictions are in place and what they are intended to achieve.

To encourage adaptation and innovation, urban planning should encourage – as opposed to discourage – investment in retail development. Planning restrictions are, in the first instance, an impediment to commercial investment. These restrictions cannot compel investments to be made in the location and form that is desired by urban planners. Despite the best intentions of planning regulators, investments may be redirected to areas and formats that are less advantageous than what may have taken place if the restrictions were not in place.

In part a rectification may be achieved by removing planning barriers that are aimed at concerns such as congestion or road safety that ultimately serve to inhibit competition. This can also be supported by strategic investments in public infrastructure that will help align commercial incentives with broader urban planning objectives.

³ Moran, A. (2006) *The tragedy of planning: losing the great Australian Dream*, Institute of Public Affairs, Victoria, Australia.

⁴ Ibid.

It is possible to gain some insight as to the impact that inflexible land use restrictions may have on productivity growth by examining comparisons of productivity growth in different international jurisdictions. The Organisation for Economic Co-operation and Development (OECD) has referenced land use restrictions as being an important effect in constraining productivity growth in the European Union (EU).

“The argument for a more flexible approach to planning ... is not about ignoring the costs of congestion, noise or the loss of cultural and environmental assets.”

Over time, countries that have allowed the retail sector to take advantage of economies of scope and scale have experienced some of the higher rates of productivity growth in the retail sector. Given observed differences in productivity growth in international studies, the potential gains to retail productivity growth from a more flexible planning system in Australia could reasonably be considered to be in the range of 1 to 1.5 per cent per annum. Over 50 years, in net present value terms, this additional productivity growth in retail services could equate to between \$52-\$78 billion of NSW Gross State Product, and \$197-\$296 billion in Australian Gross Domestic Product

Restrictions on the level of retail development also have employment impacts. Where there is limited floor space, there is also limited job availability. Allowing for increased labour productivity in larger format stores, it would be conservative to assume that 10 per cent increase in floor space resulted in only a 5 per cent increase in direct retail employment. The total employment in the retail sector is currently about 1.2 million persons. This increase would equate to 61,000 jobs Australia wide. In NSW, this would equate to over 19,500 jobs and in metropolitan Sydney 6,850 jobs.

As with productivity increases, job creation has flow on effects. Every additional retail sector job has been estimated to create an additional 1.42 jobs in the Australian economy.⁵ The full impact of a 10 per cent increase in retail floor space on employment could then be 147,000 jobs Australia wide, 47,000 jobs in NSW and 16,500 jobs in metropolitan Sydney.

This loss of income to the State and national economies and missed job opportunities should not be viewed as academic numbers. They reflect a legitimate cost of planning policies that is ultimately borne by consumers.

Another way of identifying this cost is to consider how the planning system's artificial restriction on the format and layout of supermarkets and retail stores affects consumers directly. By mandating smaller, more compact sizes and restricting large format stores, the planning system removes economies of scope and scale that could be achieved with larger formats, resulting in increased prices experienced by consumers.

In 2007, prices for food staples were on average 22 per cent higher in mid-priced stores than in larger format supermarkets and household and personal care products were between 33 and 39 per cent higher on average (EIU, Cost of living survey).

The effect of lower cost store formats on prices should not be underestimated. The US Department of Agriculture found that, after adjusting for quality and packaging, large format stores such as Wal-mart have significantly lower prices for dairy products and eggs. The report then went on to suggest that the ongoing growth in the

⁵ Valadkhani, A. (2005) *A cross-country analysis of high employment generating industries*, Applied Economic Letters 12(14).

presence of these store formats could warrant reconsideration of the way in which the US Consumer Price Index was calculated. This conclusion is supported by previous studies by Kaufman and Hausman and Leibtag. Kaufman found that US food prices are generally higher in smaller grocery stores than in larger supermarkets and also higher in inner-city and rural locations than in suburban locations.⁶ Hausman and Leibtag found that large format stores may have reduced that actual rate of food inflation by 1.5 per cent.⁷

Statistics Canada did not find the opening of large format stores biased the CPI as they suggested that existing outlets responded to the increased level of competition by lowering prices.⁸ They found that in response to the opening of new lower-priced superstores, existing food stores lowered prices prior to the opening of the outlet and they continued to respond to price changes in the new outlet over time.

Artificially restricting the format and layout of supermarkets and retail stores to smaller, more compact sizes has the potential to remove economies of scope and scale that could be achieved with larger formats, resulting in increased prices experienced by consumers

The argument for a more flexible approach to planning is largely about stimulating investment and innovation in the urban environment and increasing the ability of the planning system to respond to changes in the marketplace. It is not about ignoring the costs of congestion, noise or the loss of cultural and environmental assets. It is about assessing the effectiveness of planning strategies as well as development plans.

Altering the planning landscape to allow for a more flexible approach to development will not rapidly transform the urban environment as there are strong market based incentives that promote diversity. From a developer's point of view, the risks of a narrow and aggressive investment strategy are quite high. A more flexible approach will promote an evolution in the urban environment as developers seek to match commercial incentives with both private and public demands. That said, it remains important to be able to prevent bad outcomes where these are readily foreseeable. The use of exclusionary regulations, or exclusionary zoning policies, will always be a part of urban planning. However, using exclusionary regulations as a reactive as opposed to a pre-emptive strategy is an essential aspect of good regulatory policy.

The objective of this report is to canvass the case for significant changes to urban planning in NSW. However, this study focuses on the economic implications of restrictive versus flexible planning policies. At the same time, consideration needs to be given to the concrete options of an alternative planning model if this assessment is to have true context. This is outside the scope of the authors' expertise. However, the Urban Taskforce has put a model forward for consideration, the key points of which are:

- prohibit consent authorities in a development assessment from considering any possible direct or indirect loss of trade that might be suffered by any other planned or existing business or businesses;
- amending the NSW zoning rules so that:

⁶ Kaufman, P. et al (1997) Do the poor pay more for food? Item selection and price differences affect low-income household food costs. U.S. Department of Agriculture, Economic Research Service, AER 759, Nov.

⁷ Hausman, J. and Leibtag, J (2004) *CPI bias from supercentres: does the BLS know that Wal-mart exists?* NBER working paper #11809, National Bureau of Economic Research, Cambridge, MA. August.

⁸ Hayman, C. (2006) Outlet substitution bias in the Canadian consumer price index: A case study, Statistics Canada, Prices Division.

- new businesses are no longer prevented from developing where they offer competition to businesses located in established centres;
- retail uses are not precluded where large numbers of people may be working;
- mixed use developments (retail and residential in a single development) are not precluded in areas of medium and high density development.
- the amendment of the objectives of the *Environmental Planning and Assessment Act* to recognise the role that competitive markets play in allocating goods and services within the economy; and
- revisions to the draft sub regional strategies would include:
 - a subregional and local government area target for shop front space alongside the targets for dwellings and employment capacity.
 - abandoning the separation of retail land uses from other land uses; and
 - promoting and encouraging amenities such as retail in all of the local centres, employment lands and major arterial roads.

Quite apart from the economic effects of the policies, the Taskforce has argued that these reforms will encourage the development of compact, mixed-use communities. They argue that this will be a more efficient use of land and infrastructure and make good planning sense. This model, they say, will create more attractive, liveable, economically strong communities. The Taskforce says that such policies facilitate a development pattern that supports pedestrian based communities and reduces the dependence on motor vehicles by putting residents' and (in centres of employment such as business parks and light industrial areas) employees' daily needs within a short walk of home or work.

2. INTRODUCTION AND OVERVIEW OF THE CURRENT SITUATION IN SYDNEY

The population of Sydney is projected to increase by 1.1 million people to 5.3 million by 2031. It is important that development and planning policies are flexible enough to be able to meet the needs and demand of such a growing population.

There is concern that the rigidity of current policies and procedures in NSW will not be able to adapt and provide the services and community welfare that is required. It is likely that a more holistic approach to planning, transport policy and public infrastructure investment will be required.

Given that urban centres are already highly congested, and the costs of expanding public transport infrastructure, including roads, is extremely high, attempting to retain a high proportion of retail services in these areas may in fact be counter productive. It may be more cost effective to encourage in-fill developments and neighbourhood centres that take the pressure off these highly congested areas while still promoting pedestrian and public transport outcomes.

Re-distribution of retail and other services through areas such as residential, industrial and employment lands is also likely to improve community welfare by developing these services and industries in areas where consumers are located. Mixed use areas have the potential to provide the required flexibility in land use policies to adapt to changing market forces and population demographics.

2.1. ANTICIPATED GROWTH AND DEMOGRAPHIC CHANGE

The New South Wales Government's Metropolitan Strategy outlines the changes, challenges and proposed outlook for the state through to 2031. The plan describes Sydney as Australia's only global city, with approximately half of Australia's top 500 companies present and two thirds of South East Asia and Pacific regional headquarters of multinational corporations located in the city.

The population of Sydney is projected to grow from 4.2 million people in 2004 to 5.3 in 2031. Employment projections estimate that the current 2 million jobs located in Sydney will increase by 500,000 to 2.5 million in 2031. Currently employment is spread throughout the city with 700,000 jobs located along the economic corridor between Macquarie Park, Sydney CBD and Sydney airport.

"[A] 50 per cent increase on retail floor space is required over the next twenty-five years."

Along with these projections of population growth also come projections of increased demand for good and services and infrastructure. It is estimated that such an increase in population and employment would require:

- 640,000 new homes;
- At least 7,500 hectares of additional industrial land;
- 6.8 million square meters of additional floor space; and,
- 3.7 million square meters of additional retail space.

This does not include increased demand for health and education services.

In 2007 the Urban Taskforce commissioned property economics and urban planning consultancy Hill PDA to project the additional retail space that would be required in Sydney if the population goals predicted by the NSW Government were to be met.



Innovative and unconventional retail environments can be discouraged if retail developments and formats are restricted to a limited number of old town centres.

Hill PDA examined the demand for supermarkets, convenience stores, small mixed businesses, speciality food stores, department stores (including discount department stores), bulky goods retailers (including electrical appliances, furniture, floor coverings, hardware, sports and camping stores) and personal services (including beauty salons, photo processing, optometrists, video hire, laundries and dry cleaning).⁹

The conclusion was that currently, an average 2.1 square metres of retail space per person is demanded or required. This figure is forecast to increase to 2.5 square metres in 2031 due to rising incomes and living standards.¹⁰ This projected increase in per capita retail space is a continuation of existing trends – the current figure of 2.1 square metres per person is an increase from 1.8 square metres per person 15 years ago. Actual requirements for different sub-regions and local government areas will vary due to differences in income levels and other demographic variables.

Based on these figures, the Sydney metropolitan area (excluding the Central Coast) will need an additional four million square metres of occupied retail space by 2031. Currently supply in Sydney is eight million square metres – therefore a 50 per cent increase on retail floor space is required over the next twenty-five years.

“ [T]here is a risk that the planning system will become overly prescriptive to the detriment of the city’s potential.”

This projection suggests that the 3.7 million square metres (which included the Central Coast) projected in the Metropolitan Strategy is insufficient to meet the needs of Sydney households.

Furthermore, Hill PDA also reported the need for the provision of non-retail commercial services. In large indoor shopping centres between 5 to 10 per cent of specialities stores are non-retail and include such uses as medical services, travel agents, banks, internet, professional photography and other miscellaneous services. In older strip retail centres such uses typically occupy between 15 per cent and 35 per cent of shops and also include real estate agents.

Hill PDA advises that this equates to an additional 12.5 per cent of total retail space required for these non-retail commercial services. This means a further 500,000 square metres of space will be required by 2031 – a total of 4.5 million square metres of shopfront space.

It is important that these development requirements are not taken lightly and that any planning authorities are required to acknowledge and facilitate such growth. Further, consideration needs to be given as to whether the current centres policy is in fact suited to meeting expected population growth and the expanded demand for residential and retail services. A more holistic approach to planning, transport policy and public infrastructure investment is likely to be required. Given that urban centres are already highly congested, and the costs of expanding public transport infrastructure, including roads, is extremely high, attempting to retain a high proportion of retail services in these areas may in fact be counter productive. It may be more cost effective to encourage in-fill developments and neighbourhood centres that take the pressure off these highly congested areas while still promoting pedestrian and public transport outcomes.

⁹ Hill PDA (2008) *Demand for retailing floorspace*, Report for the Urban Taskforce.

¹⁰ This figure is similar to that published for the Victorian Department of Sustainability and Environment that projected an average retail floor space requirement of 2.4 square meters per capita in Melbourne by 2030 (Essential Economics, 2006).

Projections by Woolworths and MapInfo Dimasi (pers. comm., Paul Oates) indicate that across the four subregional areas of Sydney (East, Inner North, North East and North) there will be demand for an additional 11 supermarkets of minimum 3,100m² and an additional 2 large scale discount department stores of minimum 7,200m². This additional demand is projected on top of what Woolworths currently estimates as unfulfilled demand for 35 supermarkets and 15 discount department stores across the city.

“The draft strategies ration retail development by capping the number of full-line supermarkets and other larger format retail facilities in most suburbs of Sydney ...”

The Metropolitan Plan also outlines proposed development of more employment land areas that are aimed at increasing the density of business, people and infrastructure. This development would make use of economies of scale and scope and promote more efficient operations and innovation. However, one of the concerns that retail developers have is that there is currently no scope for retail development to be undertaken in these employment lands. Planning documents are attempting to encourage and support existing centres policies that promote retail development in existing centres, to promote multi-purpose single trip shopping.



Multi-purpose car trips are encouraged when retail facilities are located close to destinations people are already travelling to by car (such as their workplace) or along major arterial roads. By replacing single purpose car trips with multi-purpose car trips, less vehicle kilometres are travelled, reducing the strain on the road transport network.

In the face of such large scale growth projections, and changing demographics and employment models – where workers are moving in large numbers from multiple residential areas to single employment areas – it is highly likely that the planning system will also need to be similarly flexible and dynamic. Without such issues being taken into account in a dynamic and forward thinking way, there is a risk that the planning system will become overly prescriptive to the detriment of the city's potential.

"These kinds of restrictive policies can severely limit competition and allow incumbent land holders to exercise disproportionate market power and force commercial rental and lease prices well above competitive levels."

2.2. THE IMPACT OF THE SUBREGIONAL STRATEGIES

Currently, while the Metropolitan Strategy outlines (a possibly inadequate) increase in retail floor space, there is (according to the Urban Taskforce's submission to the Australian Competition and Consumer Commission) limited recognition of this requirement in the Draft Subregional Strategies for Sydney.

According to the Taskforce, Draft SEPP 66 ensures that the formal identification and categorisation of centres will govern if, when and how new retail facilities are to be developed and the subregional strategies are the documents that will prescribe a list of smaller centres ("local centres") across Sydney for the life of the Metropolitan Strategy (i.e. until 2031).

The Taskforce's report *Getting Life's Essentials* says that eight subregional strategies have been released by the Department of Planning in draft form. The Urban Taskforce has undertaken a detailed analysis of the North-East, Inner North and East subregional strategies. They concluded that the subregional strategies fail to pay any significant attention to the retail needs of Sydney over the next 25 years.

The draft strategies ration retail development by capping the number of full-line supermarkets and other larger format retail facilities in most suburbs of Sydney at either current levels, below current levels or nil (depending on the suburb).

For example, in the case of local centres, "villages" are limited to one "small" supermarket and supermarkets are banned altogether in "small villages" and neighbourhood centres. Generally speaking this means no new supermarkets, as the designated "villages" already have at least one supermarket. Neighbourhood centres are only permitted five shops – and the radius for a neighbourhood centre has been cut back to just 150 metres.

According to the draft strategies, places like Crows Nest, Hillsdale, Cherrybrook and St Ives can only have one supermarket – even when they currently have two.

The draft strategies prevent places like Lindfield, Vaucluse and Berowra from having a supermarket even though they already do. Localities like Croydon or Waverton are not permitted to have supermarket – even as their population grows in the coming years.

These kinds of restrictive policies can severely limit competition and allow incumbent land holders to exercise disproportionate market power and force commercial rental and lease prices well above competitive levels.

Enterprise zones are proposed for a wide range of areas (e.g. Parramatta Road, Anzac Parade, Victoria Road) – but retailing is to be discouraged in these areas. The Taskforce says that this will increase the number of single purpose car trips and unnecessarily contribute to traffic congestion. They say that the ability for retail in corridors to reduce car trips is ignored.

The Taskforce also criticises the prohibition on “town centres” having anything more than a single “small” shopping mall and they highlight the fact that such malls were banned altogether in other local centres.

“[C]ompact, mixed-used areas, making efficient use of land and infrastructure, make good planning sense. ... [S]uch policies facilitate a development pattern that supports pedestrian based communities and reduces dependence on motor vehicles by putting residents’ and ... employees’ daily needs within a short walk of home or work.

Only the 27 strategic centres (e.g. Chatswood, Bondi Junction) are free from express rules limiting retail growth. On average there is one strategic centre to serve the retail needs of 200,000 Sydney residents.

The Urban Taskforce argues that provisions in the sub-regional strategies that attempt to separate retail uses from other uses should be abandoned. They say that the separation and regulation of different land-uses, particularly retail, should no longer be a key planning objective. In their view, the planning system should be concerned with:

- the “form” (shape/configuration) of a structure; and
- the relationship of buildings to each other, to streets and to open spaces.

The Urban Taskforce believes that compact, mixed-used areas, making efficient use of land and infrastructure, make good planning sense. This model is said to create more attractive, liveable, economically strong communities. The Taskforce says that such policies facilitate a development pattern that supports pedestrian based communities and reduces dependence on motor vehicles by putting residents’ and (in centres of employment such as business parks and light industrial areas) employees’ daily needs within a short walk of home or work.

The Urban Taskforce says that the draft sub-regional strategies would have profound implications for Sydney. The serious flaws in these drafts need to be addressed, in partnership with industry, before any of these subregional strategies are finalised.

They say that if implemented “as is” the draft strategies will make supermarkets and shopping malls one of the most heavily regulated sectors of the economy, alongside mines, casinos and brothels.

According to the Urban Taskforce’s analysis, the draft strategies will see a dramatic extension of Sydney’s car use and will increase congestion. This is because the strategies effectively require any substantial growth in the retail

industry to be in a modest number of “strategic centres” (like Chatswood and Bondi Junction) at the expense of places where Sydneysiders will be living, working or travelling through. The Taskforce says that this would be a defacto abandonment of the idea of “walkable community neighbourhoods”.

2.3. ADDRESSING THE SUBREGIONAL STRATEGIES

It is the view of the Urban Taskforce that implementation of the draft subregional strategies would be destructive to the social and economic fabric of Sydney –

- undermining the cohesion of local neighbourhoods by forcing people to travel by car elsewhere for their needs;
- denying future Sydney households the benefits of inexpensive full-line supermarkets;
- reducing competition in the retail sector; and
- preventing the creation of more vibrant office parks with a wider range of services for the local workforce.

“[U]rban development should be seen in the context of planning failure as well as market failure. Planning failure is not simply the potential for planners to make mistakes, but the inability of a planning paradigm to deliver benefits that would justify its implementation”

The Urban Taskforce has argued that the NSW Government should undertake the following steps before finalising the sub regional strategies:

- Each subregional strategy should incorporate a subregional and local government area target for shop front space alongside the targets for dwellings and employment capacity.
- Provisions in the sub-regional strategies that attempt to separate retail uses from other uses should be abandoned.
- The subregional strategies should actually encourage amenities such as retail in all of the local centres, employment lands and major arterial roads.
- All four categories in the local centres hierarchy should simply be regarded as “local centres” and should permit the full range of retail premises.

2.4. OVERVIEW OF REPORT

In this report the benefits and costs of urban land use planning under the NSW *Environmental and Planning Act* (the Act) are examined. The purpose of this examination is to identify whether there are reforms to the Act, and the policies made under it, that would improve community welfare.

The study predominantly considers planning regulation that is directed at new and existing retail developments, for example zoning controls and format restrictions.

Each planning zone in NSW is accompanied by designated activities that are, and are not, permitted to be undertaken within them. There are also additional planning policies such as the centres policy in NSW that requires additional retail development to be focussed in a modest number of existing centres (such as Sydney's Chatswood, Bondi Junction and Burwood).

While the study is predominantly focussed on the effect of such planning policies in NSW, much of the discussion draws on studies and examples from other areas in Australia as well as internationally.

In a public policy context, the justification of land use and planning restrictions has been that urban development based solely on commercial imperative will generate unwanted consequences. That is, purely market driven incentives would fail to enhance or preserve environmental and social capital to the level demanded by society as a whole.



Public transport, such as buses, has not been embraced by the great majority of families who visit supermarkets in town centres.

In his book for the respected non-partisan think tank, *Resources for the Future*, Dr Jonathan Levine starts from the premise that urban development should be seen in the context of planning failure as well as market failure. Planning failure is not simply the potential for planners to make mistakes, but the inability of a planning paradigm to deliver benefits that would justify its implementation.¹¹

Dr Levine, who is Professor and Chair of Urban and Regional Planning in the A. Alfred Taubman College of Architecture and Urban Planning at the University of Michigan, notes that nowhere in the United States (US) is the market allowed to freely determine urban design. Urban design in Australia and the US is the product of commercial imperatives that arise under planning restrictions and public infrastructure development.

Levine articulates two divergent perspectives of urban land use planning.

The first is that land use restrictions are a collective property right held by a planning authority in the overall interest of existing property owners. That is, planning restrictions are a public good. From this perspective, the burden is on the individual or individuals seeking change to compensate or demonstrate compensation to those existing landholders, regardless of whether the restriction was in fact in the community interest.

The second is to view planning restrictions as a form of economic regulation. Here the burden shifts to identifying a specific market failure and a regulation that cost effectively reduces the impact of that failure. Levine argues that this view is essential if there is to be positive discussion and reform to land use planning. Reform of land use planning would then be placed into the broader context of microeconomic reform that has been a central part of Australian economic policy over the last almost 25 years.

There are two central goals of land use planning reform. The first is to better align urban development with community demands. A growing population along with shifting social demographics and the development and adoption of information and other technologies will continue to change the demand for retail and other urban services. These changes will remain difficult to predict and a more adaptive approach to urban planning is likely to provide greater resilience in the urban environment than restrictive regimes that are slow and costly to change.

A second goal is to ensure that planning attracts desired, efficient, investment. Planning restrictions are, in the first instance, an impediment to commercial investment. Restrictions do not compel investments to be made in the location and form that may be desired by their authors. Instead, investments may be redirected to areas and formats that are less advantageous than what may have taken place if the restrictions were not in place. A more adaptive and flexible planning regime is more likely to allow commercial incentives to be aligned with planning goals as opposed to restrictions.

The report is structured as follows:

- In chapter 2 the benefits and costs of urban land use planning are discussed in a regulatory context.
- In chapter 3 the impacts of land use regulations on economic productivity are examined.
- In chapter 4 the potential of land use restrictions to impede competition is considered.

¹¹ Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

3. THE BENEFITS AND COSTS OF URBAN LAND USE PLANNING

The large amount of uncertainty involved in estimating the benefits and costs of urban land use planning indicates that there may be significantly different results in terms of community welfare achieved from imposing a more flexible control versus restrictive regulation controls.

Where there is uncertainty, it is important that the land use planning process is able to share the burden of proof fairly, and to take into account all relevant community costs and benefits of developments as well as the planning process itself.

The position governments take in relation to uncertainty and risk is very important in the assessment process and when governments take a risk averse position, or a position in favour of incumbent developments, there is the potential for biased assessments to be made.

Allowing more market oriented planning processes will not necessarily equate to increased urban sprawl. Anecdotal evidence from developers suggest that there is both market demand and potential supply of higher density residential development in inner city and in-fill areas. However, it is important that negotiations undertaken between developers, governments and the community proceed on a neutral basis with no unnecessary transactions costs imposed on either party.

The policy objective of land use planning is to ensure that land is developed in a way that maximises the overall return from land resources to the Australian community as a whole. As the stock of land is given, this amounts to maximising the value of the land rents it generates. The argument for planning intervention is that markets or purely commercial transactions fail to reflect the true value society places on land resources, in that some values are excluded from consideration. These external or non-market values may include:

- ecological or environmental values;
- heritage values; and/or,
- amenity values.

They may also include reducing the costs imposed but not fully met by market participants, including:

- congestion; and
- social disruption.

The principle tool used to address these problems in urban planning is exclusionary regulation which may be viewed as a publicly held covenant over the rights of individual property owners. Exclusionary regulations are those regulations that prohibit one or more land uses from being undertaken on a particular site, or that may limit the size or format of a permitted use. Exclusionary regulations impose costs that in part off set the non-market benefits that these regulations may achieve. These costs include:

- the additional costs imposed or benefits foregone when a business or household is forced to locate in an area which would not be their first preference;
- the costs of reduced competition, where such reductions in competition occur; and
- the costs of forgone services that would have been available if the regulation were not in place.

The benefits and costs of land use planning are, in most cases, highly uncertain. Direct theoretical or empirical evidence is likely to have a limited role in resolving that uncertainty given the complexity of urban environments. How this uncertainty is dealt with is fundamental to the balance between competing interests in urban planning. Attempting to test the balance of benefits and costs every time a regulation is contested is a costly exercise. It appears that governments ultimately need to adopt either a flexible or restrictive attitude toward urban land use in terms of general policy settings and overall governance of the planning process. In this section the benefits and costs of urban land use planning are explored. While the emphasis is on the broad policy settings of urban planners, specific points and issues are also addressed. Given what we do know about land use restrictions and economic regulation more generally, the question which needs to be explored is when and where is a more flexible approach warranted?

“ [T]he assertions that a particular set of zoning or planning regulations will reduce urban sprawl, generate more affordable housing, create jobs or establish more vibrant city centres are all open to question from an empirical and theoretical perspective.”

It is of interest to note that, on the basis of debate in the planning literature, many of the benefits and costs of planning regulations are difficult to measure. Some of the costs and benefits are public or private, but diffuse. That is, they are shared by segments of the community. In this section, the basic conditions under which a regulatory approach is justified are explored.

3.1. UNCERTAINTY AND THE BENEFITS OF REGULATION

In an urban planning context there is an important difference in potential non-market benefits and costs and the use of regulatory exclusion. It may be prudent to adopt a more restrictive or precautionary approach if:

- there is good reason to expect that the failure to regulate is likely to impose large costs (for example, it may be thought that certain forms of development might result in severe traffic congestion);
- there is good reason to expect that failure to regulate might lead to irreversible costs or damages, as for example the loss of natural parklands; or,
- in time the uncertainty associated with the benefits and costs will be resolved and costs of electing to delay a development are likely to be small when compared to the cost of an incorrect decision.

In many cases, it is unclear if planning regulations will in fact generate net benefits even if the costs of regulations are ignored. Levine argues, and cites many examples, that the assertions that a particular set of zoning or planning regulations will reduce urban sprawl, generate more affordable housing, create jobs or establish more vibrant city centres are all open to question from an empirical and theoretical perspective.¹² The reasons for this are complex, but tend to stem from the fact that regulation does not fully shape the commercial incentives remaining after an activity has been excluded. As a consequence, they may be a poor tool to meet social objectives, when, for example, public infrastructure may be more appropriate.

One of the main cited benefits of urban planning is improved transport with lower congestion and reduced pollution. This premise has been drawn into question in a number of studies as cited by Levine.¹³

Gilbert and Dajani conclude that the extent to which urban form influences transport energy usage and the potential to use land use controls as a tool for transportation policy is not subject to definitive answers.¹⁴ Webber points out that it is urban transport systems that affect land use and shape urban design.¹⁵ Bornet and Crane conclude that urban design and transport behaviour are not linked and that urban design should not be used as a basis for transport policy.¹⁶

Given this uncertainty regarding planning outcomes Levine considers it difficult to argue that a restrictive land use planning regime is warranted on principle. Levine strongly argues the need for a more informed policy process; one that is based more on observing outcomes of the interactions between the regulatory framework and commercial incentives.

It is of interest to note that time has not greatly reduced the uncertainty associated with the effects of urban planning on the urban environment; this is reflected in the continuing debate over the role of urban planning. In part this may reflect the influence of rigid planning policies on development innovation. A willingness to experiment with more flexible land use regulation may in fact generate a lot more information about what is good urban design.

¹² Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

¹³ Ibid.

¹⁴ Gilbert, G and Dijani, J. (1974), *Energy, Urban Form and Transportation Policy*, Transportation Research, 8, 267-76.

¹⁵ Webber, M. (1961), *Transportation Planning Models*, Traffic Quarterly, 15(3), 373-90.

¹⁶ Boarnet M. and Crane, R (1997), *LA Story: A Reality Check of Transit Based Housing*, Journal of the American Planning Association, 33(2): 189-204.

3.2. ECONOMIC CONSIDERATION OF THE BURDEN OF PROOF

Levine argues that the burden of proof in urban planning is a critical aspect of land use policy.¹⁷ Stated simply:

- is it the obligation of the individual seeking to change current land use to demonstrate that, in all likelihood, it is in the best interests of the community; or
- is it the obligation of government to prove that, in all likelihood, the use should be restricted?

Current examples of such requirements that may be considered in this light include policies that confine certain land uses such as supermarkets to established centres set out in planning documents. The centres identified for shopping facilities and proposed new facilities are often laid out in planning documents that are up to a decade old. They may not take into account changes consumer preferences, new retail formats, increased residential densities in some localities and congestion of transport links to the established centre.

At the moment prospective developers are required to apply to have the restrictions reconsidered and to provide a justification, without the local authorities having to provide similar reasoning behind the applicability of the requirement ten years on from its initial imposition.

The issue is compounded by the complexity of determining, in an economic context, the appropriate costs and benefits to consider. A distinction must be made between opportunity costs to the community of either maintaining or relaxing planning restrictions and re-distribution of benefits and costs between individuals.

Changes to zoning and other planning restrictions may increase the returns to some businesses and reduce the returns of others. These re-distributional, or wealth, effects are important from an individual perspective but they are not, in themselves, grounds for determining if a change is warranted in terms of community welfare (which, all else being equal, depends on the aggregate of those values, rather than on their distribution).

"To insist that an existing land holder who wishes to have that land rezoned or a development restriction be relaxed demonstrate a net economic benefit is in fact an extremely onerous task – a burden that could substantially shift the urban planning balance toward a less adaptable planning regime and result in foregone benefits to communities as a whole."

The direct impacts on incumbent business are also not an appropriate consideration in their own right. An incumbent business has the capacity to either alter its form or make the existing site available to another business. Thus, the true opportunity cost is not measured in the context of its existing format but in the best available format. It is this opportunity cost that will be reflected in changes in land values. To give an example:

¹⁷ Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

- A newly entering restaurant may take business from an existing one. However, the value of the land on which the existing restaurant is based may not change if the exiting business can alter its offering or another business can make profitable use of the site.
- Additionally, even if the value of the land currently being used as a restaurant were to decline, that decline might be more than offset by the increased value of the site on which the new entrant is located.

The same arguments hold for the direct benefits of a development. The direct returns to a new development and the associated benefits to consumers are again not the right benchmark where the development is prohibited in one location but allowed in another. The true opportunity value of the development is the difference between having the preferred locations and format and the next best available location and format. Hence:

- A medium sized development adjacent to a centre may be prohibited; however, there is an available alternative to develop a larger scale development in a fringe location. The lost opportunity value involves weighing up the returns to the investment in the alternative locations, the utility value of having the two different offerings in the two locations and the different effects on travel costs and congestion.
- In undertaking this evaluation, it is important to avoid double counting these effects – for example, the increased travel costs may be capitalised into land values, and hence a calculation that looks at land values should not also count costs in the form of travel times.

Again, land values would change if either the prohibited development was allowed or the alternative development proceeded. With any change in zoning or format restrictions, some land values may fall and some may increase. It is the net change that is of interest, but it is extremely difficult to predict given the complexity of the urban environment and the range of choice that is available. However, it is clear that the opportunity costs and values are largely conjectural and difficult to measure post completion let alone prior to commencement. It is not the sort of information that can be elicited by submissions from a limited number of interested parties.

“[I]t is far more likely that individual community members will oppose a development that causes losses that may be small in total, but are individually concentrated, than support a project that delivers substantial net gains.”

To insist that an existing land holder who wishes to have that land rezoned or a development restriction be relaxed demonstrate a net economic benefit is in fact an extremely onerous task – a burden that could substantially shift the urban planning balance toward a less adaptable planning regime and result in foregone benefits to communities as a whole.

The task would be no easier or less costly for government if done on a case by case basis. However, governments have an alternative to consider planning regulations on a broader basis and elect to take a more flexible or restrictive approach.

If the problem is to be addressed at a higher policy level, there appear to be two fundamental views that need to be resolved.

Firstly, it may be argued that by making the process of re-zoning and other forms of land use change easier, businesses will face additional sovereign risk and investment will be below that which is socially desirable.

Secondly, it may also be argued that making the process of re-zoning and other forms of land use change more difficult creates a barrier to entry, reduces investment and reduces competition.

These views are explored in some detail throughout the remainder of this report.

“ [T]here is an incumbent bias in the resolution of planning conflicts. This bias can be reduced by limiting the extent to which direct benefits and costs to interested parties, both incumbent and new or changed businesses, are considered.”



Retail premises that are located in higher density residential communities and employment areas are likely to better meet consumer demands and reduce transport distances and times.

“The design of public policy to avoid the possibility of excess entry as a primary concern is likely to be unwarranted.”

3.3. GOVERNMENT POSITION ON INFORMATION AND RISK

In placing the onus on interested parties to gather and put forward information in support of their position when there are significant benefits that are either diffuse or public in nature can lead to a biased economic assessment.

Unless governments act to ensure that all parties' concerns are adequately represented, there will tend to be a disproportionate amount of information provided by affected individuals or groups. This is referred to as adverse selection and leads to negotiations that exclude or limit the views of the broader community where these broader community views may reflect costs and benefits such as:

- the costs of congestion in nearby residential areas; or,
- the benefits of expanded services.

In a retail context it can readily be seen why this would lead to a bias towards incumbent land users. Incumbents have an incentive to acquire information that would see the decision come in their favour - up to the point where the costs of collecting information exceeds the costs they will incur due to a change in land use restrictions. Those incumbents that have a relatively high proportion of sunk costs will have the greatest incentive to put their case forward as they are unable to recover these costs if their business ceases to trade.

A developer seeking a change has a similar incentive to build and put forward a case up to the point where the cost of assembling information exceeds the next best return on the capital they are proposing to invest. This incentive may be smaller than for incumbents as none of the developer's costs are fixed. This is all the more the case as a loosening of restrictions, if it increases competition, will bid away excess returns, reducing the prospective gains to any individual proponent.

While the gains will, in that case, accrue mainly to consumers, the net benefits to each individual consumer are likely to be far too small to make it worthwhile for any consumer to bear the fixed costs involved in seeking to have the restriction removed. Moreover, as the number of consumers that are benefited rises, the likelihood that any individual consumer will be pivotal, and undertake the investment needed to mobilise others, falls.¹⁸ As a result, the benefits of expanded retail services to consumers may not receive the attention and weight they merit. As a consequence the willingness of parties to incur costs to build and put forward a case will tend to be biased in favour of incumbents.

¹⁸ Dixit and Olson (2000) "Does voluntary participation undermine the Coase Theorem?" *Journal of Public Economics*, 76 (3): 309–35.

3.3.1. Risk

A government's position on risk also has the potential to bias economic assessments of planning alternatives. The level of uncertainty associated with different information is likely to vary considerably. If governments elect to be risk averse with respect to planning and planning changes then it will tend to discount information that is less certain. While this may seem sensible on casual inspection, it presents a serious problem in terms of generating a biased decision process that is not in the public interest.

"[F]ocussing evaluations and development proposals towards development of certain established centres may be seen by government as a substitute for the need to make public investment in infrastructure that would underpin private investment in alternate centre developments."

Most public benefits are highly uncertain in nature and may not have a measurable monetary equivalent. Diffuse private benefits, such as the value of a greater range of retail offered in a more convenient shopping location, are also difficult to estimate accurately as they reflect the preferences of individual consumers which are only somewhat indirectly proxied by consumer expenditure. The same may be said for costs of congestion and noise. In contrast, the commercial costs and returns of an established operator are relatively easy to estimate and measure with greater accuracy.

This is not to say that all claims should be given equal weight as all claims may not be based on an objective view of available information. Rather, the point is that it is important to correct for the conservative bias that can arise from too much weight being given to estimates that are known because they reflect the world as it currently is, relative to estimates that reflect possible future outcomes.

Again, in a retail context, the discounting of the less certain benefits to consumers of increased levels of retail services will tend to bias decisions in favour of incumbents. This must be qualified with the fact that in some instances there may be less certain costs associated with, for example, amenity or heritage values.

3.3.2. Addressing the Problem of Incumbent Bias

To directly address the issue of incumbent bias that has been raised would require governments to:

- see that all relevant information is made available for consideration - a process that may require significant public expenditure in determining the benefits to consumers; and
- adopt a risk neutral position with regard to the uncertainty associated with information so long as that information is an unbiased estimate of a true cost or benefit.

On a case by case basis this may be both costly and difficult to ensure. The alternative is to acknowledge that there is an incumbent bias in the resolution of planning conflicts. This bias can be reduced by limiting the extent to which direct benefits and costs to interested parties, both incumbent and new or changed businesses, are

considered. The focus would then be the indirect costs and benefits to communities arising from, for example, changes in traffic patterns, and the availability of new services.

This is likely to be especially sensible as there is no reason to expect markets not to signal the direct benefits and costs to incumbent and new businesses reasonably correctly. In other words, the price system itself should itself take care of those direct effects, as it is unlikely that entry will be profitable and attractive if the losses to existing businesses and their customers exceed the expected gains to entrant businesses and their customers. As a general result, one would not expect a market failure in respect of entry and location decisions, at least in so far as private costs and benefits (that is the impacts on businesses and on consumers) are concerned.

The design of public policy to avoid the possibility of excess entry as a primary concern is likely to be unwarranted. To the extent to which consumers find it difficult to organise themselves to sponsor or promote entry, one would expect the primary risk to be of too little, rather than too much, entry (since part of the benefits of additional entry accrue to consumers, and hence do not figure in the firm's entry decision).¹⁹

3.4. ECONOMIC EVALUATIONS AS A DEFACTO TOOL FOR URBAN PLANNING

Jurisdictions in Australia and many other countries use urban planning restrictions to preferentially promote development in particular city and town centres as opposed to less favoured centres, urban fringe or infill areas. These are often referred to as centres policies. These policies do not necessarily explicitly preclude development in less favoured areas such as urban fringe or infill areas; instead they circumvent explicit restrictions with a specific outline of how community benefits and costs are to be calculated.

Economic evaluations can be used as a direct means of enforcing centres policies by taking into account the direct consequences of an out-of-centre development on an affected centre while no consideration or equivalent weight is given to benefits that accrue outside of the centre. Therefore, any relocation of services from an existing centre to a new development may be measured as a net cost to the community, due primarily to the reduction in services in a single location. The expansion of services to the new development and potential for redevelopment or reconfiguration of the existing centre in the future is not taken into account in the evaluation.

Taking such an approach to evaluating urban fringe and infill development proposals is unlikely to deliver an optimal centres policy outcome let alone the best social outcome. These approaches restrict the ability of developers and community groups to take advantage of changing population and settlement profiles and the associated change in demand for community services. In addition, skewing an economic evaluation toward certain established centres at the expense of other areas does not dictate that the desired investment will take place within the centre. In fact, such a policy may redirect investment to an even more remote location where demand for services is reduced but the impact on established centres is also reduced. In this way centres policies may have the effect of encouraging developments that promote increased travel times and distances and reduce the overall benefits from new developments.

¹⁹ Of course, as a matter of economic theory, excess entry is possible – but so too is insufficient entry. See Novshek, W., “Cournot Equilibrium with Free Entry”, *Review of Economic Studies* 47, pp 473-487, 1980, and Mankiw, N. and M. Whinston, “Free Entry and Social Inefficiency” *Rand Journal of Economics*, 17(1), pp48-58, 1986.

For example a developer may wish to locate a stationary and business supplies retail outlet with a large floor plate in land zoned as light industrial to meet the needs of local businesses and some passing traffic. A local environment plan may prohibit from being established anywhere but the central business district in a local government area – some kilometres away from the businesses who will be the main customers. This policy may be justified by the local council as favouring investment in the central business district. The unavailability of sites, the absence of customers and higher per square metre land cost within the central business district may prevent the development proceeding there. Instead the developer may choose to build the facility in another local government area altogether. In this example, not only has the centre and the local government area missed out on the new retail outlet, the local employees of businesses who wish to purchase stationary and business supplies are made to travel further.

Where development does occur in line with a designated centres policy this does not necessarily amount to prima facie proof that the centres policy is able to achieve its objective of re-directing private investment into the centre (and even less so that it achieves that objective at a cost that is less than the resulting benefits). The mobility of development across local government areas, cities, states and countries ensures that developers have a range of options to investigate prior to investment. If land use planning restrictions happen to meet their requirements for what they project as a profitable development, then the project will be developed. However, in this situation it is very important to note that the land use restrictions have not forced the hand of the developer but instead the developer has identified a profitable development that aligns with the land use regulations.

“[W]hen these transactions costs are artificially inflated due to processes and application requirements, as well as complicated legislation, it is likely that the level of these costs will impede the efficient outcome of the planning process.”

Further, focussing evaluations and development proposals towards development of certain established centres may be seen by government as a substitute for the need to make public investment in infrastructure that would underpin private investment in alternate centre developments. While this is not necessarily inefficient (if the value to the community of deferring or otherwise reducing infrastructure investment exceeds the foregone benefits from allowing the development to proceed), such an approach can reduce the rate at which development evolves to more closely align with consumer demands.

3.4.1. Benefits of market oriented planning

It has been noted that there may be aversion to relaxing centres policies due to the uncertainty surrounding the location of future development and a desire of authorities to promote increased density in certain areas, thus limiting what is sometimes negatively referred to as “urban sprawl”. However, anecdotal evidence from surveys of developers in the United States indicates that a relaxation of planning controls may actually promote inner city development, rather than discourage it.

As cities expand and grow population densities in different areas change and what was previously considered to be an outer suburban area is re-aligned to become an inner-city fringe region. Following this pattern, the profile

of demand for both retail and housing developments in these areas will also change, tending towards increased demand for higher density development.

A study in the United States found that fewer than 15 per cent of developers surveyed across the US considered there was adequate supply of land for alternate, higher density development.²⁰ Land use regulations were cited as the main barrier to development of these alternative developments. Survey results indicated that a relaxation of land use planning regulations would lead to an increase in higher density development in inner suburbs and the central city areas as opposed to outer suburb and urban fringe.²¹ The conclusions drawn were that developers acknowledge, and are willing to invest in, the changing demand profiles of the region and that maintaining land use planning restrictions was likely to be inhibiting this market oriented change in development profile.

In terms of residential development, the survey indicated that developers would have greater interest in alternative development to low density and car oriented suburban development if land use regulations were relaxed. A residential preference survey by Myers and Gearin indicated that households were also interested in higher density, transport friendly developments.²²



Current planning policies overlook that most retail shoppers are likely to use a car even for small purchases when shopping unless a retail facility is located within walking distance of their home or workplace.

²⁰ Levine, J. and Inam, A. (2004) *The market for transportation – land use integration; Do developers want smarter growth than regulations allow?* Transportation, 31(4), pp 409-427.

²¹ Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

²² Myers, D. and Gearin, E. (2001) *Current preferences and future demand for residential environments*, Housing policy debate 12(4) pp633-659.

3.5. NEGOTIATION: TRANSACTIONS COSTS AND NEUTRALITY

Within the urban planning paradigm in Australia, there is latitude to negotiate land use outcomes, through the processes of rezoning and development approvals. Local governments have the role of representing those interests that are not a direct party to the transaction. This has the potential to limit the costs of regulatory exclusion by treating zoning and other planning regulations more like tradable property rights.²³ That is, local governments can negotiate with developers to allow a change in land use so long as the community is adequately compensated for the change. This might be achieved through, for example, the provision of additional infrastructure not directly required to undertake the development that will be to the community's benefit.

However, for this to be effective a number of preconditions need to be met:

- transactions costs of negotiation are low for all parties; and
- the negotiations are in good faith, with government acting in the broader community interest as opposed to just considering the property value interests of incumbent landholders.

Given that governments hold the implicit regulatory property right, and are assumed to be negotiating against the development in hand, the consequence of failing to meet these preconditions is that there will be an underinvestment in new retail development as negotiations will not be efficient. It is important to recognise that the cost of acquiring these rights from government will divert private investment. If transactions costs are artificially inflated or if local governments seek compensation in excess of any real net external costs then this diversion of private investment is unwarranted.

Experience strongly suggests that in metropolitan Sydney, as with most jurisdictions, transactions costs are very high. Some level of transactions costs are expected in a market transaction and complete avoidance is unlikely. However, when these transactions costs are artificially inflated due to processes and application requirements, as well as complicated legislation, it is likely that the level of these costs will impede the efficient outcome of the planning process. These costs include the time delay in processing applications through the official channels, which may be increased with expanded rights of appeal by incumbent businesses, and overly cumbersome requirements on applicants to prove economic or community benefits.

"The neutrality of governments is also potentially affected by respective levels of voting power. New businesses who are seeking to enter the area may not be able to demonstrate the ability to provide the level of political support that would be required."

Examples of the high level of transactions costs that are imposed through the current system are widely available, with complaints on the timeliness of responses to applications, as well as the overly complicated nature of the application system, involving both planning authorities as well as the legal system. Examples of potentially

²³ Fischel W. (1985), *The Economics of Zoning Laws: A Property Rights Approach to American Land Use Controls*, Johns Hopkins University Press, Baltimore and London.

excessive requirements under the planning system, for which there do not appear to be market level justification, or consequent benefits, include the requirement of a fruit and vegetable store to continually refer back to the local planning system and courts to be able to adjust its operations as business continues to grow. During the 1990s there were two separate applications submitted and accepted to revise the Penrith Local Environmental Plan (LEP) – Rural Lands, to allow for a spot zoning, and adjustment to floor space terms (*Agostino v Penrith City Council*). Accounting for all of the private and public resources required to pass these two separate judgements for a fruit and vegetable store of 150 square metres, the planning system transactions costs would have had a large impact on the overall community benefit.

Additional costs due to inherent complexities of the planning system were also brought to light when the decision handed down to refuse the application was made not on the merits of the application, but because the judge did not feel that the decision was within the court's jurisdiction to decide and that the case really required an amendment to the LEP. The fact that an application could progress so far to include the resources of the Court system only to be deemed inappropriate for a Court ruling is an example of the unnecessary complications within the system that are imposing excessive resource costs.

The extent to which zoning restrictions can impose high transactions costs is highlighted by what is referred to as the Mount Laurel (New Jersey, USA) decision in which the New Jersey Supreme Court developed an approach under municipal zoning orders to provide for low and moderate income housing. Fischel notes that "[i]f all the wood fibre and all of the books and papers written about the original Mount Laurel decision were converted into construction materials, it would conceivably amount to more low income housing than was built as a result of the decision".²⁴

In addition to transactions costs limiting the ability of a negotiation style process to achieve efficiency, the neutrality of the general government negotiator is also potentially affected. Local governments receive revenue from land rates and, therefore, they are not necessarily going to be an impartial party to the negotiations. There is a risk that undue influence will be placed on the change in local government revenue base due to the change in land use or zoning.

There is a risk that local authorities may also use the power they have in development negotiations to achieve additional planning outcomes at limited cost to the authority. Common compromises that are achieved within certain development negotiations include undertakings by developers to provide some level of public infrastructure during the process of development, for example, provision of a public road leading up to the development, where this road would be required by the developer anyway. This is consistent with the property rights view of land use restrictions and is not necessarily an issue.

"Greater diversification requires a change in the governance of the urban planning process to facilitate the evolution of the urban environment."

²⁴ Fischel W. (1985), *The Economics of Zoning Laws: A Property Rights Approach to American Land Use Controls*, Johns Hopkins University Press, Baltimore and London, p320..

However, these can be “take it or leave it” offers from a sole provider of the land use rights. There is the possibility that authorities may use their powers to attempt to force developers into a sub-optimal and as yet undeveloped area – when there are suitable sites available in developed areas – and therefore provide the initial level of public infrastructure required to promote further development. Such attempts by local authorities jeopardise the current development proposal as there is little likelihood that a developer would be willing to bear such additional costs of construction as well as face a reduction in exposure for the final development.²⁵

The neutrality of governments is also potentially affected by respective levels of voting power. This is particularly a problem in NSW where local governments have strong planning powers. Incumbent businesses that are located within their electorate form part of the base of their current political support. New businesses who are seeking to enter the area may not be able to demonstrate the ability to provide the level of political support that would be required. Therefore, additional factors other than the true net costs and benefits to the community play a role in the negotiations.

It is also important to note that zoning and other planning regulations can create artificial differences in property values in nearby areas with similar demographic characteristics (at the risk of reducing the overall land rates earnings of local councils). The more constraining and less adaptable these restrictions are the greater these differences in property values are likely to become. Artificial differences in property values can create unwanted incentives in the form of windfall gains and losses that occur when land use restrictions are changed. These windfall gains and losses can become the focus of negotiations or challenges to urban planning decisions as opposed to good urban design.

3.6. THE VALUE OF URBAN DIVERSITY

The term urban diversity is used here to describe the range of commercial and residential choice that community members have within an urban environment. Planning regulations may seek to create synergies and returns to scope and scale by attempting to co-locate retail and residential premises. However, the cost of exclusionary regulation is in part levied through reduced urban diversity.

From a consumer perspective, the benefits of diversity are reflected in a choice between low, medium and high density residential areas as well as access to retail and transport services of choice. For example, some individuals’ demands may best be met through low density housing and access to public transport to a city centre. Others may have a preference for higher density housing and walking access to a range of nearby services which is best met in a mixed commercial and residential environment. This range of choice is important as a decision to live in a particular location involves relatively high transactions costs and imposes a number of fixed trade-offs.

From a commercial retail perspective, the benefits of diversity are in allowing store locations and formats that fit the demands of the local community in which the retail businesses are to be based.

From a planning perspective diversity is also important. Planning policies that lead to a proliferation of a limited set of residential and retail formats can lead to a lack of resilience if these formats no longer meet community demands. The aggregation of retailing in congested major centres and in shopping malls are examples of strategies that risk imposing both environmental costs as well as the direct costs of increased travel times, especially where public

²⁵ This is not to say that developer charges and requirements for developers to finance construction of certain infrastructure when it is considered to be a local public good are never efficient. In certain cases, such charges are able to more efficiently direct payment towards those persons that derive benefits, such as final consumers or residents.

transport is overcrowded and costly to expand. In a more diverse economic environment some formats will fail but the likelihood of a large scale planning failure is reduced.

Jacobs considers what factors lead some cities to be able to thrive and others to languish.²⁶ She notes that those cities and areas with mixed uses, dense populations, small blocks and decentralised ownership appear to promote neighbourhood areas that can stand the test of time and regenerate themselves through diversity and variety. These areas are also able to attract new private investment without the apparent need for heavy handed regulation, attract large numbers of casual visitors and also observed more residents that were more engaged in the area.

Allowing greater diversity is a form of experimental design. First, it facilitates innovation in developments and retail formats. Second, it provides information on what development formats are meeting current and evolving urban planning goals. This is not something that that is readily achieved through, for example, exclusionary zoning to allow developments that would otherwise not be economic. Nor is it something that should be addressed on the case by case basis that characterises the current implementation of an urban planning regime. Greater diversification requires a change in the governance of the urban planning process to facilitate the evolution of the urban environment.

3.7. QUANTITY CONTROLS VERSUS PRICE CONTROLS

The consideration of quantity versus price controls to correct market failures such as externalities may be extended to the application of land use management controls such as zoning restrictions versus reliance on land use taxes or charges. The difference between the two approaches is that quantity controls are not sensitive to changes in prospective land values while price controls are. That is, with price controls a development can go ahead if the demand for the services is sufficiently high.

Quantity controls are generally preferred when small changes in the level of land allocated can have large costs. Price controls are generally preferred when flexibility in the level of land available can generate significant benefits.

According to Netzer, in general, there are three scenarios where land use zoning methods will be preferred to price control methods:

- Where the cost of land curve is relatively flat and elastic, and therefore, errors in the size of certain zones will have a limited effect on overall land prices (due to the observed fluctuations in land and property values, this scenario is unlikely to be met)
- Where there is a discontinuous benefits curve from land use practises, that is, where a slight change or increase in a certain type of use will cause a disproportionate change in derived benefits. These are occasionally referred to as threshold effects, traffic congestion is a common example; or
- If there is a very high degree of coordination required in the developments – Netzer argues that this scenario is only relevant if developers are not able to act on a large enough scale to internalise these coordination issues.²⁷

²⁶ Jacobs, J. (1961) *The death and life of great American cities*, Random House, New York, USA.

²⁷ Netzer, D (ed.) (2003) *The Property Tax, Land Use and Land Use Regulation*. Edward Elgar, Northampton, MA, USA.

Following these discussions, Netzer also illustrates the possible advantages of the use of land taxes in preference to zoning restrictions on the quantity of land available for development.²⁸ He found that while zoning and land use based taxes were both able to achieve the same development goals, the use of land taxation was able to achieve this at a higher level of community welfare. While taxation levels were admittedly higher, they were not considered by the authors to be unfeasible.

Like most quantity control regulations, the use of zoning restrictions for land use planning have been popular due to the fact that they are easily observed and can be monitored by both planning authorities and neighbourhood interest parties with relative ease. Developments that breach zoning restrictions are easily identified and corrected and the overall size of retail and residential areas are known in advance. In addition, the costs and inefficiencies of such planning policies are not as easily observed. These costs are associated with developments that do not go ahead, or inflated land values that are not easily compared to an unobserved reference case of alternate land use policies.

In contrast, the use of a more market based approach such as land use charges is not as easily understood by the general public and community interest groups, nor are the results and breaches as easily observed. Land rates do not identify a strict boundary on the area available for development, but work in a similar way to zoning restrictions by putting a price premium on land that is available for certain forms of development. Under this scenario, as with zoning restrictions, developers will assess the cost of land and land use rates in different areas, assess the level of demand for certain services and potential for expanding development in the future.

“[T]he focus should be more on the impact of existing planning paradigms as opposed to attempting to predict the outcomes of future plans.”

These considerations also take into account issues such as conglomeration effects, where developers acknowledge the benefits that they will derive from being located in a region close to residential areas as well as other service providers with complementary offerings, for example retail shopping districts and restaurants areas. It is for these reasons that land use charges are able to achieve similar land use patterns as zoning restrictions without the disparity in land values and potentially inefficient rigidity of zoning restrictions.

A charging regime is not limited to zoning; it could also be applied to restrictions on store formats.

3.8. EVIDENCED BASED POLICY

In addition to a more balanced sharing of the burden of proof, Levine calls for a more evidenced based approach to urban planning restrictions.²⁹ He notes that, too often, convenient theories hold sway over scant empirical findings. He suggests that the focus should be more on the impact of existing planning paradigms as opposed to attempting to predict the outcomes of future plans.

²⁸ Ibid.

²⁹ Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

The balance of this report is directed to examining and comparing experience overseas and in Australia. Based on concrete examples, the focus is on two areas:

- The effect of flexible versus restrictive planning approaches to productivity growth in the retail sector and broader implications of this for economic growth and community welfare; and,
- How the processes of implementing urban planning affect competition or can be seen as anticompetitive.

These two points are clearly interrelated. However, the focus of the first is on the direct effects of regulatory exclusion and the broader policy intent and outcomes of urban planning restrictions. The second is a reflection of the fact that there may be unintended consequences of the planning process that limit competition. In some instances these may go unchallenged or are immune from challenge under the planning legislation.

4. ECONOMIC TESTS AND TRANSPORT IN NSW PLANNING

Incorrect interpretation and implementation of economic tests introduced in the *Environment and Planning Assessment Act 1979* (NSW) has the ability to skew the development approval processes at the cost of community welfare and economic efficiency.

As the NSW legislation and court precedents currently stand, the economic tests appear to be problematic as:

- the number of facility providers is not always an accurate reflection of community welfare, especially in the case of returns to scale and scope achieved by larger format stores;
- they overlook the potential benefits derived from alternate land uses in the case of changing business profiles in response to new developments; and
- there is a large information burden placed on applicants with respect to forecasting or projecting future preferences of both consumers and business owners.

Requirements that transport usage policies also be considered in the economic tests increase the burden on planning instruments to achieve multiple policy objectives through a single policy instrument. Requiring multiple objectives to be achieved through single policy instruments generates potentially unnecessary tradeoffs and reduces the economic efficiency and community welfare derived from the policies.

The legislation that empowers planning in NSW is the *Environment and Planning Assessment Act* (the E, P and A Act). The E, P and A Act outlines the requirements for consent authorities in NSW to approve land use changes and new developments. The E, P and A Act also gives the Minister the power to determine the development contribution of public infrastructure to support a proposed development.

In 1995 the NSW Government entered into the *Competition Principles Agreement* with the Commonwealth Government. The agreement stated that legislation should not restrict competition, unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

The State Government committed itself to a program of legislative competition reviews, each review was required to:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;
- assess and balance the costs and benefits of the restriction; and
- consider alternative means for achieving the same result including non-legislative approaches.

In reviewing the implementation of competition policy and micro-economic reform in NSW, the NSW Government stated in 1996:

There are a number of State laws which impose restrictions on competition and add to the cost of or prevent market entry. The major Acts in this category are the Local Government Act, 1993 and Environment and Planning Assessment Act 1979.



However, in 2002, some seven years later, the NSW Government advised the National Competition Council that it had not listed the *Environmental Planning and Assessment Act* for review under the Competition Principles Agreement. This meant, unlike hundreds of other pieces of legislation, the *Environmental Planning and Assessment Act* escaped any serious review of its impact on competition.

Nonetheless, the E, P and A Act continues to impose restrictions on the competitive business environment in NSW. This can be seen from the following examples which illustrate that many of the theoretical concerns regarding the use of economic evaluations raised in Chapter 3 are practical concerns as well.

Centralising retail in a limited number of large developments does not reduce the stress on road infrastructure – it may in fact increase it.

This section specifically investigates the use of economic tests to assess development applications as well as the requirement that development applications comply with Integrated Land Use and Transport (ILUT) policies made under the NSW planning legislation. It is argued that these provisions have the ability to not only impede competition in sectors such as the retail sector, but that also have the ability to impose additional welfare costs on the community if they are not applied correctly. In addition, there is concern that planning instruments are being used to achieve multiple community and social objectives, introducing the risk of unnecessary (and possibly non-transparent) tradeoffs in their application.

4.1. USE OF ECONOMIC TESTS IN THE ENVIRONMENT AND PLANNING ASSESSMENT ACT (NSW);

Under a legislative framework, tests that are aimed at maximising community welfare through development should be clearly outlined to ensure that there is no ambiguity in their interpretation. Further, these tests should be both complex enough to be able to account for the large diversity in potential scenarios, as well as transparent enough to minimise manipulation.

Section 79C of the E, P and A Act outlines the requirement for consent authorities to consider the economic impacts of a proposed development through the approval process. The E, P and A Act does not set out how the economic costs nor benefits may be determined. The result of this is that the method in which economic consequences of development are considered within the NSW planning process has been determined through court proceedings, based on judicial interpretation of the legislation.

Notably, the legislation and the way it has been interpreted, particularly the provision on economic impacts on the locality, give rise not to an economic welfare or efficiency test but rather to what seems to be a test regarding the number of facilities. For example, in *Kentucky Fried Chicken Pty Ltd v Gantidis* (1978) 140 CLR 675, it was stated that “the mere threat of competition to existing businesses, *if not accompanied by a prospect of a resultant overall adverse effect upon the extent and adequacy of facilities available to the local community if the development be proceeded with*, will not be a relevant town planning consideration.”

While at first blush this quote may appear to suggest that the development assessment process would not protect other businesses from competition, the qualification expresses (and italicised) creates a very large window for development approvals to be refused on the basis of the effect that they will have on other businesses.

It means that if the profitability of existing individual businesses are threatened and this does raise a prospect of existing facilities ceasing to be available to the community, then the impact on profitability of existing business can be an legitimate consideration under section 79C.

Irrespective of what role planning policies and planning legislation are argued to have in considering competitive effects, the approach outlined appears immediately problematic, for at least three reasons:

- First, the test can only be interpreted as an economic welfare (or efficiency) test insofar as the number of facilities is a proxy for economic welfare. However, it is not clear why the number of facilities would make a good proxy for welfare. The number of facilities could diminish but welfare increase: for example, if in the absence of zoning or format restrictions the facilities ultimately emerging offer higher levels of customer service and competition or lower prices. This can occur, for example, when larger formats provide returns to scope and scale.

- Second, the test does not take into consideration the alternate uses of land or property that may evolve in the event that current services do leave the market in response to increased competition. It is unlikely to be the case that a current centre is going to face complete abandonment and more likely that service provision in the area will evolve and adapt to the change in the competitive climate in the region, to the ultimate benefit of residents and consumers. Therefore, the test overstates the economic costs that would fall on the area, taking only the first round effects of any proposed development, without accounting for new sources of benefits that may be established.
- Thirdly, the requirement for projection and forecasts of future impacts on the number of facilities appears to place a high burden on decision-makers and potentially opens the debate as to what constitutes a reduction in facilities in contrast to a readjustment in facilities. The error rate from the application of this flawed test could be very high (that is, some developments would be disallowed which if allowed would not have led to a net reduction in facilities), imposing economic costs, including through the curtailment of competition.

Increased uncertainty surrounding the projections of future competitive dynamics and the possibility for error would discourage businesses that are not prepared to incur the risk and cost of litigation to enter the market, thus inefficiently reducing the level of development applications that are made. This effect is likely to be especially pronounced for the reasons set out above – namely, that part of the benefit of entry in an urban planning context accrues to consumers, while the benefit of preventing entry is largely captured by the incumbent, giving the latter a strong incentive to exploit legal barriers to the development of new facilities.

Importantly, the UK Competition Commission when investigating the supply of groceries in the UK note that the control of land in highly-concentrated local markets by incumbent retailers acts as a barrier to entry, by limiting entrants' access to potential sites for new larger grocery stores. They focused on the use of restrictive covenants as one means of controlling land.³⁰

In an Australian context, the use of economic benefits testing is also a means by which incumbents can control land use.

4.1.1. Misrepresentation of economic tests

While the interpretation of economic tests as considered above is not strictly ideal, there is also evidence that these tests are being applied in equivalently less than ideal situations. These, admittedly limited, examples provide an indication of the difficulty in requiring legal professionals to undertake inherently complicated economic analyses.

One of the most consistent issues with the application of the economic impact test is the inherently static approach that appears to have been adopted. In the case of *Jetset Properties v Eurobodalla Shire Council* (2007) NSWLEC 198, the Land and Environment Court of New South Wales rejected the application to build a large scale supermarket in the area due to the impact that this might have on surrounding small local shopping centres. Evidence was heard from local shop owners who outlined the impact that the proposed development would have on the operation of their businesses as they currently stood. While this first round impact does have some standing in consideration,

³⁰ United Kingdom Competition Commission (2008) *The supply of groceries in the UK: market investigation*.

a more accurate reflection of the regional economic impact of the proposed development would have been achieved through additional information on the potential alternate business opportunities that would be viable, as well as the consumer benefits associated with entry.

The opportunity cost of the current smaller shopping districts considers the next most valuable use of the land. For example, if the land currently occupied by a small shopping centre may be redeveloped into a bed and breakfast accommodation with a breakfast café serving the local area as well as guests, then this would be considered to be the opportunity cost – value forgone – from having a small shopping centre instead. In a dynamic economy, it is only the difference between the current value of the shopping centre and the opportunity cost that should be considered in an economic test of the impact of a new development.

A further issue that came to light in the discussion of *Agostino v Penrith City Council*, when the Court was deciding on the expansion of a fruit and vegetable store, is the apparent confusion of introducing competition and increased sharing of the local market with a potential reduction in overall retail services. While the case was dismissed for other reasons, the judge continued to discuss the merits of the application with respect to the economic tests that may be applied. Within this discussion, reference was made to a nearby local supermarket servicing the area. The Court accepted that with an expansion of the fruit and vegetable store in both size and range (where the increase in range only included cheese), “a substantial component of the local trade attracted to [the local supermarket] would be diverted to the store if it were permitted to retail items typically found in a convenience or general store” and further that “[t]he potential loss of the valuable service which the [local supermarket] provides the community is an important planning issue”. These two statements are not innocuous and could potentially lead to further distortions in the application of the economic test.

If there is indeed only one local supermarket that would feel any impact from the expansion of the fruit and vegetable store, then there is realistically limited scope for an overall reduction in the “extent and adequacy of facilities” in the community. If there was sufficient demand for overlapping services in the region, expansion of the fruit and vegetable store would merely be likely to increase the level of competition in the area for these services. Admittedly this would reduce the market share enjoyed currently by the local supermarket; however, this is an issue associated with increased competition (and associated lower prices or improved quality afforded to the consumers), not a reduction in the provision of facilities.

In addition, the ruling further elaborated that the local supermarket and fruit and vegetable store provided “important but distinct services” to the community. If this is indeed the case, and the services are distinct, then an expansion in one form of services should not have a devastating impact on the demand for the other services.

Difficulties in undertaking the required economic tests have also been illustrated through Court proceedings. In *Jetset Properties v Eurobodalla Shire Council* (2007) NSWLEC 198, there were three town planners and three market researchers all providing evidence to the Court, where a judge was required to assess the merits of the testimony of each. In this case, the evidence given by the market planners for the applicant and the market planner for the council on the economic impacts were in stark contrast. Both parties used different data sources and different methodologies to project the potential economic impact on surrounding businesses due to the proposed development. There was limited common ground between the two.

The ability for the two parties to have approached the same question so differently, and arrive at distinctly different results, highlights the onerous task of undertaking the required economic tests. To be fully met, the economic

tests require a projection of future shopping patterns, service demand, population demographics and, ideally, assessment of alternate uses of existing businesses. Since these models are, in their most basic form, making projections of future impacts and reactions, they are also inherently difficult to prove.

Objections to the methodologies that were expressed in the proceedings included the validity of using phone interviews to determine current and prospective shopping patterns in the event a development was undertaken. It was deemed that such surveys were susceptible to response bias and leading of the respondents. While this is certainly a possibility in any form of survey, there are methods that may overcome or limit these problems. The Court also noted the difficulties in determining relatively simple but necessary figures such as the current level of business revenue provided by residents and that provided by tourists in the region, and the proportion of residential income that was spent on local retail services.

Additional criticisms of projection models also include the inability of mathematical models to allow for the adaptation of shopping patterns over time, and the ability for consumers to respond to changes in the market. These issues further limit the economic tests to a static model which are likely to overestimate the economic costs of a proposed development.

Case Study: An extension of a fruit and vegetable store - 2002

Examples of misrepresented economic tests are not limited to larger development applications. In this situation, the applicant operated an existing fruit and vegetable store in Llandilo.

Llandilo is a rural area with residences and paddocks dominating street frontages. Properties adjoining the site are used for residential and rural activities including grazing and horticulture. Llandilo Village is situated at a distance of 1.4 kilometres from the store and includes a supermarket, post office, produce store.

The fruit and vegetable store had a gross retail area of 150 square metres. It was located on a 2 hectare site with an 82 metre long street frontage. A 200 square metre rural shed used for storage and packaging of products was situated adjacent to the store. The store is serviced by a car park having 32 marked parking spaces and a 9 metre wide driveway.

The store owner lodged a development application to increase the retail area of the store from approximately 150 square metres to 286 square metres. The application also proposed the addition of a "deli counter". Such a section was to be used for the retail sale of a range of products currently offered for sale including ready-made pasta, bread and dairy products such as milk. The store owner also wanted to sell cheese from the deli counter. Cheese was not within the range of products already authorised for sale from the store under the original planning approval.

Penrith City Council refused the development application and it was appealed to the Land and Environment Court.

The local environment plan (LEP) had an exhaustive list of all goods which may be retailed from the store. The Land and Environment Court rejected the application to sell cheese, because it was not listed as an item permitted for sale in the LEP. The Court also rejected the application to increase the size of the retail floor area, because it exceeded the limit imposed under the LEP (150 square metres).

The refusal was given despite the fact that the Court agreed that the extension of the building (as proposed in the application) would not adversely impact the rural character of the surrounding locality. The Court said the existing store was located on a large block of land and is positioned to the left side of the block when viewed from the street frontage. It said that the proposed extension would locate the store more evenly on the site and would not adversely impact on the scenic quality of the landscape. The Court said it would have granted the extension in size of the building if it were able to determine this issue on its merits.

However, the Court went onto to say that it would have still rejected the proposed increase in the range of retail items proposed by the applicants and the addition of a deli counter, even if the LEP had not already expressly prohibited the change.

The Court said that the increased range of goods proposed to be sold would alter the character of the "fruit and vegetable store" to a vegetable store and delicatessen, akin to a convenience or general store". The LEP contains a prohibition upon general stores being located within three kilometres of one another. An existing general store is distanced approximately 1½ kilometres from the applicants' premises.

The Court also said that the economic impact of increasing the product range of the store would adversely affect the supermarket at Llandilo Village. The testimony of the proprietor of the village's supermarket included the argument that a substantial component of the local trade attracted to Llandilo Village would be diverted to the store if it were permitted to retail items typically found in a convenience or general store.

The Court said the potential loss of the valuable service which the Llandilo Village supermarket provides the community was an important planning issue.

The Court said that both the Llandilo supermarket and the store provide important but distinct services to the Llandilo community and the approval of the deli counter and conferring the right to sell cheese would "disturb the present balance".

Misrepresentations of the economic test in this case include:

- the extremely limited assessment of the competitive impacts, including an omission of the likely reduced prices consumers may have enjoyed if local competition was increased;
- no formal assessment of how the expansion of product range to include cheese (the only additional product to be requested in the application) would have impacted the business of the local supermarket; and
- no consideration of the ability of either the supermarket or the fruit and vegetable store to adapt and evolve in the future in response to changes in competition;
- the inconsistency of the statement that the two businesses provided "important but distinct services" with the conclusion that an expansion of the fruit and vegetable shop may have a devastating impact on the operation of the supermarket.

Case study: A bulky goods retail outlet in Warringah Council - 2003

There are also examples of how the use of economic tests has reversed previously approved development applications, increasing the uncertainty involved in the process, and reducing developer confidence in the system.

Centro Properties Limited commenced court action to invalidate a 2002 development approval from the construction of bulky goods retail outlet, shops, restaurants and associated parking granted by Warringah Council.

The development application proposed the erection of a multi-tenancy bulky goods centre with ancillary access roads, signage and landscaping comprising proposed uses of bulky goods shops, and restaurants. The development was to be located in Austlink Business Park.

Since 1999 Centro had been the owner of a shopping complex in nearby Warriewood (just over eight kilometers away) which included two supermarkets and a discount department store.

The local environment plan (LEP) included bulky goods shops, other shops and restaurants as appropriate development for the area.

Centro argued that the Council had failed to consider economic impact in the locality when granting the approval.

Specifically, they said that the council had not properly applied section 79C(1)(b) of the *Environmental Planning and Assessment Act* which imposes a mandatory relevant consideration to consider the likely impacts of the development on economic impacts in the locality.

Since the proposed development comprises a large bulky goods retail centre together with retail shops comprising 4 per cent of the proposal, the Court said it was plain that economic impacts in the locality were a relevant consideration and an essential part of the issues to be considered.

The Court found that the "economic impact in a locality (for example, marginalising other developments in the locality which provide a facility presently enjoyed by the community) is a proper consideration to be taken into account as a matter of town planning".

The Court said that the absence of specification of the proposed uses within bulky goods shops, combined with the numerous small tenancy areas, would lead to the bulky goods retail centre functioning, in practice, as a retail shopping centre.

The Court observed that the Council considered the market share which the proposed development might successfully attract, but did not consider the impacts that attraction might have elsewhere. The Court said that section 79C requires consideration of the impacts of the proposed development on the locality, not the success of the proposed development.

Centro argued the council's staff had asserted that there would not be any significant impact on

the viability of other centres in the Warringah local government area, without any evidence.

The Court upheld Centro's argument. It found that since:

- there was no information addressing the issue before the Council;
- the proposed development potentially draws trade from a large area including areas well outside the local government area; and
- there was no assessment of the likely uses within the bulky goods component of the proposed development because the development application does not nominate those uses,

the consent should be invalidated.

The Court said that "it is not adequate to say that because no similar development exists in this area that the Council can be assumed to know what the impact on traders in the locality is likely to be."

Such information was "essential for the proper consideration of the development application."

In this example, the planning system overtly prevented a new retail shopping centre from being created on the basis that existing retail traders may be affected by the new business.

4.2. EXCLUDING COMPETITIVE ISSUES FROM DEVELOPMENT ASSESSMENTS

In its submission to the Australian Competition and Consumer Commission's grocery prices inquiry *The impact of the NSW planning system on retail competition* the Urban Taskforce argued that the planning system is not equipped to assess what the costs and benefits of increased competition and that any attempt to do so is likely to disadvantage ordinary consumers result in inefficient outcomes.

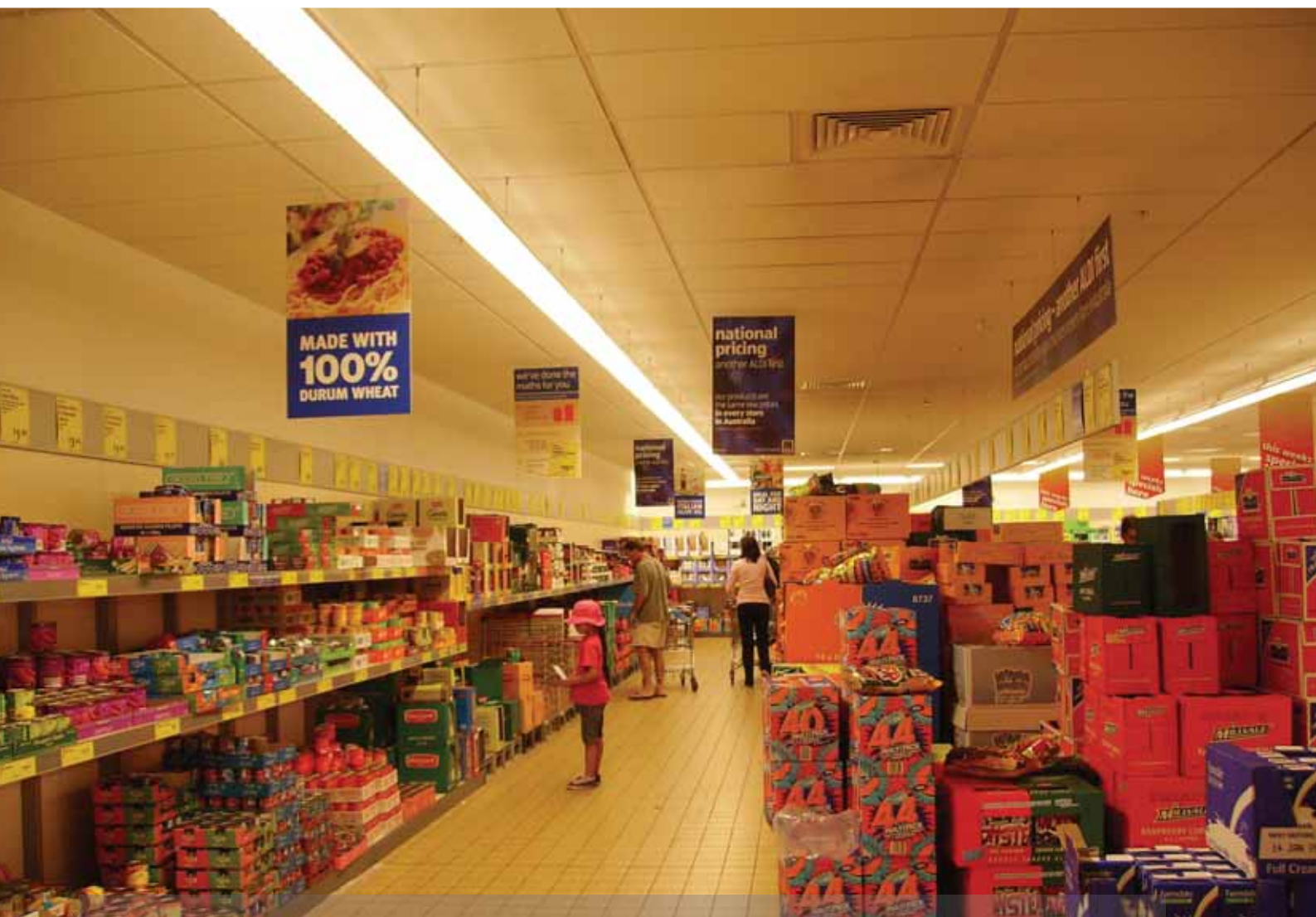
"When economic tests are incorrectly applied in the planning process, placing undue emphasis on a static picture of the local economy ... it is likely that incorrect assessments will be made, with the ultimate effect of reducing and inhibiting competition through rejection of development applications. "

As the current legislation stands, there appears to be a large window of opportunity for courts and councils to consider competitive effects when assessing development applications. The application of these tests to challenge

development applications is also not uncommon in the planning process in NSW. As has been demonstrated, the application of competitive tests is highly complicated and there is a high probability that incorrect assessments will be made.

Establishing the competitive effects of a proposed development and the change in community welfare associated with this altered competition environment are two separate issues. It is highly possible that community welfare may be improved due to increased competition in local geographic markets, even if there is a change in the number, type and form of services provided in the area. Increased competition generally leads to reduced prices for goods and services and promotes a more dynamic business sector that is encouraged to innovate and evolve in response to market forces and technology advancements.

When the determination of competitive effects and community welfare are amalgamated into a single test for economic impacts (as in the E, P and A Act) it is important to ensure that a dynamic approach is taken to move beyond a simple count of current services that may be affected in the future. It is extremely important to consider future possible uses for current property and business in the future, as well as the additional services that may be



Competition requires that the success or failure of supermarkets depends on the choices of their customers, not the protection of the planning system.

attracted due to the development. Changes in population demographics and market forces are also important considerations.

When economic tests are incorrectly applied in the planning process, placing undue emphasis on a static picture of the local economy (such as the current number and form of services) it is likely that incorrect assessments will be made, with the ultimate effect of reducing and inhibiting competition through rejection of development applications.

As well as foregone reductions in prices for goods and services, and a potential slowing of the rate of business innovation additional issues associated with incorrect application of economic tests include a reduction in developer confidence, and a resulting redistribution of investment funds into jurisdictions with lower levels of development risk.

The Taskforce's arguments for amending section 79C of the *Environmental Planning and Assessment Act* to make it clear that, when considering a development application, no direct or indirect consideration may be given by a consent authority to any possible loss of trade that might be suffered by any other planned or existing business or businesses appear to be well grounded.

"[F]avouring retail developments in city centres comes at a cost of increased congestion when transport infrastructure is at or near full capacity."

4.3. INTEGRATION OF TRANSPORT AND LAND USE, NSW

In 2001, the NSW Government released its Integrated Land Use and Transport (ILUT) package. The aim of the package was to provide guidance for government agencies, councils and developers on how to include integrated land use and transport goals into future development. While the policy is still not finalised more than six years later, it is still considered during development assessments, for example *Terrace Tower Holdings Pty Ltd v Sutherland Shire Council* (2003) 129 LGERA 195. The aim of Draft SEPP 66 is to attempt to force future developments to achieve transport goals. It influences both the process of zoning and the process of assessing individual development applications.

Within the ILUT package, draft State Environment Planning Policy 66 – Integration of Transport and Land Use (draft SEPP 66) outlines the principle that businesses and service providers that are known to generate transport demand should be located in areas that offer a choice of transport options and increase the opportunities for consumers to make fewer and shorter trips.

However, as discussed previously, there are a number of studies that call into question the ability of a planning system to achieve reductions in private transport use and reduce congestion and energy usage issues (Gilbert and Dajani³¹ and Webber³²). These studies suggest that it is urban transport systems that influence land use patterns and not land use patterns that should be shaping transport usage. In the case that developments are channelled toward centres with numerous transport options, it is crucial to ensure that the transport facilities are designed and

³¹ Gilbert, G and Dajani, J. (1974), *Energy, Urban Form and Transportation Policy*, Transportation Research, 8, 267-76.

³² Webber, M. (1961), *Transportation Planning Models*, Traffic Quarterly, 15(3), 373-90.

forward managed to be able to cope with such large scale and concentrated growth.

There is also evidence that the ability of public transport networks to provide a viable transport option to private vehicles is struggling in Australia. Moran presents the following discussion on the possibilities of Australian public transport due to population densities and the locational distribution of employment centres:

Public transport needs high concentrations of people. A rule of thumb is that rail-based systems require 40,000 people per square kilometre to be viable. Such a system therefore works, after a fashion, in Hong Kong, which has that population density. Express bus systems need 26,000 per square kilometre.

Australian cities have densities of about 1,500 per square kilometre and reach only 5,500 even in the densest suburbs. On top of this, concentration levels have been falling for decades in spite of land rationing by the government designed to promote denser urban living. Even an intensification of this government-created shortage of land will not reverse the trend.

The estimates of what is required for a viable public transport system with growing patronage levels are also being made worse by the changing nature of workplaces. More and more trips are cross-town. These trends are exemplified by a declining share of employment in central areas where radially based public transport systems work best. [...] in Melbourne, jobs in the central area fell from 55 per cent to 28 per cent of the total between 1961 and 2001. In that latter year, the CBD accounted for only 10 per cent of jobs.³³



Concentrating retail activities in a limited number of strategic centres leads to congestion when existing transport infrastructure is at capacity.

³³ Moran, A. (2006) *The tragedy of planning: losing the great Australian Dream*, Institute of Public Affairs, Victoria, Australia.

The requirement that the land use planning regulations be a mechanism to achieve transport and environmental goals adds another constraint on the application of planning legislation to maximise community welfare. The planning process appears to be viewed as a single tool whose use is to achieve a number of social and community objectives, for example, promotion of business economies of scale and scope, city design and transport usage goals.

It is a well understood principle in public policy that meeting multiple goals with a single or limited number of instruments generates unwanted trade-offs and reduces economic efficiency. For example, favouring retail developments in city centres comes at a cost of increased congestion when transport infrastructure is at or near full capacity.

“Allowing the development of retail services that are available before, during and after work hours in areas where consumers are already located will result in a considerable reduction in transport congestion into centres, as well as reducing the time and transport costs that these consumers face.”

4.3.1. Inconsistency between planning documents and transport usage

Along with the economic tests outlined in the E, P and A Act, Draft SEPP 66 places an increased level of emphasis and priority on development in certain established centres, and those with reasonable access to public transport options. The policy is directed at reducing the number of trips that consumers are required to make to go shopping or conduct routine tasks such as going to the post office etc. However, the method used in the policy is to amalgamate all of these services in a single area, while disregarding the current transport habits of the majority of shoppers. There also appears to be a limited acknowledgement of other planning policies that are promoting, for example, the development of large scale, out of centre, industrial and employment areas that potentially increase the number of cross city trips employees undertake.³⁴

Difficulties may be arising from the stated goal of promoting single, multi-purpose trips. While this may be a desirable intention when there are potentially significant community welfare gains to be achieved from a reduction in traffic congestion and environmental issues, careful consideration needs to be taken of current and evolving transport usage patterns. This is especially the case when these transport usage patterns are the result of other government policies such as the large scale development of out of centre employment and industrial areas, or the restriction of higher density residential options such as three or four bedroom apartments (as will be discussed in Section 6). One of the key single purpose trips that is not considered in the current policy outline appears to be the trip to and from work each day via either private or public transport. Not only is this single purpose trip not mentioned in the planning documents, but there is an additional movement in related strategies (The Metropolitan Strategy; the Right Place for Businesses and Services Strategy) to ensure that retail developments are explicitly excluded from large scale industrial and employment areas.

Allowing the development of retail services that are available before, during and after work hours in areas where consumers are already located will result in a considerable reduction in transport congestion into centres, as well as reducing the time and transport costs that these consumers face. In addition, these developments will provide the level of services that such a large population requires during business hours, for example, banking, post office,

³⁴ Department of Planning, NSW (2005) A City of Cities: A Plan for Sydney's Future – Metropolitan Strategy. NSW Government.

and leisure shopping as well as shopping for food staples on a daily basis. The development of large scale industrial and employment lands have been discussed as being “disconnected form any community fabric [requiring] that workers drive to get lunch or run errands”.³⁵

Further inconsistencies arise in the planning process when there appears to be an avoidance of mixed use developments that include retail and residential services. It is noted that compact, mixed use areas are able to make efficient use of land and infrastructure, as well as to promote lively community areas and pedestrian based communities. These positive attributes, while able to support the goal of reducing inefficient reliance on car transport, are necessarily in conflict with the outlined centres policy discouraging retail developments out of established centres. This highlights the unnecessary and potentially welfare reducing tradeoffs that are required when a single and relatively inflexible policy mechanism is used to achieve multiple policy goals.

Case study: A supermarket in Wyong - 2005

The applicant lodged a number of development applications with Wyong Shire Council for the construction of a supermarket and other uses of as site from October 2003. None of these were approved by the Council.

In April 2004 a competitor lodged a development application for a supermarket on another site. The competitor’s application was approved by Wyong Shire Council.

Under the *Wyong Local Environmental Plan* (“the LEP”) all the relevant land was zoned as an “urban release area”. A “local shopping centre” was permissible in the zone subject to certain limitations, including that only one centre is permissible in Wadalba and Blue Haven.

The LEP’s provisions meant that the applicant’s application for a rival local shopping centre could not be approved. As a consequence it launched a legal challenge, arguing that the LEP’s limitation that there could be only one local shopping centre was invalid.

The applicant argued that the limitation to a single shopping centre was invalid because it was not a bona fide attempt to exercise power under the *Environmental Planning and Assessment Act*. They said that the primary operation and effect of the restriction was the protection of other retail developments in the area from the threat of competition. The applicant submitted that the protection of retailers from competition is not an end or object within the scope of the *Environmental Planning and Assessment Act*.

The applicant said that restriction in the LEP does not take as its reference point any actual use or development of land nor does it take as its reference point any assessment of the needs of the locality nor the continued viability of retail facilities in the locality.

The applicant claimed that the effect of the limitations was to immunise the person holding the consent from the threat of competition. By taking the grant of consent as its reference point, the

³⁵ Smart Growth Network (2003), *Getting to Smart Growth II: 100 More Policies for Implementation*, USA, November.

applicant said that “protectionism” was unconnected with the statutory objects of the Act.

Wyong Shire Council claimed that the LEP was made for a proper purpose, namely the preservation of a hierarchy of retail centres between regional, district, neighbourhood and local areas. This purpose was generally reflected in the Wyong Shire Council Retail Centres Strategy Plan 1996 (“the Retail Centres Strategy Plan”). The Retail Centres Strategy Plan included several objectives, one of which was about “protecting the integrity of existing major centres to the extent that they continue to perform a useful community function”.

The Council argued that the limitation was not a protectionist provision. Rather it operated to enable a retail centre to be established in Wadalba to prevent the expansion of retail centres that might exceed the environmental capacity of the land.

The Council also argued that even if the effect of the limitation is protectionist, its purpose is not. In any event, the Council argued, it was in the public interest that such prohibitions are available.

The NSW Land and Environment Court found that the objects of the *Environmental Planning and Assessment Act* provide wide powers to a council and to the Minister for Planning to prepare and make an LEP which controls development. The Court said that a broad prohibition on a second local shopping centre in Wadalba is a legitimate purpose under the Act.

4.4. WITHDRAWAL OF THE ILUT PACKAGE AND DRAFT SEPP 66

In its submission to the Australian Competition and Consumer Commission’s grocery prices inquiry *The impact of the NSW planning system on retail competition* the Urban Taskforce argued that the ILUT package undermines the operation of a free-market economy in the provision of retail services to the public. They said it discourages multi-purpose trips because it ignores the significant trips that are already going to be taken by most households, irrespective of the concentration of activities in centres.

The Taskforce highlights that by preventing a new single retail property being recognised as a new centre, the policy effectively precludes the private sector from successfully initiating a new centre. As a result the decision to create new centres is reserved for the bureaucracy. The Urban Taskforce believes that bureaucrats are so keen to ensure there is no oversupply in retail property assets that they are unlikely that they will take the initiative to establish new centres. The Taskforce observes that private sector operators are also prevented from establishing new retail facilities outside of centres.

According to the Taskforce, the ILUT package ensures that bureaucrats, rather than consumers, ultimately decide whether or not new retail facilities are necessary. In their view the proper function of the market is undermined. That is, if an existing retail facility is doing a poor job of servicing consumers, or is charging its tenants excessive rents (which mean artificially high prices to consumers) then an entrepreneur should be free to establish a new competitor retail facility. The ILUT package protects the owners of existing retail properties from the discipline of competition.

The Urban Taskforce has argued with the formal withdrawal of the ILUT package, including Draft SEPP 66.

5. LAND USE REGULATIONS AND COMPETITION

The central objective of urban planning is, in large part, to facilitate the flow of public and private services through the coordinated use of land resources. However, the over-reliance on exclusionary regulation can severely undermine this objective by impeding competition.

Anti-competitive constraints can take the form of:

- Barriers to entry from new competitors due to a lack of available sites;
- Restrictions that reduce the flexibility of competitors to react to changes in demand or to compete with other stores.

The consequences of reduced competition are often seen in:

- Higher prices;
- Reduced choice and convenience; and
- Fewer incentives for innovation.

The links between urban planning restrictions and competition have been established in a number of international studies and are supported by pricing surveys conducted in Sydney and submissions by retailers to the Australian Competition and Consumer Commission.

5.1. COMPETITION AND PRICES

Restrictions on the amount of land that is available for certain forms of retail development and the impact that this has on productivity growth has already been discussed. The impact on the level of competition that established stores or areas are likely to face also needs to be considered.

Land use restrictions that require certain formats of stores, or define when, where and how certain stores may evolve, are likely to have the effect of reducing competition by impeding the entry of new competitors into the geographical market.

“ [I]n the planning sector, governments appear to be upholding anti-competitive processes that elsewhere would potentially be considered to be contravening the *Trade Practices Act*”

In some cases, the restriction on entry takes the form of a complete refusal of allowing competitors to establish due to presiding land use regulations. Alternatively, if competitors are able to establish themselves, land use regulations may place limits on the format of their operations (for example their scale). These policies will also reduce the level of competition within the market as the new competitors – and potentially the existing operators – are not able to take advantage of improvements in information technology in the operations associated with store format.

Restrictions on competition levels due to restrictive land use policies result in increased inefficiencies in both the retail service provision market and the market for developers. A restriction on the possible format of retail developments or housing developments has the potential to reduce the level of competition between property developers. This is due to the fact that there are limited opportunities for development and less market scope for innovation by developers.

The direct effect that a lack of competition in retail markets has on consumers is an increase, or forgone reduction, in possible prices for goods. Hausman and Leibtag reported that land use restrictions, zoning regulations and political pressure from interested parties in the US resulted in the prevention of Wal-Mart stores entering certain geographical markets and therefore prevented consumers from accessing a potential 25 per cent reduction in food expenditure.³⁶

Such restrictions on competition will generally result in higher prices for both land and goods and services for sale (allowing those successful developers to pay inflated land prices). Current planning and regulatory systems in Australia generate pools of resources that may be misused – examples include high-profile corruption allegations and in some cases charges in northern Melbourne, Geelong, the Gold Coast and Wollongong.³⁷

Where there are strong actions being taken toward increasing competition and reducing the influence monopolies and duopolies have in other areas of the economy, in the planning sector, governments appear to be upholding anti-competitive processes that elsewhere would potentially be considered to be contravening the *Trade Practices Act*.³⁸

5.1.1. Cost of living and retail prices in Sydney

The Economist Intelligence Unit (EIU) regularly publishes cost of living indexes for over 130 cities around the world. Using price data for products such as staple food items, fresh fruit and vegetables, household supplies and personal items (as defined by the EIU) it can be seen that over the past 18 years, there has been a statistically significant

³⁶ Hausman, J. and Leibtag, J (2006) *Consumer benefits from increased competition in shopping outlets: Measuring the effect of Wal-Mart*. Institute for fiscal studies, Centre for Microdata and Practice, Working Paper.

³⁷ Moran, A. (2006) *The tragedy of planning: losing the great Australian Dream*, Institute of Public Affairs, Victoria, Australia.

³⁸ Ibid

increase in price differences between supermarkets and smaller format mid-priced stores. That is, not only are small format mid-priced stores more expensive than supermarkets, this price differential is increasing over time. Further increases in the proportion of these smaller mid-priced stores relative to supermarkets could be expected to disproportionately increase the cost of living above that expected with a higher proportion of larger format supermarket type retail stores.

Figure 1: Average percentage price premium of mid-priced stores over supermarkets (Household supplies and personal care items)

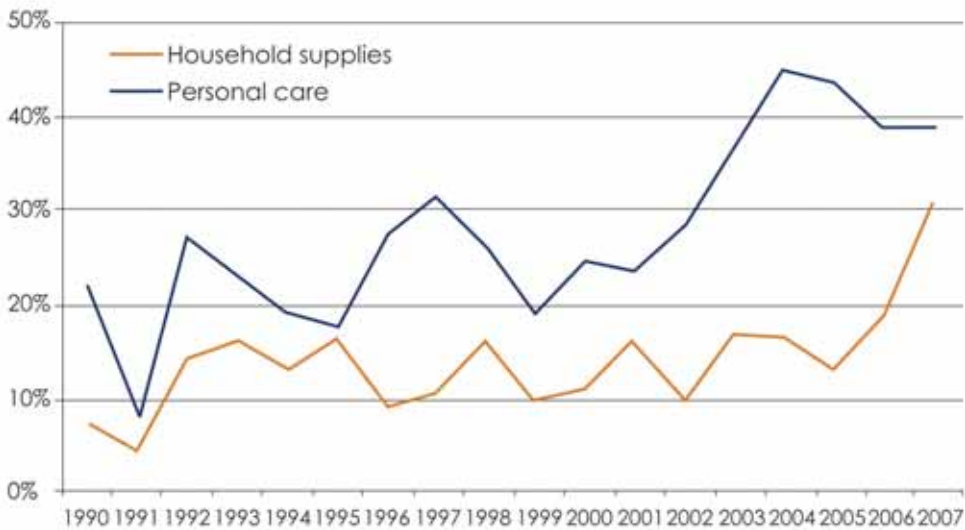
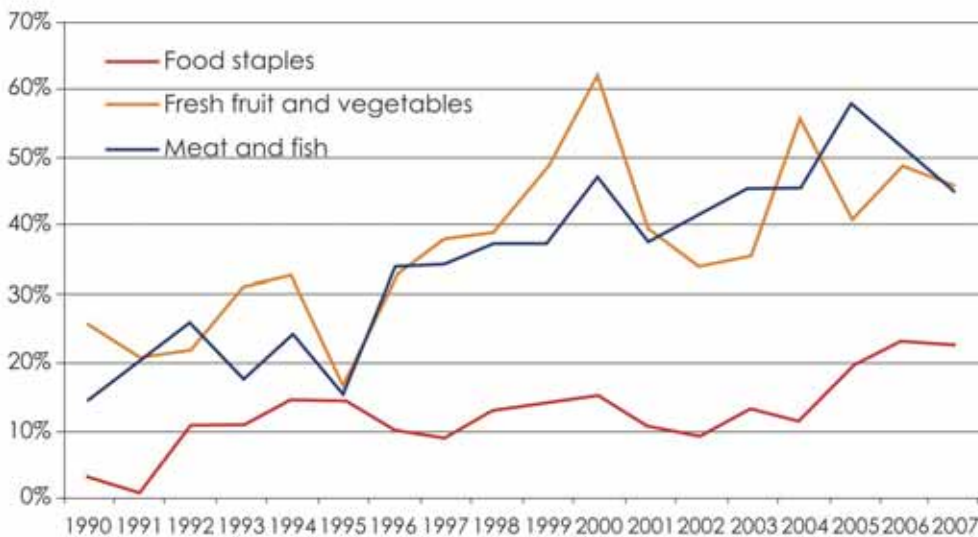


Figure 2: Average percentage price premium of mid-priced stores over supermarkets (Food staples, fresh fruit and vegetables and meat and fish)



“In 2007, prices for food staples were on average 22 per cent higher in mid-priced stores than in larger format supermarkets and household and personal care products were 33 and 39 per cent higher on average.”

In 2007, prices for food staples were on average 22 per cent higher in mid-priced stores than in larger format supermarkets and household and personal care products were 33 and 39 per cent higher on average (EIU, Cost of living survey).

The effect of lower cost store formats on prices should not be underestimated. The US Department of Agriculture found that, after adjusting for quality and packaging, large format stores such as Wal-mart have significantly lower prices for dairy products and eggs. The report then went on to suggest that the ongoing growth in the presence of these store formats could warrant reconsideration of the way in which the US CPI was calculated. This conclusion is supported in previous studies by Kaufman and Hausman and Leibtag. Kaufman found that US food prices are generally higher in smaller grocery stores than in larger supermarkets and also higher in inner-city and rural locations than in suburban locations.³⁹ Hausman and Leibtag found that large format stores may have reduced that actual rate of food inflation by 1.5 per cent.⁴⁰

Statistics Canada did not find the opening of large format stores biased the CPI as they suggested that existing outlets responded to the increased level of competition by lowering prices.⁴¹ They found that in response to the opening of new lower-priced superstore, existing food stores lowered prices prior to the opening of the outlet and they continued to respond to price changes in the new outlet over time.

These results highlight the important connection that land use planning and zoning policies in NSW may have on the overall cost of living in major cities and regions of Sydney. Artificially restricting the format and layout of supermarkets and retail stores to smaller, more compact sizes has the potential to remove economies of scope and scale that could be achieved with larger formats, resulting in increased prices experienced by consumers.

“Artificially restricting the format and layout of supermarkets and retail stores to smaller, more compact sizes has the potential to remove economies of scope and scale that could be achieved with larger formats, resulting in increased prices experienced by consumers.”

5.1.2. Current experience in the Australian supermarket sector

One of the questions raised in the Australian Competition and Consumer Commission’s Issues Paper *“ACCC Inquiry into the competitiveness of retail prices for standard groceries”* covers the impact that local land use and zoning restrictions may have on competitiveness and entry into the retail grocery sector in Australia.

Question 39 asks “Is access to suitable sites a significant impediment to the entry or expansion of supermarket chains? Do local planning and zoning laws impede access to suitable sites? Please provide details.”

Publicly available submissions from a number of participants in the grocery sector in Australia, notably Franklins

³⁹ Kaufman, P. et al (1997) *Do the poor pay more for food? Item selection and price differences affect low-income household food costs*. U.S. Department of Agriculture, Economic Research Service, AER 759, Nov.

⁴⁰ Hausman, J. and Leibtag, J (2006) *Consumer benefits from increased competition in shopping outlets: Measuring the effect of Wal-Mart*. Institute for fiscal studies, Centre for Microdata and Practice, Working Paper.

⁴¹ Hayman, C. (2006) *Outlet substitution bias in the Canadian consumer price index: A case study*, Statistics Canada, Prices Division.

Pty Ltd and Aldi Stores, have made comments in response, noting that currently, certain land use restrictions and zoning regulations are having an impact on their ability to compete effectively in their markets.

Franklins Pty Ltd state that:

Access to new suitable sites is a significant impediment to expansion of supermarket chains. Local planning and zoning restrictions tend to bear little resemblance to commercial reality, areas that are zoned for retail uses are not necessarily in appropriate locations. Additionally, government initiatives to increase population densities have created demands for retail space that cannot be met under existing zoning criteria. Rezoning applications are a long and slow process which further hampers the ability to respond to consumer demand. This is particularly relevant in inner city areas where higher population densities are being encouraged where there are generally smaller lot sizes that require amalgamation to provide significant land to accommodate a supermarket development.⁴²

This statement highlights a number of competitive issues that are of current concern in the retail grocery and undoubtedly other sectors of the Australian economy. Current zoning regulations are not adapting to keep pace with market forces, some of which are government policy driven. Increased population densities in inner city and inner suburban areas are relocating demand for retail and grocery services, while zoning regulations are impeding the development of these retail services, forcing them to locate in less than optimal sites, or reducing the scale on which they are able to operate. At the same time, an inability of grocery service providers to supply the level of demand in the market has a flow on effect to grocery prices, which has a further detrimental impact on community welfare. That is, residents are not only unable to shop in their preferred areas, but when they do go shopping the prices they pay are likely to be higher due to the restrictive effects of the zoning regulations.

Aldi Stores also note access to suitable sites for development as being one of the largest impediments to competition within the Australian retail grocery market. Aldi Stores note the requirement that new retail developments must be undertaken within defined activity areas, but that the amount of land that is appropriately zoned is in limited supply, thus imposing a constraint on new developments. The flow-on effect of this restriction in supply is claimed to be a reduction in retail level competition.

Aldi Stores note that:

As the economy grows it is extremely important that planning and zoning laws keep pace with development and allow for the expansion of retail activity centres. Unfortunately, it is our experience that local planning authorities are often constrained by a lack of resources, which makes it hard for them to deal effectively with the strategic planning required for future growth.⁴³

Future developments in retail markets are likely to be inhibited by rigid planning regulations that do not have the flexibility to adapt in a changing market place. This rigidity will be felt in terms of reduced levels of productivity growth, increased costs of development, a distortion in the capital market with investment directed into more productive sectors and an ultimate impact of reduced competition in the final product markets such as retailing and residential housing sales.

⁴² Franklins Pty Ltd (2008) Response to the ACCC inquiry into the competitiveness of retail prices for standard groceries, Volume 1. March, p10.

⁴³ Aldi Stores (2008) Public submission to the ACCC grocery inquiry, March, p10.



New entrants, like Aldi, have found the planning system to be a major barrier to securing sites for new stores.

5.2. UNITED KINGDOM COMPETITION COMMISSION FINDINGS

The UK Competition Commission in a report *The supply of groceries in the UK market investigation* reached a number of conclusions with regard to the impact of planning restrictions on retail competition. They stated:

We found that the planning system, in pursuing the broad-based objectives for which it is intended, necessarily constrained the development of new larger grocery stores, but placed more limited constraints on entry by mid-sized grocery stores and convenience stores as well as extensions to existing larger grocery stores. Securing planning permission for a new larger grocery store takes a significant amount of time in terms of site assembly and the planning process. We found that the costs associated with these activities, together with the risk of permission not being granted, represented a more significant barrier to entry for other grocery retailers and new entrants than for existing large grocery retailers.⁴⁴

They found 90 controlled land sites on which grocery retailers had been prevented from establishing that each

⁴⁴ United Kingdom Competition Commission (2008) *The supply of groceries in the UK: market investigation*.

restriction was acting as a barrier to entry in a highly-concentrated local market. The report noted that the planning regime and local planning authorities, in accordance with policy objectives, operate as barriers to entry or expansion in a significant number of local markets through:

- limitations on the construction of new larger grocery stores; and
- the imposition of costs and risks on smaller retailers and new (entrants without pre-existing grocery retail operations in the UK) that are not borne to the same extent by existing large grocery retailers.



Allowing retail in new centres of residential density increases the opportunity for people to walk to the shops

5.3. ZONING AND COMPETITION IN NSW

In March 2006, the NSW Government gazetted the *Standard Instrument (Local Environmental Plans) Order 2006* ("the Standard Instrument") for preparing new local environmental plans.

"[T]he Standard Instrument creates zones where it is expressly stated that businesses are unable to be established if they would provide competition to businesses in established centres."

The motive was to ensure that local plans across NSW use the same planning language, making it easier for communities to understand what is planned for their local area and the zoning controls. All councils are required to use the Standard Instrument to prepare a new principal local environmental plan for their area, to be completed by 2011.

However, in a submission to the Australian Competition and Consumer Commission's grocery prices inquiry the Urban Taskforce highlights that the Standard Instrument creates zones where it is expressly stated that businesses are unable to be established if they would provide competition to businesses in established centres. As discussed above, impediments to competition can have wide ranging adverse effects on economic growth, productivity growth, employment and the cost of goods and services to consumers.

The Urban Taskforce argues that this can be rectified by amending the Standard Instrument so that:

- In a "Business Development Zone" all retail and office premises and other similar land uses should be permitted, even if it would provide competition to businesses located in established centres;
- In "Enterprise Corridor", "Business Park"; "General Industrial"; and "Light Industrial" zones all retail premises should be permitted, even if it would provide competition to businesses located in established centres; and
- The definition of "shop top housing" should be returned to its pre December 2007 state so that any retail premises could go into the ground floor of a mixed use development in "General Residential", "Medium Density Residential", "High Density Residential" and "Neighbourhood Centre" areas.

By requiring retail growth to take place in a limited number of strategic centres, the owners of retail properties in those centres may not be forced to price competitively.



6. ZONING, PROPERTY VALUES AND INVESTMENT

When the amount of land available for certain uses is reduced due to exclusionary zoning and land use policies, property values are likely to be inflated to reflect this artificial scarcity.

The distortion of property values will have flow on impacts to investment decisions and the location of new developments. The high mobility of development capital means that jurisdictional areas with restrictive planning processes and artificially inflated land prices are likely to lose development projects to other jurisdictions with more flexible planning processes and lower zoning rents on property values.

Where such zoning restrictions and property value impacts reduce the number of new businesses establishing in a region, this can have adverse impacts on the level of retail competition, resulting in potentially higher prices for goods and services, and an increase in the costs of living.

There is evidence that current zoning restrictions in NSW and Australia are having an adverse impact on the ability of new and emerging businesses to locate in affordable and appropriate locations.

By design, land use regulations place limits on the amount of land that is available for certain forms of development. These restrictions, if not made carefully, run the risk of misaligning the demand and supply for land and creating an imbalance in the demand and supply of land for alternative uses.

There are three main concerns with an incorrect alignment of demand and supply for available land:

- the generation of artificial scarcities and undue price differentials for land zoned for different uses when excess demand for land is generated;
- the forced relocation of investment from urban centres and their immediate surroundings to greenfield areas where there are fewer restrictions; and
- the generation of lumpy as opposed to continuous distributions of land values leading to retail and housing formats that are required to fit into sub-optimal formats due to land affordability as well as land use regulations.

The fact that land use regulations can have a significant impact on land and property values means that planning regulations may be captured by concerned parties with a vested interest in these property values.

Once investment has been moved away from areas where retail growth is desired and into more greenfield areas, this investment is generally considered to be sunk and unrecoverable, limiting the likelihood of relocation in the future. The implications of this include the long term redistribution of supply of services from the given investment as well as the possibility that it may generate flow-on investments in outskirt areas that are also suboptimal (relative to development in high demand growth areas).

Increasing restrictions on land use, store size and format and location also has the potential to influence competition in retail markets and result in higher prices for goods, and increased costs of living. Data from the Economist Intelligence Unit (EIU) is used to investigate differences in prices between larger format supermarkets and smaller format mid-priced stores in Sydney.



The streets of many of the strategic centres identified for further concentration of retail are already heavily congested

6.1. ARTIFICIAL LAND SCARCITY AND INFLATED LAND PRICES

When the supply of land for certain uses is restricted below the level of demand, there is a premium placed on land values. An artificial resource rent will have been generated and capitalised into land prices.

The impact of land use regulation on housing prices has received a large amount of attention recently, with Day indicating that differences in regulation policies in between Sydney and Houston, Texas, are some of the main

drivers of differences in housing affordability between the two cities.⁴⁵ Day notes that the average house costs 9 times the median income in Sydney but only 2.7 times the median income in Houston.

Capitalisation of land use restrictions in land prices is not a new concept. However, with a rapidly expanding population and economy, this capitalisation runs the risk of becoming deeply embedded and generating opposition to re-zoning applications on the basis that current land values may be reduced, irrespective of whether, on balance, this reduction is in the best interests of the community.

Over time, it is likely that the disconnect between property values under inefficient policies restricting land supply and property values implied under an expanded and more adaptable policy will increase.⁴⁶ In this case, the vested interest current land holders have in maintaining the status quo and defending their property values also increases. The result is that political pressure on the planning system is also likely to increase with opposition to changes becoming more intense. The longer that such a situation is allowed to continue, the greater the amount of time and money that may be invested into challenges, further increasing the economic costs associated with such restrictive land use regulations.⁴⁷

6.2. DISCONTINUOUS LAND PRICING PATTERNS

The effect of land use regulations on land prices may be especially felt on the boundaries of zoning regions. Hence there may be large disparities between property prices on one side of a street compared to the other.

For example, Day noted instances where residential land was valued at \$100 per square metre, and land lying just outside the residential boundary was valued at \$10 per square metre.⁴⁸ These large price differentials in land located in such close proximity is not unheard of in city areas and with land suitable for retail and commercial development.

Such large price differentials indicate a relatively large misalignment of demand and supply factors for various forms of land uses. If approached in terms of economic efficiency, an increase in the restricted land base could potentially generate large economic or financial gains, as well as increases in community welfare. There would of course be some winners and losers. Currently restricted and artificially inflated land values would experience a reduction in prices but when the increase in land values of the newly re-zoned land exceeds this reduction, there will be an overall increase in community welfare.

"Where land is zoned for commercial purposes, but the supply is restricted to the extent that developers are essentially priced out of the market, the planning system becomes counter productive."

⁴⁵ Day, B. (2005) A tale of two cities: Address to the HIA National Planning Conference, July, 2005, Melbourne, Australia.

⁴⁶ This is an example of the persistence mechanisms described in Coate, Stephen and Morris, Stephen. "Policy Persistence", American Economic Review, 1999, 89(5), pp. 1327–36.

⁴⁷ In the very long run, in a model where population is mobile (the so-called "open city" model), population shifts will equalise quality-adjusted costs across jurisdictions. However, it is unclear whether this model has great relevance to current circumstances and even if it did, a great deal of harm could be done before the equalising forces set in.

⁴⁸ Day, B. (2005) A tale of two cities: Address to the HIA National Planning Conference, July, 2005, Melbourne, Australia.

The misalignment of land values across differently zoned regions in close proximity creates potential issues with land affordability for developers as well. Where land is zoned for commercial purposes, but the supply is restricted to the extent that developers are essentially priced out of the market, the planning system becomes counter productive. Land located within a reasonable distance from expensive, retail zoned land, such that community benefits from the development would be achieved (for example, within walking distance of high density residential areas or employment centres) may not be considered appropriate from a zoning perspective as it is not located on the main street designated for retail businesses. In this situation, restricted supply of retail land has had the effect of discouraging retail development due to artificially inflated prices. Areas that are priced favourably for retail development and still meet the needs of developers and the community in terms of possible service provision and location are also excluded on the premise of their location, resulting in no development being undertaken despite the possibility to improve community welfare.



Retail that is close to homes and workplaces is more likely to be accessed by pedestrians than retail concentrated in a limited number of strategic centres.

“Restrictions on the number of shopping centres that are approved for development generate a direct restriction on the supply of retail floor space. This restriction is observed through a premium of rents paid in shopping centres relative to regions with less restrictive development processes.”

6.3. INCREASED TENANCY COSTS IN AUSTRALIA

Restrictions on the number of shopping centres that are approved for development generate a direct restriction on the supply of retail floor space. This restriction is observed through a premium of rents paid in shopping centres relative to regions with less restrictive development processes.

In their submission to the Productivity Commission's inquiry *"The market for tenancy leases in Australia"*, the Southern Sydney Retailers Association provided comparisons on the rental and leasing costs faced by retailers in Australian shopping centres compared to European shopping centres.

Referencing the Westfield Group's reports on occupancy costs at June 2005, the following percentages of retail turnover apportioned to occupancy costs were reported:

- Fashion – 20.8%
- Footwear – 20.2%
- Jewellery – 18.1%
- Leisure – 16.1%
- General retail – 17.2%

This is then to be compared to the occupancy costs experienced by retailers in some of the larger European cities, reported in Table 1, which are substantially lower.

Table 1: Retail occupancy costs in European shopping centres

Country	Shopping centre	Occupancy costs as percentage of retail turnover
France	La Part Dieu Shopping Centre, Lyon	7.5
	Villeneuve Shopping Centre, Lille	8.5
	Velizy Shopping Centre, Paris	8.3
	St Steve Shopping Centre, Rouen	9.9
Sweden	Taby Centrum Shopping Centre, Stockholm	7.7
	Solna Centrum Shopping Centre, Stockholm	8.2
	Forum Nacka Shopping Centre, Stockholm	10.2
Austria	Donauzentrum Shopping Centre, Vienna	7.6
Spain	Parquesur Shopping Centre, Madrid	8.2
	La Vaguada Shopping Centre, Madrid	10.6
	Les Glories Shopping Centre, Barcelona	11.8
Denmark	Fisketorvet Shopping Centre, Copenhagen	9.9
Czech Republic	Chodov Shopping Centre, Prague	9.1
Poland	Galeria Mokotow Shopping Centre, Warsaw	9.8

Increased occupancy costs faced by retailers in Australian shopping centres have a direct impact on the prices Australian consumers face for their retail goods and services. Flow on effects include an inefficiently low level of retail service provision to Australian consumers, reductions in productivity growth and the ability of retailers to innovate, as well as a reduction in the level of employment in the industry.

7. CASE STUDIES OF RESIDENTIAL AND RETAIL DEVELOPMENT

In Australia and internationally, there are numerous examples of how planning processes and zoning restrictions have, to the detriment of community welfare:

- Failed to take into account all of the benefits of a project;
- Selectively considered community concern or approval of a project;
- Been unable to flexibly adjust to changing technology, demographics and market forces.

In addition, there are also numerous examples of how a flexible approach to planning and development applications has been able to improve community welfare outcomes through:

- Promoting mixed-use developments that have reinvigorated struggling local areas and shopping centres;
- The establishment of public and private partnerships to improve development outcomes to the benefit of the community.

The ability of residents to find housing and accommodation options that match their preferences is greater in cities that provide explicit policies directed toward promoting a diversity of housing options. Therefore, residents that have a preference for compact, higher density living areas, within walking distance to retail services are more likely to be able to live in such areas if development policies are flexible enough.

This section outlines a number of case studies of development experience within New South Wales, Australia and internationally. The case studies provide examples of development issues such as:

- The willingness of local authorities to engage developers to achieve urban planning goals and the role that local authorities play in gaining specific outcomes;
- The role of community opposition to development applications and the impact that this opposition may have on the decisions of local authorities;

- The alterations to development plans occasionally negotiated by local authorities, such as a reduction in density, and the impact that these revisions have on the ability of developments to achieve development goals and profitability requirements;
- The role of retail and residential development in achieving transport goals, such as a reduction in travel time, and encouragement of the use of public transport options.

A further study based on the preferences of residents and their ability to fulfil these preferences under different zoning regimes is also presented. The study compares Boston and Atlanta and illustrates the result that in areas where zoning regulations are flexible enough to provide a wide mix of development type (for example, detached, car oriented as well as higher density, pedestrian oriented developments) then it was more likely that residents would be able to reside in an area that met their preferences, rather than being forced into a suboptimal location.

Some of the key points that can be drawn from the case studies include that in no situation was the planning authority a neutral observer, that is, in no instance was a purely laissez-faire approach taken to the proposed developments. Related to this observation is a discussion by Levine on the strategic actions of developers when submitting proposals and anticipating the actions of planning authorities. These actions included:

- Developers not submitting proposals in areas where they feel they would be profitable due to presumptions that planning authorities would not even consider them, or alter them to the point that they were no longer profitable;
- Developers submitting proposals that were not in the ideal form but considered to be more likely to be approved by authorities, for example, lowering the proposed density of a development; or
- Developers submitting proposals that were of higher density than they would ultimately be interested in developing, presumably to allow for some level of negotiation with authorities.⁴⁹

“ [T]he difficulties of the rigid documentation and assessment criteria that are faced by any potential applicant are increased in the case of Aldi Stores as their format does not match that outlined within the town plans.”

⁴⁹ Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

7.1. ACCOUNTING FOR ALL OF THE BENEFITS OF A PROJECT

The strict application of published zoning plans generates tension between the planning authorities and the development industry when ideas and innovations move beyond the scope of published zoning plans and the rigid criteria laid down under planning policies. Without scope for consideration of innovative development applications, there is a risk that a development with strong community benefits will be inefficiently rejected or altered to the detriment of community welfare.

7.1.1. The experience of Aldi Stores in Australia

In their submission to the ACCC inquiry into grocery prices, Aldi stores noted the difficulty faced when attempting to acquire land and approval to develop new store locations within Australia.⁵⁰ The layout and business model of Aldi stores is not the same as the traditional major supermarket stores customarily operating within Australia. In addition, Aldi stores note, most town planning instruments were drafted prior to the entry of Aldi into the Australian market. Therefore, the difficulties of the rigid documentation and assessment criteria that are faced by any potential applicant are increased in the case of Aldi Stores as their format does not match that outlined within the town plans.

Beyond being able to provide strong competition to the existing supermarkets in Australia, Aldi stores consider the planning system too rigid to account for additional benefits, such as: support of complementary businesses, smaller total store footprint, limited trading hours, control over limited deliveries and a commitment to minimising environmental impacts through store construction and design. As these benefits are not taken into account, the company has found it difficult to obtain development approval in its preferred.⁵¹

7.2. FAILURE TO RESPOND TO COMMUNITY DEMAND

One of the objectives of planning reform is to more closely align urban design with changing community demand. A restrictive planning process has the potential to generate missed opportunities in terms of foregone development and developments that did not reach their full potential.

7.2.1. Availability of apartments in Sydney, NSW

The City of Sydney restricts three or four bedroom apartments to eight per cent of new unit developments in Potts Point, Elizabeth Bay and Rushcutters Bay. In Camperdown they can only be 15 per cent of new developments. The City of Sydney's rules affect 24 suburbs and the central business district.

The rules applying to former South Sydney local government area (now part of the City of Sydney) explicitly state that the purpose of the rules are to preserve a social mix that existed in 1991. It may well be the case that a South Sydney apartment was not a popular choice for families sixteen years ago, but society (and the property market) has changed a lot in this time.

⁵⁰ Aldi Stores (2008) Public submission to the ACCC grocery inquiry, March.

⁵¹ Ibid.



Parking and traffic issues are often more easily managed when retail is more decentralised and located within walking distance of workplace or higher density homes.

The shortage of three and four bedroom homes in these areas has started to squeeze renters, with local rents skyrocketing. For example, over the twelve months to August 2007, rents for three bedroom homes across the Sydney metropolitan area increased by seven per cent, but in the City of Sydney rents shot up by 14 per cent (August 2007 NSW Department of Housing *Rent and Sales Report*).

While rental increases across the board are occurring for all dwelling types, the disproportionate rental increases observed for larger homes are indicative of the more than significant gap between demand and supply. The market is prevented from adjusting to address this shortfall by development control plans that say it is permissible to build one or two bedroom apartments, but not three or four apartments. Such planning policies make it harder for families to secure larger sized homes in inner Sydney.

Many new families in the inner city cannot afford a detached house in the inner suburbs and, if they want stay in the area, must live in two bedroom apartments. With the large demographic changes, and changes in lifestyle observed over the past 15 years, it appears to be difficult to justify imposing the social mix of 1991, by law, on a large part of the City of Sydney in 2008.

Developers argue that if a unit development, within a particular envelope, would be approved for a particular site, the council should not be in a position to dictate how many apartments contain one, two, three or four bedrooms. Arguably, the developer has a better idea of the market forces and level of demand for their products – local communities should be free to evolve based on the choices of homebuyers, rather than bureaucratic rules imposed by planning policies.

7.2.2. Ku-ring-gai Development, Ku-ring-gai, NSW

The housing format observed in Ku-ring-gai was typically of a house and garden layout, with existing houses generally situated on a quarter acre block. There is a major railway line going through the council (North Shore line – stations at Lindfield, Roseville, Killara and Gordon).

Located 10 kilometres from the city of Sydney, Ku-ring-gai council was refusing to increase local housing density even though there was evidence of very strong market demand that could be achieved following the required principles of transit oriented development. Higher housing densities had already been embraced by neighbouring councils along the same railway.

In 2005, the NSW state government was required to step in and create a special planning instrument to provide an avenue for the higher density development to be undertaken. This enabled increased densities of between 4-5 times around centres over what was previously permitted. Since then there has been the construction of significant new high density housing, with more to come.

7.2.3. Pembroke Park, West Bloomfield Township, Michigan

Having located a site at the edge of the Detroit city region, 24 miles from downtown Detroit and 9-10 miles from the two nearest suburban centres, a residential developer, recognising a strong market interest in higher density housing from childless families, young professionals and seniors in the area, proposed a 122 unit residential development. The original zoning for the 20 acre site allowed for 30 detached dwellings.

While the site was acknowledged by the developer to be neither transit oriented, mixed-use or pedestrian oriented, there were alternate benefits from the chosen site such as being located in a highly accessible area, close to large employment centres and where the shared-wall construction offered reductions in construction costs and improved efficiency.

These benefits would have provided lower construction and running costs, attractive alternatives to detached dwellings, allowing residents to live closer to their area of employment. Therefore, while the development did not include specific transit oriented solutions, it was indirectly reducing the transport reliance of residents.

The final development negotiated between the developer and the local authority was 61 detached homes on the site, reducing the construction and efficiency benefits of the original design as well as the profitability of the development.

The view of the developers subsequent to the completion of the project was that in many areas, although there may be market demand for higher density developments, local authorities generally do not have the tools to be

able to “react to, respond, review and approve” new forms of development that are being introduced as a result of changing market demand structures. In this case, potential market demand and alternate forms of community benefits were not considered in the approval process.⁵²

“In many cases, there is the potential for new developments to breathe new life into an area, promoting demand for goods and services in the immediate vicinity with additional benefits flowing on to the existing centre as well.”

7.3. MIXED USE DEVELOPMENTS PROMOTING RETAIL DEMAND

Included in a large number of town planning documents across Australia is reference to some form of a centres policy. These policies are directed at focussing retail and business activities into a single area, promoting network economies between businesses, and reducing the amount of travel time undertaken by shoppers. However, these policies may also have the effect of limiting the amount of out of centre growth due to unsubstantiated concerns about the viability of existing centres. In many cases, there is the potential for new developments to breathe new life into an area, promoting demand for goods and services in the immediate vicinity with additional benefits flowing on to the existing centre as well.

7.3.1. Bunnerong Road, Hillsdale, NSW (Southpoint Shopping Centre)

Completed in 2004, the Southpoint development provides an example of how mixed use residential and retail development has been able to reinvigorate a small neighbourhood shopping area without adverse effects being imposed on nearby larger centres.

Prior to development, Bunnerong Rd, Hillsdale was a relatively run down neighbourhood with no train station and a small shopping centre, approximately 30 years old with a single Woolworths and some small scale local amenity shops.

In the past, high rise developments were not permitted under the council town plan for the region. This was revised when the Botany Council produced a master plan for the area, rezoning the land which allowed for a new 16 storey development. This development provided the impetus for a regeneration of the area. Increased numbers of residential apartments increased the demand for services in the near vicinity, allowing the shopping precinct to expand to accommodate a second supermarket as well as a wide range of specialty stores, a post office and childcare facilities.

Without the allowance of higher density residential development, the small neighbourhood shopping centre would not have been sustainable. The increase in density ensured that not only were those existing services still required, but also provided avenues for expansion and improvement in services. The site is located only 3 kilometres from Port Botany and is very convenient to the South Sydney and Botany employment lands on a main road that links to Universities and Anzac Parade.

⁵² Levine, J. (2006) *Zoned Out: Regulation, Markets, and Choices in Transportation in Metropolitan Land Use*, Resources for the Future, Washington DC.

7.4. THE EFFECT OF COMMUNITY OPPOSITION

It is important that opposition be considered when development applications are being assessed as this will provide additional information on the costs to the community from the proposed development. However, this consideration needs to be taken into account in light of balancing vocal opposition with silent – or at least quieter and potentially less organised – promotion. Due to the nature of new developments and redevelopments, and the impact that zoning regulations may have on land values in an area, there is a high possibility that organised opposition groups, with vested interests in protecting the status quo will be more able to mobilise and oppose the development proposal. Those residents and consumers likely to benefit from the development are likely to be more dispersed and less able to generate a voice as clearly.

“[I]t is the role of the presiding authority to ensure that the total community benefits and costs are considered, not only those of highly visible and vocal parties.”

This effect is not uncommon in many public policy debates. When the benefits of a project are highly dispersed, or directed at groups that are not as yet involved – for example prospective residents or clients of new retail facilities – and the costs are more easily identified by a select group – for example, shop owners in reasonable proximity – it is the role of the presiding authority to ensure that the total community benefits and costs are considered, not only those of highly visible and vocal parties.

7.4.1. Whisman Station, Mountain View, California

In the region of Whisman Station, California, housing affordability issues were considered to be a substantial concern by the planning authorities. Both developers and planning agencies perceived a significant amount of demand for residential alternatives to single family homes. A private developer identified a site for residential development located next to the region’s light rail system that provided transport direct to the Silicon Valley employment centre. In addition, there was judged to be ample demand for high density developments in the area and consultants had previously assessed the site as able to sustain 21 units per acre with even more optimistic regional plans suggesting up to 25-30 units per acre.

The project had proponents including the local regional transport agency interested in constructing a light rail system, employment groups looking to increase accommodation options for employees and environmental groups looking for alternatives to auto-intensive sprawling developments.

However, critics of the development argued that the area had already absorbed more than its fair share of high density development, and that one of the neighbouring localities should be increasing its level of high density development. The community criticism proved strong enough to alter the views of the planning authorities who negotiated the final development down to a 12.5 unit per acre density.

7.4.2. Barangaroo, East Darling Harbour, NSW

The redevelopment of Barangaroo, East Darling Harbour was a move by the New South Wales Government to create a new city precinct that would provide increased economic vitality, employment and cultural facilities for the previously un-zoned port land in Darling Harbour.

The project was likened to other public development projects around the world that had an urban renewal focus and aimed at rejuvenating city areas.

However, the prospect of urban development on Sydney Harbour port lands has faced considerable community opposition, resulting in a reduction of the permitted development density. Currently, the Barangaroo development has a floor space ratio of approximately 2:1. Over the 22 hectare site, 11 hectares have been set aside as public open space, leaving the remaining developable area with a floor space ratio of approximately 3:1, much lower than the adjoining CBD areas (with 10:1).

This lower density has been locked in by the NSW Government, despite acknowledgements by the government of a shortage of commercial office space and clear undersupply of residential dwellings in this part of the city, which is also considered to be having an impact on affordability.

7.5. PUBLIC PRIVATE COOPERATION FOR DEVELOPMENT

Public private cooperation can provide a number of benefits to the development process. These include:

- Public interest provides a signal that there is willingness on the part of local authorities to promote and facilitate the development. This is not a small issue in the development applications process as opposition from public authorities can increase the costs of submitting applications and ultimately lead to applications being refused, dissuading private developers from considering a project;
- In certain situations, there are public benefits that may arise through a private development application. The example that is considered in this section is the construction of private housing developments with public housing residences. The joint initiative provides the public benefits of increased social integration with an aim of reducing social problems. The formation of a public private partnership increases the likelihood that public benefits from such developments will be maximised.

7.5.1. Bonnyrigg, Western Sydney, NSW

The Bonnyrigg urban renewal project in Western Sydney is an example of public private partnerships with strong community and political support aiming to make a difference to the vitality and sense of community within a region. Originally a large scale, 76 hectare, low density traditional housing development with 500 residential homes, the NSW government proposed a thirty year public private partnership to redevelop the site with increased residential



Rigid planning rules can be slow to adapt to new retail formats.

density, and increased access to both public and private housing options. Private partners to the project are Becton Property Group, St George Community Housing Association, the Spotless Group and Westpac Banking Corporation.

Plans for the site have involved a rezoning to allow for an increase from 500 residential properties to approximately 2,300, including maintenance of approximately 900 public housing properties. The expansion in residences in the area will be heavily supported by the Liverpool to Parramatta Transit Way, and the location of the current Bonnyrigg shopping centre providing retail services that was originally built as a stand alone centre, 5 kilometres away from Cabramatta.

Rejuvenation of the Bonnyrigg area will result in an increase in the social diversity of the area, an improvement in economic activity and an increased level of usage of urban facilities such as the transit way. However, development

would not have been possible without the support of local and state government authorities, as well as the prior development of urban infrastructure such as the stand alone shopping centre and transit way.

7.5.2. West Village, Dearborn, Michigan

In West Village, Michigan, US, city officials and a number of developers recognised a demand for increased housing levels at increased densities, based on proximity to large employment centres, and a high proportion of younger residents that were looking for more affordable housing options to the traditional models.

The Mayor selected a site, previously zoned for commercial uses, and called for interest from developers. It is felt that this decision, locating an area previously zoned for commercial development that currently held marginal retail uses with low occupancy rates, was the main reason for limited community opposition.

The development required a large number of variances to development codes, but as there was strong political leadership, and willingness to proceed on the side of the developers, the project was ultimately developed with 76 residential units, neighbour-hood scale retail options, and a plaza.

Political leadership was considered to be key, but it is fair to note that without a willing developer, no amount of leadership would have been sufficient to encourage the development.

7.5.3. Rio Vista West, San Diego, California

When a developer approached the planning authorities with a proposal to develop a piece of land currently owned by the developer, they were informed that the development would be required to fulfil requirements of a transit oriented development (TOD) following re-zoning negotiations over the previous two years.

The TOD initiative was introduced when the planning authorities found out that only 17 per cent of households included two adults with children living at home. Therefore, a disproportionately large amount of development geared towards this demographic and there was a large amount of interest in, and unsatisfied demand for, alternatives to single family dwellings and auto-oriented lifestyles.

The development eventuated with 11 dwelling units to the acre, with both residential and retail developments. Throughout the process, there were a large number of revisions that were required to community and town plans; however, the planning authorities recognised the benefits of the development and worked to streamline the process to reduce development costs and ensure that the development proceeded.

7.6. INABILITY FOR PLANNING DOCUMENTS TO ADJUST TO CHANGING MARKETS

This section is related to the ability of planning assessments to account for all of the benefits of a proposed development, not only those that are explicitly outlined in planning documents. Over time, technology, demographics and market demand forces are evolving. The rise of the Internet has had an impact on the demand for physical stores, an increasing number of “double income, no kids” households has changed the profile of supermarket shoppers and increasing international trade has also had an effect on the range of products and shopping experiences that are potentially available within Australia.

However, there is substantial evidence that planning regulations are not keeping up with these developments and this is having an impact on both the competitiveness of certain industries, and the ability of consumers to access products in a timely and efficient manner.

7.6.1. *Woolworths Limited v Warrnambool City Council (VCAT)*

In the Victorian Civil and Administrative Tribunal (VCAT), a case referred to as the Warehouse Group case – *Woolworths Limited v Warrnambool City Council* – brought to light issues that arise when planning documents draw artificial distinctions between products and services that are provided. In this case VCAT investigated whether or not the Warehouse Group was selling goods that did not fall under the cover of restricted goods as was required on their zoning. The emphasis was placed on the sale of videos, and whether music CDs, blank CDs, and/ or DVDs should fall under the category of videos, which were permitted to be sold on the premises.

The findings of the case stated that DVDs would fall under the category of videos, but neither blank nor music CDs would, and therefore, were not allowed to be sold on the premises. This finding was reached despite the fact that there is no difference in appearance of CDs and DVDs.

7.7. THE IMPACT OF LEGISLATIVE POWERS ON DEVELOPMENT EXPERIENCE

There is evidence that different planning policies and recourse to legislative powers may have an impact on the development of affordable and alternative residential dwellings.

In New Jersey, under what is termed the Mount Laurel decisions, the Supreme Court directed municipalities to ensure that zoning ordinances were required to provide for low and moderate income housing. The primary mechanism that was used to facilitate lower cost housing was a developer charge imposed to ensure the municipality complied. Developers would be able to circumvent the charges if they, for example, dedicated a proportion of their projects to “affordable housing options”.

In contrast, the Pennsylvania Supreme Court took a more flexible approach to facilitating residential development. Local government authorities were required to provide sufficient zoning options for developers. If developers felt that there was insufficient options available to them, they had the right to what was termed a “builder’s remedy”.

In this case developers may be awarded a court mandated authorisation to develop a piece of land of their choosing, thereby removing the power of the municipality to control the development. This essentially gave the municipality an incentive to negotiate development applications with developers to ensure that there was a favourable outcome achieved.

The rationale for the “builder’s remedy” was that developers should not be denied the ability to develop and construct residential properties where there is sufficient market demand. The benefits to affordable housing were a by-product of allowing more flexible and flexible zoning.

Levine outlines a study of the effect of the two different policies in Pennsylvania and New Jersey over the period 1970-1990, noting the differences in development profiles of the two areas, as well as noted statements on the additional costs the policies placed on developers.⁵³

The effect of the Mount Laurel decision was seen to be an increase in litigation and an increase in the cost of developing alternative, affordable residential developments. Pennsylvanian development over the period was geared more towards alternatives to single family developments, and providing a greater mix of housing options.

7.8. UNFULFILLED DEMAND FOR DEVELOPMENT

Where there is an artificial restriction placed on land available for certain types of development, for example, mixed use residential and retail, three observable outcomes can be expected:

- the quantity of developments of this nature will be reduced compared to what would otherwise have occurred;
- areas in which such development is allowed will command a price premium due to the artificial constraint on supply put in place by the regulations; and
- residents who face the constrained supply will obtain lower levels of satisfaction with the amenities provided in their current area, or the choices that are available to them.

Levine investigates this last point by comparing Boston and Atlanta, identifying the probabilities of residents with specific preference profiles living in areas that matched their preferences.⁵⁴

The study showed that where zoning and planning regulations were directed towards providing a good mix of residential, transport and retail options, there was a greater association between the preferences of residents, and the characteristics of their neighbourhoods.

The two cities, Boston and Atlanta, had relatively comparable populations and demographics, but Boston had a significantly smaller area and a greater degree of variability in alternate development options such as transit oriented and pedestrian friendly, higher density residential developments.

The first round of results indicated that in Boston, residents who had higher preferences for more densely developed,

⁵³ Ibid.

⁵⁴ Ibid.



Mixed use development allows retail premises to be co-located where people live, bringing services to higher density residential communities.

transit oriented areas were more likely to be living in such an area, as opposed to their counterparts in Atlanta. That is, while approximately 30 per cent of Atlanta respondents (compared to 40 per cent of Bostonian respondents) expressed a preference for transit oriented and pedestrian friendly neighbourhoods, in Atlanta, those residents were less likely to be living in areas with those characteristics.

The results indicated that area characteristics were more closely aligned with actual preferences and outcomes in Boston than in Atlanta, providing evidence that in the more sprawling city, with less variability in development alternatives, there was a greater disconnect between the preferences of residents and their ability to satisfy these preferences.

7.9. OBJECTIVES OF NSW PLANNING LEGISLATION

The objects of the NSW E, P and A Act include the encouragement of:

the proper management, development and conservation ... towns and villages for the purpose of promoting the social and economic welfare of the community and a better environment ...

and

the promotion and co-ordination of the orderly and economic use and development of land, ... ecologically sustainable development ... [and] increased opportunity for public involvement and participation in environmental planning and assessment.

There is no express provision in the objects of the Act to promote competition.

In their submission to the Australian Competition and Consumer Commission's Grocery Prices Inquiry, the Urban Taskforce argues that the object of the E, P and A Act should be amended so that the Act's existing objective of:

the promotion and co-ordination of the orderly and economic use and development of land

be re-written to read:

the promotion of competition and the economic use and development of land.

The Urban Taskforce also criticised the statutory description of the Minister for Planning's role. Section 7 of the Act gives the Minister for Planning responsibility for:

... promoting and co-ordinating environmental planning and assessment for the purpose of carrying out the objects of this Act and, in discharging that responsibility, shall have and may exercise the following functions: ...

- (c) to promote the co-ordination of the provision of public utility and community services and facilities within the State,

- (d) to promote planning of the distribution of population and economic activity within the State,
- (e) to investigate the social aspects of economic activity and population distribution in relation to the distribution of utility services and facilities ...

The Urban Taskforce observed that this description does not recognise any role for market forces. It instead assumes that the Minister for Planning is solely responsible for the planning of economic activity within NSW. The Taskforce believe this statutory definition of the Minister's role needs to be amended to reflect the important role that competitive markets play in the NSW economy.

The Taskforce says that the statutory summary of the NSW Minister for Planning's role set out in Act should be amended so that the existing provision giving the Minister responsibility:

to promote planning of the distribution of population and economic activity within the State

be re-written to read:

to promote planning of the distribution of population within the State;

to promote planning which facilitates the operation of competitive markets within the State's economy.

8. RETAIL PRODUCTIVITY GROWTH AND PLANNING RESTRICTIONS

Planning restrictions can have a number of different effects on the productivity of the retail sector, for example through adverse restrictions on hours of operation, store formats and land availability.

The importance of the retail sector in the Australian economy means that any impact on the productivity of the sector may have wide reaching impacts on the level of employment, economic growth and earnings at both the state and national level.

The OECD, in reviewing productivity growth in member countries, has found that land use restrictions have been an important factor in constraining productivity growth in the EU where planning policies are relatively restrictive compared to the US where there is more flexibility. Australian retail productivity has been approximately 50 per cent of that experienced in the US over the past decade.

Based on international comparisons, potential productivity gains of 1 to 1.5 per cent per annum could be achieved in the Australian retail sector through a more flexible and transparent land use planning system. Over 50 years, in net present value terms, a 1 per cent productivity growth rate in retail services would equate to \$52.42 billion of New South Wales GSP and \$196.64 billion of Australian GDP. If an additional 0.5 percentage point increase in productivity growth was achieved over this time, this would equate to \$78.87 billion of NSW GSP and \$296.08 billion Australian GDP.

Retail services are an important and expanding part of the overall economy. However, retail productivity growth, that is the growth in the level of services for a given level of input resources, has tended to be lower than in other sectors of the economy here in Australia and overseas.

While measuring productivity growth in retailing involves substantial challenges, some part of the productivity gap can be attributed to economic regulations or restrictions placed on the provision of retail services. Although a number of these restrictions reflect environmental, health and safety issues, there are also regulations that serve simply as economic constraints of retail business development. These include regulations on:

- hours of operation;
- zoning of land suitable for retail; and
- store formats that are often location specific.

The focus here is on zoning and format restrictions that form a large part of urban planning.

In this chapter, the importance of trends in retail sector productivity is explored. This is followed by a discussion of how planning restrictions can impede retail productivity growth, drawing on Australian and overseas studies. Finally, the implications of these restrictions on overall economic growth and employment in Australia, and NSW in particular, are considered.

8.1. IMPORTANCE OF THE RETAIL SECTOR

Total retail trade turnover in Australia in 2006-07 was \$225 billion, with New South Wales accounting for 32 per cent or \$73 billion.

Figures 3 and 4 show the breakdown of total retail trade turnover by sector category.

Figure 3: Australian retail trade

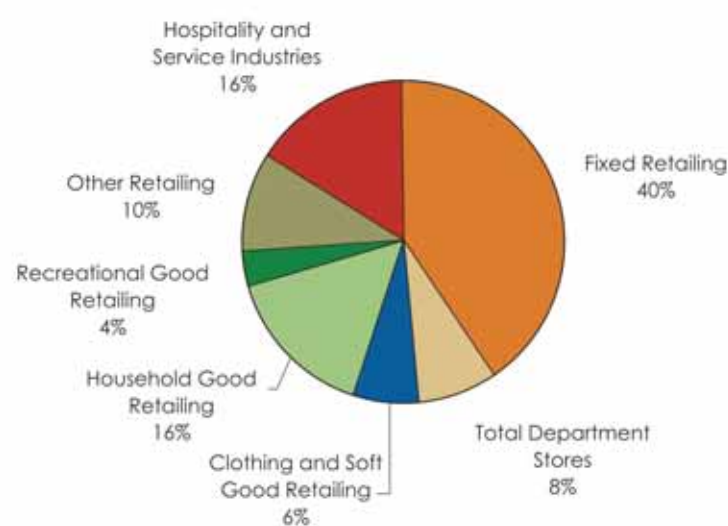
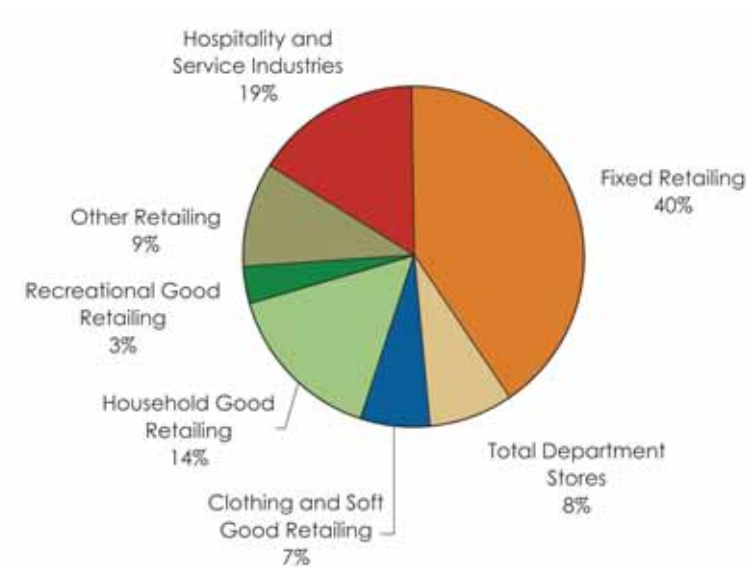


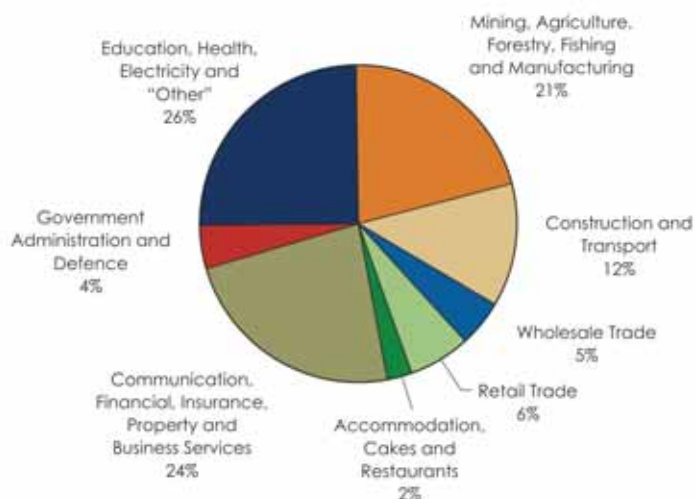
Figure 4: New South Wales retail trade



The breakdown of retail turn-over in NSW is similar to the national average. Retail goods in total account for 81 per cent of turn-over in NSW as compared to 86 per cent for Australia as a whole.

Retail services accounted for 6 per cent of Australian GDP in 2006-07, (see Figure 5). In dollar terms the value added from retail services was \$62.8 billion in 2006-07. Retail services accounted for about 5 per cent of NSW GSP or about \$17 billion.

Figure 5: Retail share of GDP in Australia; 2006-07



8.1.1. Sydney

Of the 1.3 million people employed in metropolitan Sydney, nearly 137,000 are employed in retail trade according to the 2006 ABS census. This is about 10 per cent of total employment and rises to almost 12 per cent for females. For those aged 15 to 19 years of age retail trade accounts for over 24 per cent of those person employed and around 19 per cent of those person aged 20 to 24.

Supermarkets and grocery stores accounted for over 22,000 or 16 per cent of those employed in retail trade. Clothing and footwear account for almost 11 per cent of employment in retail trade in metropolitan Sydney while department stores account for over 7 per cent.

8.2. LAND USE REGULATION AND PRODUCTIVITY

Land use regulations can affect the location of retail outlets and store formats. Both of these aspects can have an influence on productivity, through either a restriction on a store's ability to alter its format in response to, for example, changing technology, expand retail offer due to land use restrictions, or impede the ability of new stores to open in certain areas that would generate these productivity gains. By comparing productivity growth in different jurisdictions, mostly drawing on international experience, it is possible to gain some insight as to the impact that land use restrictions may have on productivity growth.

A number of studies have compared retail productivity between countries. The Organisation for Economic Co-operation and Development (OECD), in reviewing productivity growth in member countries, has found that land use restrictions have been an important factor in constraining productivity growth in the EU, most notably in Belgium and Italy where there has been little to no growth, as well as in the Netherlands and the UK, with annual productivity growth well below 1.5 per cent. In its Economic Survey of the United Kingdom, 2007, the OECD noted improved planning regulations to be one of the top three means of improving productivity growth in the UK.⁵⁵ In Italy, the OECD concluded that the attempt to preserve traditional small shop formats was a significant impediment to retail productivity growth. Limited evidence from areas where more progressive planning approaches were being adopted supported this assertion.⁵⁶

A number of these comparisons in terms of labour productivity have been made between the US, where land use regulations on retail development are relatively flexible, and countries where land use regulations on retail development are restrictive. Retail productivity was found to be 3 times higher in the US than in Korea, which is known to have stringent planning requirements. Japan also lagged significantly behind US growth.

Flath noted the very high number of stores per capita in Japan resulting in part from restriction on large store formats as well as high urban densities. Regulations on store size became increasingly misaligned with consumer demand as the percentage of households with automobiles increased.⁵⁷ As a result, in 2000, the government of Japan relaxed the *Large Store Law* to reduce the level of regulatory distortion. The response may have occurred a little too late as existing urban density and infrastructure may continue to limit the ability of retailers to offer alternative formats.

Retail productivity in Australia is only around 50 per cent of that in the US and the gap has widened over the last decade. Retail productivity growth in the US over the period has been about 4 per cent as opposed to 2.4 per cent in Australia.⁵⁸

8.3. STORE FORMAT RESTRICTIONS

There is an acknowledged life cycle of most goods and services within a market. There is a high growth cycle early, followed by a mature cycle where the products and services are established in their respective markets, followed by a decline as new products enter, or consumer preferences change.⁵⁹ Store formats, layouts and sales techniques also follow the same patterns and as with product cycles, to avoid becoming obsolete, adaptation in format, layout and sales techniques is required.

Therefore, restrictions on store formats, and the ability of retailers to adapt their methods of presenting goods and services to consumers, are likely to have an impact on the ability of these stores to manage changing demand and consumer preferences.

⁵⁵ OECD (2008a), Economic survey of the United Kingdom 2007: Assessing the productivity gap, Paris..

⁵⁶ OECD (2008b), Economic survey of Italy 2007: Enhancing competition and productivity series, Paris.

⁵⁷ Flath (2003) *Regulation, Distribution Efficiency and Retail Density*, NBER Working Paper no. 9450.

⁵⁸ Rahman, J. (n.d.) *Comparing Australian and United States productivity*, Staff Paper, Australian Government Treasury, Canberra.

⁵⁹ Corstjens, M. and Doyle, P. (1983) *A dynamic model for strategically allocating retail floor space*, The Journal of the Operational Research Society, Vol. 34, No. 10 (Oct., 1983), pp. 943-951.

Current store format restrictions affect a wide aspect of retailing. A large number of these restrictions are direct as, for example, limitations placed on:

- floor space;
- goods that can be sold;
- car parking and other forms of access; and
- signage.

“By constraining land use, property values tend to reflect the returns to a limited set of activities. As a consequence, there is less variation in property values for land zoned for certain uses. This in turn requires the format of the store to fit the land value as opposed to finding a site that fits an optimal store format.”

Examples of these types of restrictions in NSW, and Australia more generally, are abundant. Floor space restrictions are placed on infill and neighbourhood developments that are located near larger retail centres. Retail food and clothing outlets are prohibited within certain zones designated for retailing. Car parking spaces and signage are limited in mixed commercial and residential areas.

Store formats can also be restricted indirectly through the effect of zoning on property values. By constraining land use, property values tend to reflect the returns to a limited set of activities. As a consequence, there is less variation in property values for land zoned for certain uses. This in turn requires the format of the store to fit the land value as opposed to finding a site that fits an optimal store format.

This is not say that optimal store formats do not take into account the cost of floor space in a particular region. For example, small format retail may be the ideal fit for high density residential areas even though operating costs are higher. However, zoning restrictions that preclude medium or large scale retail formats in areas where there are higher densities of homes or employment, or existing high volumes of traffic may lead to large format stores being located at greater distances from population centres or transport routes thereby increasing travel times and inconvenience costs for consumers and residents.

8.3.1. Store formats and productivity

Baily and Solow note that the evolution of retailing formats has made a substantial contribution to productivity improvements in the provision of retail services.⁶⁰ They specifically cite the development of supermarkets, department and discount stores as well as ‘category killers’ such as Toys “R” Us. They note that in the US, the emergence of large scale stores has, in total, reduced the number of general merchandise stores. Smaller stores have also evolved and adopted specialty formats with a limited but targeted range of products with a higher

⁶⁰ Baily, M and Solow R, (2001) ‘International Productivity Comparisons Built from the Firm Level’, *The Journal of Economic Perspectives*, Vol. 15, No. 3, pp 151-172.

retail value add. These shops have tended to cluster together, often in shopping malls and near larger scale retail 'anchor' stores.

Baily and Solow compared retail productivity in Japan, Korea and the Netherlands with the US.⁶¹ In Japan and Korea, where there has been little evolution in shopping formats, productivity was substantially lower than in the US. Overall, productivity in Korea was 40 per cent lower. They cite land use regulations as a major factor in limiting Korean retail productivity growth.

Productivity growth in most store formats in the Netherlands is also lower than in the US, as can be seen in Table 2. Out of town specialty chains are used as the reference productivity level.

The effect overall is compounded due to the fact that the Netherlands has a substantially smaller percentage of the higher productivity formats. They go on to say land use restrictions have been used to restrict growth in retail formats, slowing their evolution and imposing a retail productivity penalty.

Table 2: A comparison of Format Productivity in the Netherlands and the US.

Format	Productivity		Format Percentage	
	Netherlands	US	Netherlands	US
Mass merchandise	70	100	29	43
In town specialty chains	70	80	25	21
Department stores	80	90	5	10
Traditional stores	50	60	29	15
Out of town specialty chains	100	100	10	8

Source: McKinsey Global Institute and Max Geldens Foundation for Societal Renewal (1997).

Note: Out of town specialist chains set to 100 in 1994.

McKinsey report that the percentage of high and low productivity formats in the UK is similar to the Netherlands.⁶² This is consistent with an assessment of what has been holding back productivity growth in the UK made by Griffith and Harmgart.⁶³ They note that the contribution of new stores to retail productivity growth in the UK is much lower than in the US. They cite, as a likely cause, the substantial increase in the number of small format stores, as opened by the four major UK chains (Tesco, Sainsbury, Asda and Safeway), as opposed to larger stores in edge and out of town locations.

In Italy, slow growth in retail productivity compared to other EU countries from the early 1990's through 2005 led to the introduction of a number of reforms including the removal of restrictions on the range of products sold. In case studies reported by the OECD, performance had improved where these reforms were adopted.

The US stands in sharp contrast. Gordon concluded that the freedom to reconfigure retailing was responsible for productivity growth in the US retail sector.⁶⁴ Gordon stated that all the retail productivity growth that occurred in the 1990s was due to new establishments, not existing stores, regardless of how much information technology (IT) they invested in. The same study concluded that, in contrast, IT was a major source of productivity growth in other sectors.

⁶¹ Baily, M and Solow R, (2001) 'International Productivity Comparisons Built from the Firm Level', *The Journal of Economic Perspectives*, Vol. 15, No. 3, pp 151-172.

⁶² McKinsey Global Institute and Max Geldens Foundation for Societal Renewal (1997), "Boosting Dutch Economic Performance", Washington DC and Amsterdam.⁶³ Flath (2003) *Regulation, Distribution Efficiency and Retail Density*, NBER Working Paper no. 9450.

⁶³ Griffith R. and Harmgart H. (2004) "Retail Productivity", Institute for Fiscal Studies, University College, London.

⁶⁴ Grodon, J. and Krizan, C. (2003) The link between aggregate and micro productivity growth: evidence from retail trade. NBER Working Paper, 9120.

Foster showed that the majority of retail productivity growth in the US was driven by existing firms that close unproductive stores and store formats and open new ones.⁶⁵ They also showed that stores belonging to national chains tend to have a strong productivity advantage over single units and regional chains. However, single establishments or regionally based new entrants were shown to have a strong productivity advantage over their existing counterparts. This again suggests that the ability to adapt retail formats to changing consumer demands and new technologies is an important aspect of overall retail productivity gains.

8.4. THE EFFECT OF URBAN LAND USE RESTRICTIONS ON ECONOMIC GROWTH

Monash Model forecasts reported by the Department of Communications, Information Technology and the Arts, suggest retail productivity growth in Australia of approximately 1.8 per cent from 2004 to 2024. This is well below what has been achieved in the US. While it may not be reasonable to expect that Australian retailers can match the US due largely to market demographics and size, Rhaman concluded that there is a substantial opportunity for Australia to improve retail productivity growth.⁶⁶

Adopting a more flexible approach to urban land use planning in Australia may only be one means of achieving these gains but it is a significant opportunity. Equally important, as the demand for retail services increases and urban land values continue to rise, land use restrictions may have a more significant effect on curtailing retail productivity growth.

Based on international comparisons, potential productivity gains of 1 to 1.5 per cent per annum could be achieved through a more flexible and transparent land use planning system.

Table 3 presents the direct impacts of retail productivity on both the GDP of Australia and the GSP of New South Wales. Over 50 years, in net present value terms, a 1 per cent productivity growth rate in retail services would equate to \$52.42 billion of New South Wales GSP and \$196.64 billion of Australian GDP. If an additional 0.5 percentage point increase in productivity growth was achieved over this time, this would equate to \$78.87 billion of NSW GSP and \$296.08 billion Australian GDP.

These figures provide an indication of what may possibly be achieved from an increase in retail services productivity through improved efficiency of store format adaptation and location developments.

Table 3: Direct impacts of retail productivity on Australian GDP and NSW GSP

YEARS	1 % ongoing growth rate		1.5 % ongoing growth rate	
	New South Wales (\$billion)	Australia (\$billion)	New South Wales (\$billion)	Australia (\$billion)
15	12.98	48.67	19.50	73.10
30	32.50	121.86	48.84	183.24
50	52.42	196.64	78.87	296.08

⁶⁵ Forster L., Haltiwanger, C. and Krizan (2002), "The Link between Aggregate and Micro Productivity Growth: Evidence from Retail Trade", NBER Working Paper No. 9450.

⁶⁶ Rahman, J. (2007.) *Comparing Australian and United States productivity*, Staff Paper, Australian Government Treasury, Canberra.

“In an economy such as Australia where there is close to full employment, a low fertility rate and no specific immigration policies directed toward increasing the population, increasing productivity is an extremely important factor in ensuring that economic growth continues into the future.”

The GDP increases presented in Table 3 are ‘type I’ multipliers. That is they only take into account the direct effects of productivity growth within the retail sector. They do not take into account the flow on effects of lower retail prices on consumer demand. As such they understate the overall economic impact of retail productivity growth. Nevertheless, the direct effects are substantial. Over a 15 year horizon, the annualised value of 1 percent increase in retail productivity is approximately \$3.21 billion per annum for Australia as a whole and \$0.85 billion per annum for NSW. The annualised value of 1.5 percent increase in retail productivity is approximately \$4.81 billion for Australian as a whole and \$1.28 billion per annum for NSW.

As productivity growth compounds, the effects increase over time. Over a 30 year horizon, the annualised value of 1 percent increase in retail productivity is approximately \$7.55 billion for Australia as a whole and \$2.01 billion per annum for NSW. The annualised value of 1.5 percent increase in retail productivity over 30 years is approximately \$4.81 billion for Australian as a whole and \$11.35 billion per annum for NSW.



In an economy such as Australia where there is close to full employment, a low fertility rate and no specific immigration policies directed toward increasing the population, increasing productivity is an extremely important factor in ensuring that economic growth continues into the future. Without increases in the size of the labour force, increased economic growth and income will have to be sourced through increased labour and capital productivity.

Larger format food stores provide an opportunity for lower cost purchases and greater food choice.

8.5. RETAIL GROWTH AND EMPLOYMENT

As highlighted by Moran, zoning and format restrictions can significantly lower the level of retail service provision.⁶⁷ Estimates retail of retail floor space per capita are presented in Table 4. Countries with highly restrictive retail urban planning policies include Japan, Hong Kong, Korea and to a lesser extent the UK. Retail planning is substantially less restrictive in Canada and the US. Australia falls in the middle of the range but is still over 25 per cent below New Zealand in terms of total retail floor space per capita.

The figures suggest that a more flexible approach to retail planning and developments has considerable scope to increase the level of retail services provided per capita.

Table 4: Number of shopping centres and total retail space per capita for selected countries

Country	Shopping centre floor space (sq ft per capita)	Total retail floor space (sq ft per capita)
United States (2003)	20.2	39.2
New Zealand (2000)	4.3	25.8
Australia (2003)	6.4	20.4
United Kingdom (2000)	3.2	14
Hong Kong (2003)	NA	12.9
South Korea (2002)	NA	12.9
Singapore (2003)	4.3	10.8
Canada (2003)	12.8	NA
Japan (2002)	3.2	10.8

Source: Moran, A. (2006) *The tragedy of planning: losing the great Australian Dream*, Institute of Public Affairs, Victoria, Australia.

Consider the potential effects of a 10 per cent increase in total retail floor space on employment. Allowing for increased labour productivity in larger format stores, it would be conservative to assume that 10 per cent increase in floor space would result in a 5 per cent increase in direct retail employment. The total employment in the retail sector is currently about 1.2 million persons. This would equate to 61,000 additional jobs Australia wide. In NSW, this would equate to over 19,500 jobs and in metropolitan Sydney 6,850 jobs.

As with productivity improvements, job creation in retail services has flow on effects in associated industries. Valadkhani estimates that for every additional retail sector job an additional 1.42 jobs would be created in the Australian economy. The full impact of a 10 per cent increase in retail floor space on employment would then be 147,000 jobs Australia wide, 47,000 jobs in NSW and 16,500 jobs in metropolitan Sydney.⁶⁸

⁶⁷ Moran, A. (2006) *The tragedy of planning: losing the great Australian Dream*, Institute of Public Affairs, Victoria, Australia.

⁶⁸ "Valadkhani, A. (2005) *A cross-country analysis of high employment generating industries*, Applied Economic Letters 12(14)."

9. CONCLUDING COMMENTS

The architecture of urban planning in NSW and many other jurisdictions appears to be based on design principles that reflect not only a predetermined view of what is in the community interest but a limited set of options to achieve those interests. In a complex environment with changing pressures and priorities, an adaptive planning process that promotes diverse outcomes and innovation would appear to be a more appropriate policy cornerstone. The level of urban diversity and innovation in residential and retail services should be seen as one measure of good urban design.

“Public investment in transport infrastructure is likely to be a more effective means of promoting desired development options than trying to control the location of residential and retail developments.”



The shift to higher density living should be accompanied by a focus on pedestrian friendly walkable communities. Local retail provides a reason for people to walk around their neighbourhood.

Land use restrictions limit investment options. However, this is often a very ineffective means of directing investment that is in the greatest interest of the community. In many instances it is more cost effective to use incentives to promote outcomes that are desired as opposed to trying to prevent all those that are not. Instead of seeking to avoid regulatory constraints individuals will tend to nominate themselves through their willingness to invest and pay for a greater level of urban amenities. Public investment in transport infrastructure is likely to be a more effective means of promoting desired development options than trying to control the location of residential and retail developments.

“[F]avouring retail developments in a modest number of centres comes at a cost of increased congestion when transport infrastructure is at or near full capacity.”

Land use restrictions are often seen as means of achieving a multiplicity of goals including social equity, improved urban amenities and greater transportation efficiency. It is a well understood principle in public policy that meeting multiple goals with a single or limited number of instruments generates unwanted and potentially unwarranted trade-offs. For example, favouring retail developments in a modest number of centres comes at a cost of increased congestion when transport infrastructure is at or near full capacity . This illustrates the point that the planning framework needs to be utilized in the context of supporting private and public infrastructure to make planning goals feasible in the first instance and cost effective in the second.

Current inconsistencies and reforms for the future

This report has identified a number of inconsistencies in the NSW planning legislation and associated policies. These inconsistencies have the potential to adversely impact economic efficiency, community welfare and reduce productivity in the retail sector. These issues have been raised by the Urban Taskforce in previous publications where a series of reforms to the NSW planning system have been advocated, namely:

- the formal withdrawal of the ILUT package, including Draft SEPP 66;
- a new prohibition be imposed on any direct or indirect consideration may by a consent authority in a development assessment to any possible loss of trade that might be suffered by any other planned or existing business or businesses;
- amending the NSW zoning rules so that:
 - the rules no longer prevent new businesses being established when they offer competition to businesses located in established centres;
 - retail uses are permitted wherever large numbers of people may be working;
 - use developments (retail and residential in a single development) are permitted in areas of medium and high density development;

“The argument for this more flexible approach to planning is largely about stimulating investment and innovation in the urban environment. It is not about ignoring the costs of congestion, noise or the loss of cultural and environmental assets.”

- the amendment of the objectives of the *Environmental Planning and Assessment Act* to recognise the role that competitive markets play in allocating goods and services within the economy; and
- the draft sub regional strategies should be revised to:
 - incorporate a subregional and local government area target for shop front space alongside the targets for dwellings and employment capacity.
 - abandon attempts to separate retail land uses from other land uses;
 - actually encourage amenities such as retail in all of the local centres, employment lands and major arterial roads; and
 - collapse the four level classification system for local centres into a single simple description of “local centres” which permits the full range of retail premises.

The argument for this more flexible approach to planning is largely about stimulating investment and innovation in the urban environment. It is not about ignoring the costs of congestion, noise or the loss of cultural and environmental assets. It is about assessing the effectiveness of planning strategies as well as development plans.

A more flexible planning approach will not rapidly transform the urban environment, as from a developer's point of view, the risks of a narrow and aggressive investment strategy are quite high. It will promote the evolution of that environment as developers seek to match commercial incentives with both private and public demands. Such a planning approach must also adapt to both planning options that deliver bad outcomes as well as those that deliver preferred outcomes. The use of exclusionary regulations will always be a part of urban planning, but that use should not preclude potentially worthwhile developments. Rather, using exclusionary regulations as a reactive as opposed to a pre-emptive strategy would make for a better approach than the current system.

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