

24 May 2011

Mr Philip Weickhardt
Presiding Commissioner
Inquiry into Australian Retail Industry
Productivity Commission
GPO Box 1428,
Canberra City ACT 2601

By email: retail@pc.gov.au

Dear Commissioner,

Re: Public inquiry into the Economic Structure and Performance of the Australian Retail Industry

The Urban Taskforce is a non-profit organisation representing Australia's most prominent property developers and equity financiers. 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.

We appreciate the opportunity to make a submission to the above inquiry.

1. Planning laws heavily regulate retail development

Planning laws heavily regulate retail development in Australia. We documented much of this regulation in two submissions that we recently provided to the Productivity Commission's inquiry into planning, zoning and development assessment.

Attached to, and forming part of this submission, is *Fixing Town Planning* laws. Pages 14, 19, 36-48, 52-67, 74-83, 116-124 are the most relevant portions of the submission. Also attached is *Striving for a Better Planning System* where pages 49-56 are of direct relevance.

2. The structure and performance of the Australian retail industry is adversely impacted by planning and zoning laws

In 2008 the Urban Taskforce commissioned former ACCC chairperson, Professor Allan Fels, to examine the impact of town planning laws on retail competition. His study, *Choice Free Zone*, observed that:

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... \$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.¹

Retail productivity has been found to be three times higher in the US than in Korea, the former having relatively relaxed planning laws for retail development and the latter well known to have stringent planning requirements. Japan also lagged significantly behind US growth.²

The evolution of retailing formats has made a substantial contribution to productivity improvements in the provision of retail services in the United States.³ This has included development of supermarkets, department and discount stores as well as 'category killers' such as "Toys R Us".⁴ Smaller stores have also evolved and adopted specialty formats with a limited but targeted range of products with a higher retail value add.⁵ These shops have tended to cluster together, often in shopping malls and near larger scale retail 'anchor' stores.⁶

The majority of retail productivity growth in the US is driven by existing firms that close unproductive stores and store formats and open new ones.⁷ Stores that belong to national chains tend to have a strong productivity advantage over single units and regional chains.⁸ 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.⁹

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.¹⁰

In Japan the very high number of stores per capita in Japan results, in part, from restrictions on large store formats as well as high urban densities.¹¹ Regulations on store size became increasingly misaligned with consumer demand as the percentage of households with automobiles increased.¹² As a result, in 2000, the government of Japan relaxed the *Large Store Law* to reduce the level of regulatory distortion.¹³ 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.¹⁴

The *Choice Free Zone* report is available online.¹⁵

3. The internet is contributing to the increasing obsolescence of traditional town planning approaches

The most notable commercial feature of the internet generally, and high speed internet in particular, is the way it now allows services to be delivered remotely, in the same way that the industrial revolution allowed goods to be manufactured at a distance from the end user.

¹ A Fels, S Beare and S Szakiel, *Choice Free Zone* (2009) 93.

² Ibid 96.

³ Ibid 99.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid. 96.

¹¹ Ibid. 96.

¹² Ibid. 96.

¹³ Ibid. 96.

¹⁴ Ibid. 96.

¹⁵ <<http://www.urbantaskforce.com.au/attachment.php?id=1519>>.

The internet agglomerates consumers into larger markets and so it allows locally isolated persons to benefit from the product variety made available for consumers elsewhere.¹⁶ By increasing the size of markets relative to fixed costs, the internet therefore brings market allocation nearer to the ideal in which any goods and services, available to individuals, does not depend on either the number of their neighbours or the most popular product preferences, in the particular community in which they live.

This allows, for example, an individual to purchase a specialised book, which might be of interest to them, but not of sufficient general interest in their community to be stocked by the local book store. However, it is likely that expenditure that is otherwise destined for business providing goods and services within the travelling distance of an individual's home will be increasingly substituted with services provided over the internet (several scholars have found empirical evidence for substitution of physical shopping by internet shopping).¹⁷

This is a positive step, and beneficial to consumers, because the goods and services they purchase are more likely to more closely reflect their preferences.

A study by academics at the University of Pennsylvania used economic census data on the location and size of book, music, and clothing stores, matched by post code to data on internet purchasing patterns, to establish that people buy more books and clothing online or via catalogues, relative to their offline expenditure in local stores, as they live farther from their nearest book and clothing store.¹⁸

Traditional town planning policies require retail to be centralised in "activity centres". This can reduce the ease of access to retail services in two ways.

Firstly, activity centres can become congested, and therefore difficult to access. The time spent in entering and existing congested streets and parking will divert some purchasers to on-line stores.

Secondly, activity centre requirements can end up positioning retail services at a greater travelling distance from consumers. The additional travel time will divert some purchases to on-line stores.

In short, **as access to the internet spreads, as it becomes faster, and the quality of the on-line purchasing experience improves, activity centre policies (that limit retail development) will reduce the ability of traditional walk-in shops to compete with online stores.**

This means that overseas based on-line stores will receive part of their custom courtesy of the regulatory interventions of the Australian planning authorities. It also undermines the sense of community that planners are trying to create through the activity centres approach.

It is important that activity centre policies be modified so that walk-in stores are able to more closely compete with online stores in terms of convenience. This means a greater willingness to allow retailers to build and operate new stores where they assess customer demand requires it, and a greater willingness to allow new retail precincts to compete with existing precincts to avoid congestion.

Interestingly, planning regulators have not come to terms with the existence of online retailing at all. For example, in NSW, the standard provisions used in planning schemes defined "retail premises" as follows:

a building or place used for the purpose of selling items by retail... whether the items are goods or materials (or whether also sold by wholesale) ...¹⁹

¹⁶ Todd Sinai, Joel Waldfogel, "Geography and the Internet: is the Internet a substitute or a complement for cities?" (2004) 56 *Journal of Urban Economics*, 1-24, 3.

¹⁷ "Substitution or complementarity? How the Internet changes city centre shopping" (2007) 14(3) *Journal of Retailing and Consumer Services*, 192-207, 194.
Jesse W.J. Weltevreden

¹⁸ Todd Sinai, Joel Waldfogel, "Geography and the Internet: is the Internet a substitute or a complement for cities?" (2004) 56 *Journal of Urban Economics*, 1-24, 3.

¹⁹ *Standard Instrument (Local Environmental Plans) Order 2006*, Dictionary.

Clearly, a person using their home to operate an online eBay store will find that their home falls into the definition of “retail premises”.

There is nothing in the definition of “retail premises” that limits the phrase to a walk-in retail store. (In *Upton v Yarrolumla Shire Council*²⁰ it was held that the sale of goods to “mail order customers” occurred on premises of the seller, there is no reason to think that anything different would apply in relation to internet sales).²¹ This raises important public policy issues, because “retail premises” are typically banned in the residential zones, light industrial and business parks where many online stores are actually located.

The NSW standard planning scheme provisions do allow, in residential areas, a “home business” but the definition of this business type specially excludes:

the sale of items ... by retail, except for goods produced at the dwelling or building ...²²

In business parks and light industrial precincts, a “warehouse or distribution centre” is typically permitted but it is defined to mean:

a building or place used mainly or exclusively for storing or handling items (whether goods or materials) pending their sale, but from which no retail sales are made.²³

So if the sales, staff and equipment for an online store are co-located with the warehouse from which the goods are stored and dispatched, the entire premises will be prohibited in a typical “out-of-centre” business zone. In law, the equipment and staff who operate the online store would need to be located in an activity centre (even though no customers physically attend the premises), while the goods are dispatched from separate warehouses elsewhere.

Of course, in practice, online stores ignore these planning requirements and the planning system is yet to realise that the retail sector is rapidly evolving from the 1970s environment in which current planning approach was constructed.

Planning laws need to be reformed to recognise that online retailing exists and cannot (and should not be) tightly regulated in the way the walk-in stores have been in the past.

Walk-in stores, even when their customer numbers are modest, are tightly regulated in terms of location. As a result they face high land costs. Online stores cannot be (and should not be) so regulated, and therefore have low land costs. Stores whose main business is online sales, are generally unable to accept walk-in business, creating a rigid and artificial barrier between the two formats.

A business operating an online store from a warehouse in a light industrial zone will be reluctant to actually allow customers to personally attend the premises to pick up the goods they have ordered and paid for online. Mailing the goods will not attract the attention of planning authorities, but the dreaded crime of personal attendance onsite by customers, would no doubt lead to proceedings under state planning laws.

The rigid regulation of walk-in stores, and the inevitable lack of planning regulation for online stores, places walk-in stores at a disadvantage to their internet based competitors.

Australian retailing has been artificially fractured into a low-cost online sector and a high-cost walk-in sector, courtesy of town planning laws. **There should be a greater capacity for these two formats to merge, as suits the competitive needs of individual businesses. This would require a more flexible approach to activity centres planning policies.**

²⁰ 101 LGERA 435.

²¹ [46].

²² *Standard Instrument (Local Environmental Plans) Order 2006*, Dictionary.

²³ *Standard Instrument (Local Environmental Plans) Order 2006*, Dictionary.

4. Your issues paper

Case law

Your issues paper says that

consideration of the costs and benefits to existing businesses have been recognised in case law as an unjustifiable barrier to new business entry but are nevertheless reported to still be in use by some councils in New South Wales, Queensland and South Australia.

Your paper implies that the practice in these jurisdictions is at odds with the case law. However, as we explain in pages 37-39 of *Fixing Town Planning Laws* a giant exception (loophole, if you like) was explicitly created by the High Court in the case law which has been fully exploited by planning decision-makers over the last 32 years.

NSW proposed instrument

Your issues paper says that:

The New South Wales Government has proposed legislative measures to ensure that competition is not grounds for rejection of land development applications.

This is not correct for the reasons we document in *Fixing Town Planning laws*, pages 39-48.

Firstly, the measure that was proposed by the former Keneally Government was not legislative. The former government merely proposed an administrative instrument (known as an "environmental planning instrument"). The document was to be known as the *State Environmental Planning Policy (Competition) 2010*. It was only a draft, and the Keneally Government elected not to proceed with the proposal prior to its defeat at the polls in March 2011. No new proposal has been advanced by the O'Farrell Government.

Secondly, the key provisions in the proposed instrument did nothing but codify the existing 32 years of bad law. In particular, the provisions retained the current anti-competitive loophole which allows planning authorities to consider the impact of new businesses on the trade of existing businesses.

Viability of existing businesses should not be considered at development assessment or rezoning

Your issues paper also refers to the draft report of the Productivity Commission's inquiry into planning, zoning, development assessment, by saying that it recommended that

Impacts on existing businesses not be a consideration when assessing proposed developments.

However, we note (and support) the conclusion reached by the Productivity Commission in its final report that planning systems should:

eliminate impacts on the viability of existing businesses as a consideration for development *and rezoning* approval (emphasis added).²⁴

Given the strong undersupply of appropriately zoned retail land in many jurisdictions, true reform requires the protection of existing businesses to be ended as a planning practice for rezoning processes, as well as development assessment processes.

Consideration at a generic level

Your issues paper says:

To minimise the potential to restrict competition, it is highly desirable that the broader implications of business location on the viability of activity centres be considered at a generic level during city planning processes, rather than in the context of specific businesses during development assessment processes.

²⁴ Productivity Commission, *Planning, Zoning and Development Assessments* (2009) xvlii.

The anti-competitive impacts of such a potential loophole are set out in pages 49-54 of *Striving For A Better Planning System*.

In brief terms, we think it is better to avoid considering the "viability activity centres" at any point in the planning process. It is difficult to consider the issue of "viability of a centre" without considering the trade and adverse impact of competition on individual businesses. The planning system does a very poor job of assessing these matters.

A case study of a very typical approach taken by planning authorities is offered in section 3.1.3 of *Striving For A Better Planning System*. The case study illustrates how planning strategies mechanistically dole out anticipated demand amongst an oligopoly of landlords based on consultants' reports generating demand predictions.

Your issues paper asks:

How do the different ways that states and territories determine the size and number of activity centres impact on retailing? Are the definitions of centres unnecessarily constraining different types of retailers?

Our answer to the first question is provided in the attached documents. Our answer to the second question is yes (also detailed further in the attached documents).

Thank you for the opportunity to make a submission to your inquiry. We are more than happy to meet with you and./or provide further information.

Yours sincerely
Urban Taskforce Australia

~~Aaron Gadiel~~
Chief Executive Officer

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