SUBMISSION

Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessment

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1. Introduction

This submission is based on many years of international public and private sector experience in banking, economics and engineering including being responsible for the World Bank's urban policies for the reduction of poverty under the presidency of Robert McNamara. My comments are founded on a broad long term view of the affairs of man primarily through the lens of real world political welfare economics. My focus is on the policy underpinnings of regulations rather than how existing processes can be improved. Substantial costs of regulation flow from inappropriate policy underpinnings and it is here that major improvements in efficiency can be obtained. None-the-less the structure of my submission follows the frame of the Issues Paper and adds a conclusion that summarizes the implications of the insights presented.

2. Scope of Study

While familiar with the COAG framework and processes behind this type of enquiry and the bounds which terms of reference place on the Productivity Commission, to get at the causal relationships that are the prime reasons for the excessive cost of business regulation, the submission ignores such limits in the interests of political welfare rationality.

2.1. What the Commission has been asked to do

For the Study to inform urban policy, the focus on the regulatory burden of planning, zoning and development assessment on business is too narrow. Many of the drivers of the cost (and benefits) to business (and the community at large) of planning, zoning and development assessment (PZDA) are in turn driven by the processes and costs of delivering infrastructure and other services, as noted in the Issues Paper reference (page 28) to NSW Urban Taskforce (2007) estimate of developed land costs.

On "benchmarking" its political popularity has its origins in comparative analysis of production processes from an earlier industrial age, and its broad adoption has been in part due to the simplicity of its use in public discourse. However policy formation deserves better and improvement in the efficiency of industrial (and service provision) process has moved on to the goal of seeking continual improvement of processes through tracking of value added (benefits) and reduction of waste (costs). The general field goes under the title of "Lean Thinking". In this lean approach benchmarks have a role as a measurement datum without the implications that a universal reference can overcome the constraints of local conditions or that the attainment of a "benchmark" is the end goal.

Two other fundamentals of meeting the goal of improved efficiency in land supply (and any other production process) are: to identify the variables with most impact on cost and on opportunities for its reduction; and to regulate or specify the means of supply in a manner that allows innovation to reduce costs.
If the costs as presented by the NSW Urban Task Force were disaggregated further and presented in a form showing dependencies between different components this would highlight the dominance of the cost of infrastructure services. And in turn it would bring focus on how the cost of common use networked infrastructure services is highly dependent on the cost impact of physical attributes such as topography.
A second fundamental policy shift that can result in cost efficiency is available in changes to the form of regulatory tools (regulations/standards/guidelines). In other fields and for a long time the form of specification has shifted from specifying detailed means to achieve outcomes (including physical specification), to the functional specification of such outcomes. This shift allows suppliers the flexibility to innovate and/or adapt to ever changing demand. For completeness of discussion it also allows demand to adapt to alternative more efficient supply. In zoning this is the difference between specifying land use as say residential and specifying it as requiring the functional properties of residential occupancy that are also compatible with most small/medium service industries. The nature of land use is discussed further in section 3.1.

2.2. The Commission's approach to the study

The approach to the study follows a well establish and successful path and pleasingly emphasises the undertaking of research separate from that reflected in submissions. This is to be applauded with the proviso that those employed to undertake such research have the necessary expertise in the field. In this regard it is noted that both the Commissioners do not appear to have expertise directly in the land use policy area. It is also noted that by their origin in public service, the majority of members of the Advisory Panel that is providing governance for the study is made up of individuals with vested interest in maintaining the status quo. It would have been desirable to have included independent experts from outside this group such as persons from the private sector and academia.

3. Planning , zoning and development assessment

The practice of land use planning, zoning and development assessment in Australia has its origins in the UK master planning process evolved to deal with incompatible environmental conditions attached to different land uses of the early industrial age. Current Australian practice in an endeavour to keep up with the evolution of the values that drive our economy has put in place a multitude of other policy instruments to mitigate the negative environmental impacts of one activity on another, and added these conditions on to the planning and zoning processes founded in the master planning approach. The issues paper notes, for example (page 11) that the Tasmanian Planning Commission has functions under 6 acts and "minor" functions under a further 12 acts. The result of this iterative/piecemeal approach to regulatory development is a decision-making process to individual land use assessments that has added complexity and opaqueness to the DA process with resulting increase in "regulatory"costs. It has

also resulted through a series of decisions by the quasi judicial land and environment courts in a shift of responsibility from applicants to the regulatory body.

3.1. Planning and zoning

Despite the evolution (and complexity) of approaches to regulating land use by zoning, current practice remains largely two dimensional and unconstrained by functional analysis of the cost of providing services at different levels.

While it is well established that the utility or value of a particular plot of land is a function of its location with respect to available services, and regulatory constraints including such as permitted uses, plot ratios, setbacks and floor space ratios, little research has been done on the economics of such regulatory constraints.

In these circumstances the planning profession and its urban design affiliate have been left to make value judgements on what is appropriate across the whole range of variables in the built form resulting in significant cost imposts on economic activity. The culture in these professions ensures that values such as conformity and the latest fashion in design aesthetics dominate their judgement of what is desirable.

The Productivity Commission should propose government support of research into the costs and benefits of each of the current regulatory instruments, to be used as evidence to formulate functional regulations that allow more long term flexibility and efficiency as urban economies evolve. It will surprise few practitioners in urban policy formulation when such research shows that once constraints are mapped and optimal characteristics of efficient services are imposed on zoning analysis, there are only a small number of feasible options worth investigating.

Once such evidence is available and appropriate decision making processes are in place planning and urban design professions would have a firm base from which to advise on functional capacity of land use/services (and where appropriate on the aesthetics of the built form). And the ongoing task of zoning would be reduced to a simple check of the functional demands of a proposal from what is most often now a return to first principle analysis of the physical characteristics of a development proposal.

In the proposed context of functional regulation, strategies such as a “centres policy” would be supported by market valuation of land at a high level close to highest level of functional capacity of available services. For example, land close to nodes in the transport network would claim high value for any use within the capacity of available services, with the market deciding on appropriate mix and arrangement of retail/commercial/ or residential use.

Discussion of the appropriate nature and goals of zoning is much larger than is appropriate in this submission but the enquiry would provide a major contribution to urban economic efficiency if it were to recommend a program of ongoing analysis of the issues raised.

3.2. Development assessments

As discussed above the costs of “Business Regulation” of land use under the current complex framework is driven largely by the treatment of each proposal as

unique requiring fundamental analysis of its impact when considering approval. When government land use planning lags demand, this is inevitable. However a planning system that keeps ahead of demand with functional zoning of land use having responded to all constrains need not result in costly development assessment processes.

3.3. Regulatory system for planning, zoning and development assessments

At base all systems that regulate exchange have legitimacy where the product in question has for efficiency, monopoly supply characteristics and/or there is a need to manage external costs and benefits that are not captured in its price. The mechanism available to overcome the inadequacies of market pricing of product (including of the land use product) in the exchange of property rights, is the exercise of political rights to establish regulations.

These political rights flow through elected government representatives and on to regulators to "represent" the views of the electing community. In the context of land use regulation, the regulators are mostly government planners. In the existing Australian system they are therefore required to make what are effectively political judgements. And where agreement is not found we fall back on a quasi legal system of adjudication based on the common law advocacy model.

This suggests that the room for political judgement should be as small as possible, and that disagreements should be adjudicated using an inquisitorial approach by person's expert in the field. The Eddington UK Transport Planning Study has an excellent discussion and recommendation on this topic.

3.4. Government coordination and cooperation in planning, zoning and development assessments

The essence of regulation of land use ***is*** to efficiently coordinate the provision of land and services whist including consideration externalities that may not yet be the subject of zoning considerations as in global warming. There is a strong causal relationship between use and services so unequivocally these matters should be analysed and supply decisions coordinated.

Transaction cost economics provides the tool for assessing the institutional arrangements that drive the decision making process and should be applied to all existing and proposed regulation of supply. Such an approach goes way beyond benchmarking while clearly there is a place for a reference statistic that reflects net benefits of one regulatory regime over alternatives as described in 3.1 above.

4. Focus for the analysis in this study

The use in the issues paper of a definition of the goal of regulation as the achievement of outcomes that are "socially optimal" is a simplistic and imprecise interpretation of the wisdom available in well developed disciplines in economics and sociology.

The reference to the outcomes of the "market place" as requiring regulation reflects a view of markets that belongs to the distant past. The essential characteristics of efficient markets are described in the first two points in Box 3 of the Issues Paper but many economists, including this author, see little relevance in describing ideal market exchange. We know the boundedness or limits on the

inputs to choice of each participant when considering options in market exchange and how the circumstances of exchange require varying degrees of regulation. In this reality “socially optimal” is sufficiently imprecise a goal for regulation to allow an interpretation as referring to optimal efficiency in political welfare terms. However, this enquiry would be better served by use of the more precise term.

4.1. Impact on competition

Given the comments just made above in 4, it is no surprise that I would prefer the title of this area of enquiry to be “Impact on market efficiency”. There is an ongoing confusion in Australia and elsewhere that has its recent origins in the Hilmer Report and embodied in the Trade Practices Act. The Hilmer Report provided the basis for the removal of anti-competitive (anti-trust trade practice) activity that restricted the efficiency of many markets but the inference taken by politicians and prevalent in public discourse has been that the existence of competition equates with efficient markets. In mathematical terms competition is a ***necessary*** feature of an efficient market but it is not ***sufficient***. As noted in Box3 efficient markets require many buyers and sellers. The definition of “many” is imprecise and variable but it would be a major contribution to rational discussion of markets and regulation if the enquiry placed the focus on efficiency of the market for land rather than on the existence or otherwise of competition.

4.2. Impact on compliance costs

The many issues raised for discussion as to their impact on compliance costs can all be analysed using the methods of transaction cost economics. As discussed above the cost of complying with regulations would be much reduced if functional approaches to land use regulation were adopted. However this still leaves the issue of who bears these costs.

Despite what is claimed by developers it is axiomatic that all the costs of land use, including regulatory costs of development are ultimately borne by the user of the land. Just how much and when they are incurred (as distinct to when they are charged) varies depending on whether they are costs directly associated with a particular lot or costs incurred my many lots as with infrastructure service costs. In addition the life of services far exceeds the average tenure of land users. But all this variation in timing and size of costs is the stuff of financial engineering and can be dealt with by financial instruments that smooth the imposition of costs over time on particular users of land.

4.3. Impact on efficiency and effectiveness in the functioning of cities

Development economics has long observed the impact on growth of economic activity of the efficiencies that come from the close proximity of economic entities in the urban environment. It has been called many things including agglomeration effects but research has not yielded definitive causal relationships that help in planning land use. We are aware of the drop in transaction costs and increase in opportunity for innovation that occur in densely settled urban areas compared to less dense land use. But we have had to leave it to individual entities to take the location decisions that result in clustering of activities that produce growth. Hence the flexibility to adapt to new demands is important as is the price signal attached to land in different locations and uses.

It is this desirable capacity for adaptation that points us towards functional zoning and away from specific use zoning as discussed above. It also points to the need for congestion charges as part of the price signal that drives location decisions.

Despite our inability to quantitatively describe the causal relationships that result in efficiencies of urban economies, the rational response is to continue to improve the institutional arrangements that permit efficient decision making by entities choosing locations of and amounts of land they need as a factor of production.

Some of this objective is captured in use of soft criteria such as “liveability” and “ease of doing business” to measure progress but they should not be seen as opportunities to pursue party political objectives or personal monuments that are not in the interest of the broader community.

4.4. Ensuring adequate supply of land for different uses

Broad political welfare economic efficiency (again not just the monetized economy) is obtained when allocation of resources to the supply of a product occurs as close in time as possible to the expression of demand for that product. The supply of the product that is land for different uses is no different. It is complicated by land value being driven by public infrastructure service products that have economic lives and scales that are usually different to the needs of a single entity. The ideal supply of water and energy infrastructure services would see each land parcel being self sufficient but we would still be left with the need to provide transport and communications services to allow the exchange of resources (in the form of products) to take place between different locations. Consequently it is necessary to ensure the supply of land ahead of demand. But with an informed approach to the supply of products that result in serviced land, the timing of the execution of the task of supply becomes manageable. For example, the allocation of right of ways for services is a key supply decision that can be taken when zoning is determined, **without the need to fully develop supply of the infrastructure facilities themselves.** To extend the example in transport on say the link between two centres in a metropolitan area, the facilities in the right of way could start with an arterial road, shift to a limited access road as demand increases, and then later dedicate a pair of lanes to bus only, and ultimately maybe a fixed rail facility.

It should be noted that not all urban growth requires an expansion of developed land and that with functional zoning the market would lead to increasing densities and intensity of economic activity around locations with high valued services. With such an approach to the supply of land the much commented concern about land banking and speculative profits takes on a new perspective. The greatest jump in land value currently occurs when zoning of use is changed.

“Speculative” profits are the result of existing inefficient regulation and would be replaced with “normal” profits that are the goal of every exchange between two entities.

Many of the issues listed for discussion and submissions in this final section of the Commission’s Issues Paper go to these consequences of the existing system of supply with the general flavour of discussion pointing to changes at the

margin. It is the contention of this submission that while improvements within the existing framework are possible, significant improvement will only come when the framework itself is reviewed along the lines suggested which will now be summarized.

5. Conclusion

The goal of this submission is to contribute to continued improvement of the land supply system with benchmarking only one part of the desired process. It advocates exploring a shift from end use specification to functional specification of zoning.

The tools of zoning need research using Transaction Cost Economics applied particularly to infrastructure services divided into constituent products such as right of ways and facilities instead of current focus on end products such as a trip in transport services.

In the determination of functional zoning the initial step should be to map constraints which will tightly limit the number of feasible (functional) zoning options. In such circumstances it is suggested that a planning system that keeps ahead of demand with functional zoning of land use having responded to all constrains need not result in costly development assessment processes.

Improvements in the regulation of land use will never completely remove conflict but there is a need on cost grounds to move towards an inquisitorial system and away from the existing advocacy approach.

In the broader context of reducing regulatory cost the focus should be on efficient markets not only on competition.

In sum the market for supply of land would be improved if the enquiry supported a move towards a functional approach to zoning and that the supply of infrastructure services that are a major influence on land cost should analysed to reflect the component products involved rather than the current focus on end product consumption.