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Assessing net community benefit in the Victorian planning system

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This paper represents the views and opinions of the author Dr Marcus Spiller.

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Introduction

Statutory planning practice in Victoria has struggled with the concept of ‘net community benefit’ since the advent of this term in the Victoria Planning Provisions (VPP) in 1996.

This paper explores the reasons for the continuing controversy surrounding how the idea of net community benefit (NCB) might be applied in the planning system, and proposes some ways forward.

Statutory origins

The term ‘net community benefit’ (NCB) made its debut in the Victorian planning system in 1989 when, through the then Ministry for Planning and Environment (MPE), the State Government issued a new policy dealing with retail centres. The *Metropolitan Activity Centres* report capped off a process begun in the Government’s 1987 metropolitan policy – called *‘Shaping Melbourne’s Future’* – which saw an unwinding of a so-called ‘prescriptive’ centres policy to allow for greater market flexibility in the provision of retail services, office parks and the like.

As reported by Peter McNabb & Associates Pty Ltd et al (2001), the Metropolitan Activity Centres report sought to resolve the tension between policy objectives to do with ‘planned centres’ on the one hand and ‘market dynamism’ on the other, by establishing a set of decision guidelines for formal incorporation into the State Planning Policy Framework¹. These guidelines were in force till 2000.

“The guidelines were based on a set of principles around the concept of net community benefit. This approach placed an emphasis on achieving a balance between new, innovative and competitive developments on the one hand, and certainty and consistency for industry, the wider community and activity centre patterns on the other. What the guidelines established was a conservative ‘checks and balances’ mechanism that necessitated rigorous and careful investigation of all new proposals”².

This move reflected the dominant public policy sentiment of the time, namely that regulation and government influence in the economy had become altogether too burdensome, dragging down productivity and living standards. Market resource allocation had to be given greater voice while public policy should look to improve market functioning through, say, more clearly defined property rights and better price signalling. Market competition should be optimised, starting with the stripping away of regulatory barriers to entry. Planning controls, including on the where developers of retail centres could and could not invest, were seen as a prime target for reform.

Thus, regulation should only be tolerated if the welfare gains to the community (a clear centres hierarchy which offered travel and sustainability benefits) demonstrably outweighed the costs (higher grocery prices due to dampened competition).

Cost benefit analysis and NCB

Cost benefit analysis (CBA) is the primary means by which economics – as a discipline – influences public policy. These days, no government initiative of any significance, be it a spending or regulatory measure, will be implemented without first being tested for ‘economic efficiency’.

The initiative in question will be deemed ‘efficient’ if it generates an improvement in community welfare compared to a base case where life goes on in the absence of the mooted project, spending program or regulation. Community welfare in this context is not a collectivist concept. Rather it represents the sum of the individual preferences of each member of the community. Some individuals may place a high value on the benefit promised by the initiative – say, access to a new community facility such as a cycleway – while others may be indifferent as they don’t care for cycling as a transport or recreational option.

If an individual truly values the benefit on offer from the policy initiative, they are assumed to be willing to pay for it, regardless of whether access will be priced. Much of CBA practice is about estimating, and aggregating, what individuals are willing to pay for anticipated positive effects of a policy initiative. Often these benefits have no market price, so economists have to resort to indirect measures of willingness to pay. Even when there is a market price, economists must investigate ‘consumer surplus’, the extra amount, over and above the market price, that some individuals would be willing to pay for the service or product. It is in the imputation of benefit value that much of the controversy in CBA resides.

¹Peter McNabb & Associates Pty Ltd and University of Melbourne Research Team, in association with Roy Morgan Research and Arup Transportation Planning (2001) Activity Centre Policy Review, A study of policy and centres of activity in metropolitan Melbourne and Geelong (https://www.planning.vic.gov.au/_data/assets/pdf_file/0014/100661/Activity-Centres-Review-June-2001.pdf)

²Peter McNabb & Associates Pty Ltd et al (2001) page 41

As well as potentially delivering benefits valued by the community, implementation of a new policy will come at a cost. Resources of land, labour, capital and environmental assets that, in the base case, could have been used to deliver other benefits will have to be diverted to the production of benefits promised by the initiative under consideration. That is, these resources have an opportunity cost. The resource costs of the policy are typically measured at the market price of the land, labour and capital deployed to policy implementation. Where non-priced environmental resources- like clean air and healthy streams – may be ‘consumed’ as part of the policy, value must again be determined based on willingness to pay in the community.

CBA therefore identifies the additional costs incurred by the community in diverting from the base case towards the policy case and contemplates whether these are outweighed by the benefits gained in making the diversion. Often, the timing of costs and benefits will vary, requiring both streams to be expressed in ‘present value terms’. This brings into play another core concept in economics – the ‘social discount rate’.

This is premised on the assumption that individuals and communities would need to be compensated if they are to be persuaded to defer enjoyment of the proceeds from using land, labour and capital from today to a future period. To give up a \$1 benefit today for a promised return in 5 years, the amount received in that future period would need to be greater than \$1 to compensate for foregone interest, inflation and risk. In other words, a nominal \$1 received in a future period has a lesser or ‘discounted’ value compared to a \$1 received today. This discount can be expressed as an annual interest rate – that is the amount by which the \$ foregone today would need to accumulate in value to provide an amount at a future time which is on par with current value in the eyes of the person who is making the investment.

CBA as applied in public policy cannot work without a further, more philosophical, concept known as the Kaldor Hicks rule. This provides licence to aggregate and compare costs and benefits across the community regardless of their incidence on individual members of that community. With this rule in place, the efficiency test becomes one of whether those who gain in welfare from the policy initiative – estimated by their willingness to pay – could, in theory, compensate those who would suffer a loss of welfare and still be ‘in front’. This is known as ‘net community benefit’. Other policy initiatives – in taxation and regulation – might have to be applied to effect this compensation but the provision of the compensation is not, itself, part of the efficiency test in CBA.

CBA requires rigour and discipline. As a tool in public policy practice for almost a century, a number of conventions have developed to ensure comparability and accountability in these analyses. Nevertheless, it is clear that when dealing with willingness to pay for non-traded benefits there is considerable room for professional divergence on preferred methodologies. As with any other social science, evolution of estimation theories and methodologies are governed by the scholarly peer review process.

While the rules and conventions of CBA are widely accepted and are constantly being improved, this does not imply impending obsolescence of political debate in favour of ‘scientific’ economic analysis to determine resource allocation.

Community ‘values’ – not in the willingness to pay sense, but in terms of beliefs and social mores – will inevitably play a crucial part in policy decisions.

Although CBA could be applied without boundaries in terms of what costs and benefits might be counted, observed practice is that it is confined to policy choices that are conscionable for the community. For example, policy choices that involve the extinction of species would not be regarded as ethically acceptable regardless of the scale of benefits on offer.

CBA and Regulatory Impact Assessment

CBA is routinely used in assessing the welfare impacts of all types of regulation other than planning.

Across the nation, any policy change which is anticipated to have significant impact on business and the community generally will typically be subject to a Regulatory Impact Assessment (RIA). Under these assessments it needs to be demonstrated that the direct and indirect costs of compliance with proposed regulation or policy will be outweighed by the benefits of regulation.

The 7 Regulation Impact Statement Questions

- 1 What is the policy problem you are trying to solve?**
Clearly identify and define the problem you are trying to solve.
- 2 Why is government action needed?**
Clearly identify why there is a legitimate reason for government to intervene.
- 3 What policy options are you considering?**
Identify a range of genuine and viable alternative policy options.
- 4 What is the likely net benefit of each option?**
Identify who is likely to be affected by each regulatory option and assess the economic, social and environmental costs and benefits.
- 5 Who will you consult and how will you consult them?**
Explain the purpose and objectives of consultation.
- 6 What is the best option from those you have considered?**
Indicate which of the identified options you are leaning towards.
- 7 How will you implement and evaluate your chosen option?**
Discuss what success looks like and how your implementation plan will achieve this.

OBPR
The Office of Best Practice Regulation

Federal and state governments have set up entire agencies, along with extensive assessment guidelines, for ensuring the appropriate review of new regulations. Notable examples include:

- The Commonwealth Office of Best Practice Regulation (OBPR) Feds: <https://obpr.pmc.gov.au/about>
- Better Regulation Vic: <https://www.vic.gov.au/better-regulation-victoria>
- NSW Best Practice Regulation Guidelines: <https://www.treasury.nsw.gov.au/finance-resource/best-practice-regulation-guidelines>, and
- Office of Productivity and Red Tape Reduction in QLD: <https://www.treasury.qld.gov.au/queenslands-economy/office-of-productivity-and-red-tape-reduction/>

Indeed, Australia is considered an international leader in regulatory review and assessment, as assessed by the OECD. (<https://www.oecd.org/gov/regulatory-policy/learning-from-australias-oversight-of-regulatory-impact-analysis.htm>)

Across all Australian jurisdictions, CBA is the cornerstone of the RIA process. Proponents of new regulations must demonstrate clarity about the problem being addressed and show that they have considered a wide range of options to resolve the issue, including but going beyond the proposed regulation. They must then prove, as best they can, that the anticipated benefits of the preferred option outweigh the costs. This thinking is illustrated in steps 4 and 6 in the following chart, taken from the OBPR guidelines.

CBA in planning

Before discussing how and why CBA and NCB might enter into planning deliberations, it is important to be clear about what we mean by the ‘planning system’.

Urban planning is a system of regulations on land use and development intended to optimise welfare in the city building process within sustainability limits.

Regulation of land use and development through the planning system is necessary because of ‘market failure’, specifically, the presence of externalities, and natural monopoly in the provision of urban infrastructure. Notionally, were all externalities to be reflected in transacted prices through astute market design (e.g. congestion pricing, carbon pricing, subsidies for habitat protection etc), ‘planning’ would not be necessary; urban development would spontaneously take a welfare optimising form.

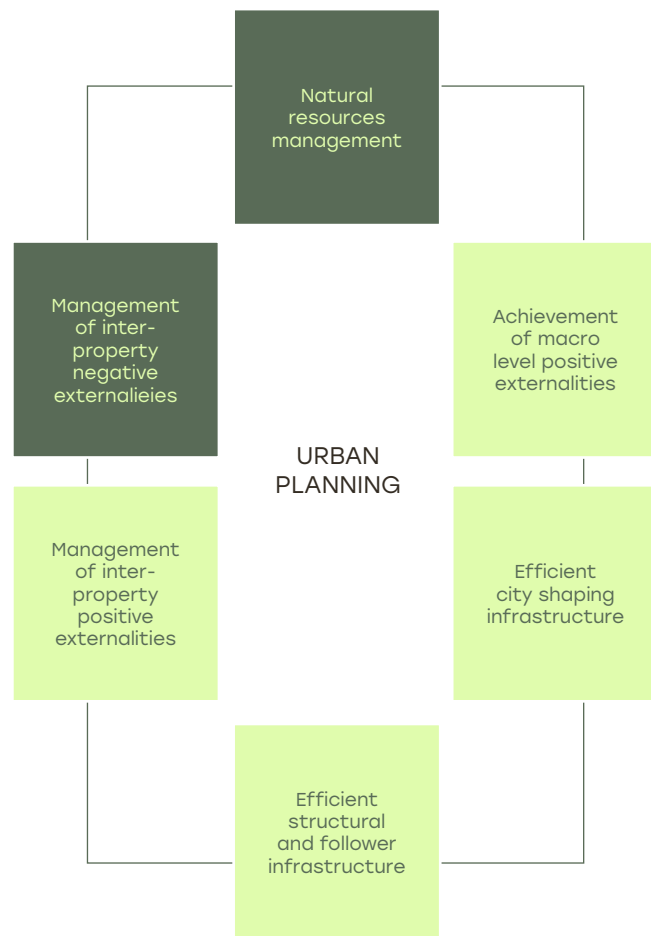
In the real world, designed adjustment of prices to fully reflect externalities is nigh on impossible to achieve. Regulation of land use and development is the next best solution.

Optimisation of welfare in the urban development process implies the framing of plans and development standards that will correct for negative externalities, protect or create positive externalities, and facilitate delivery of urban infrastructure (which is prone to natural monopoly).

The legislative architecture of urban planning typically involves three elements, all of which are evident in Victoria’s system.

- The *plan making process*, that is, the procedures that must be followed for land use and development policies and standards to become law
- The *scope or substantive content* of plans, that is, the adopted strategies and development standards pertaining to urban development; these may variously relate to the scope of development impact assessment, land release and infrastructure co-ordination strategies, built form rules and infrastructure funding mechanisms, to name a few, and
- The processes and procedures by which *development consent* decisions are made and reviewed.

FIGURE 1: WELFARE GAINS FROM URBAN PLANNING SYSTEMS



Source: SGS Economics & Planning Pty Ltd

An effective urban planning system would be expected to deliver, or contribute to, the following benefits;

- *Avoidance of inter-property negative externalities:* these typically include overshadowing, overlooking, noise intrusion and air pollution and other emissions which might unreasonably compromise the utility of neighbouring properties were a land use or development proposal for another property to proceed.
- *Creation and protection of positive externalities at the inter-property / precinct / neighbourhood scale:* this pertains to neighbourhood character, heritage values, cultural values and other distinctive and appreciated features of a place that might be vulnerable to ‘inappropriate’ development.
- *Creation and protection of positive externalities at the suburb, town, metropolitan and regional scales:* these externalities relate to the welfare gained by communities through a ‘designed’ versus a laissez faire urban future. Examples include saved congestion and vehicular emissions through the creation of public transport friendly and active transport friendly urban forms, generation of productivity gains by building clusters of related firms and production of vibrant town centres by managing retail and related flows into hierarchies of activity nodes.
- *Beneficial deployment of the ‘city shaping’ power of major infrastructure investments* (such inter-urban freeways and metropolitan rail), thereby increasing the flow of Wider Economic Benefits (WEBs) from such projects, including agglomeration linked productivity gains.
- *Cost savings in the provision of lower order - ‘structural’ and ‘follower’ - urban infrastructure*³. These benefits include avoidance of wasted infrastructure capacity, or failure to provide infrastructure, when development takes an ad-hoc rather than orderly sequence in a given service corridor.

- *Conservation of natural resources / protection from inappropriate development.*

Delivery of these welfare benefits will require both the *management of the effects* of incremental development, and the formulation of a deliberate *development vision* for the area in question.

Some externalities are amenable to mitigation through generic development standards covering, for example, site coverage, overlooking, overshadowing, stormwater run-off and the like. In these circumstances, developments can be assessed for compliance without necessary reference to an overarching plan or development vision.

This approach can be taken further so that, in the absence of specific development standards, each successive development can be assessed ‘on its merits’. This effectively entails a case by case cost benefit analysis to determine whether, on balance, the positive effects of the proposal at hand outweigh the costs in present value terms.

The case by case merits paradigm is insufficient when the urban planning system is seeking to deliver the benefits of a *designed* rather than purely market driven pattern of urban development. Thus, for example, appraisal of a marginal development which breaks from a notional urban growth boundary may well indicate a welfare gain and, therefore, present a prima facie case for a development consent to be issued. However, cumulative approvals of similar proposals which do not comply with a growth boundary may render unattainable the (presumably demonstrated) welfare gains of more compact and contained urban development.

The benefits on offer from sound urban planning are summarised in the following chart. The shaded values require reference to some form of designed future or vision for urban development. That is, they cannot be fully or even partially delivered through a case by case effects based regulatory regime.

⁴<https://www.heraldsun.com.au/leader/inner-east/residents-call-for-action-on-st-kilda-triangle-site-which-has-laid-empty-for-more-than-a-decade-after-being-earmarked-for-development/news-story/a2e4a30c7e3a09c61bb063b54c8249ff>

It is evident that planning embodies choices about whether a particular project will add to or detract from welfare in the sense of mitigating (or leveraging) externalities and/or contributing to an adopted designed future. Planning assessment therefore involves a scope of evaluation similar to that applied in CBA. That is, the consequences of approving a development proposal in terms of net externalities and compliance with a designed future must be appraised.

A number of techniques can be applied to this end all of which involve some form of goals achievement matrix. Implicitly, planning is directed at finding the best 'designed future' versus a trend case allowing for risk, and then evaluating successive development proposals against compliance with this designed future and the externality ledger. This resonates with the scope of CBA.

Given that CBA and 'planning evaluation' represent the same public policy endeavour, why is it that CBA is not, as yet, routinely applied in the Victorian planning system to assess both plans and development applications?

Five factors have a major bearing on this situation; divergent views about the scope of impacts in planning evaluation versus CBA evaluation, undefined subsidiarity in planning deliberations, scepticism over the achievability and desirability of monetising impacts, reluctance in planning to separate efficiency and distributional questions and institutional inertia. We discuss each of these in turn.

Divergent views about the scope of impacts

Practicing planners and economists looking at the same evaluation exercise may follow different rules or conventions in deciding what impacts to count and how.

A good example relates to the job impacts of development proposals. It is commonplace within a planner's matrix evaluation to count the jobs generated by say a new supermarket development as a positive social impact of the proposal. Within an economist's CBA framework these jobs would typically **not** be counted as a benefit partly because the supermarket may be simply redistributing retail expenditure, and the jobs that go with it, from somewhere else close by. Thus, there is no net gain in employment across the district in question compared to what would have happened in the base case. Moreover, employment is typically counted as a cost in CBAs because labour is being diverted away from some other productive use. For these reasons, economists will usually only count job creation as a benefit where the project in question is bringing labour into production which would have otherwise remained 'idle'. This is counter intuitive for many planners, as evidenced by the routine citation of 'jobs created' as a benefit in matrix evaluations of development options.

Undefined subsidiarity in planning deliberations

CBAs are usually applied in line with protocols and guidelines established by State Governments. Not surprisingly, these guidelines require the analysis to be conducted for the whole community aligned to State boundaries. This means that local benefits cannot be credited in a CBA if they are offset by costs incurred outside of the local area and vice versa. This creates a perplexing situation for many planning assessments which are, in the main, focussed on a *local* community.

The controversial 'Triangle site proposal' in the Melbourne bayside suburb of St Kilda exemplifies this difference in defining the scope of the impacted community⁴. A cost benefit analysis showed that this tourism and hospitality project would generate significant local nuisance by way of noise and 'anti social behaviour'. However, taking a statewide perspective, it would deliver a net community benefit because the Triangle would be an appealing destination for other metropolitan residents and tourists.

The CBA and planning evaluation approaches could be reconciled if strict subsidiarity were applied. That is, if the project in question only had local effects, one might expect that a CBA would reach much the same merits conclusion as a planning assessment. However, there are no protocols in planning around subsidiarity and the weight to be given to 'off-site' or 'out of district' effects.

Scepticism over the achievability and desirability of monetising impacts

A defining characteristic of CBA is that it seeks to express all impacts in \$ terms as far as possible, by assessing willingness to pay via a range of well rehearsed techniques.

In terms of urban development propositions, CBAs have featured valuation of a range of impacts which, at first glance, appear to be beyond monetisation. These include social capital enhancement, preservation of cultural heritage, preservation of sunshine to parks and improvements to public realm vibrancy.

Good CBA practice compels the analyst to document their assumptions and workings to support third party scrutiny. Nevertheless, implicit in observed practice is rejection of the idea that a \$ value can be placed on things treasured by the community which are 'above the market'.

Reluctance in planning to separate efficiency and distributional questions

Because of the Kaldor Hicks 'rule', CBA neatly separates the question of efficiency – that is, whether the project makes the community as a whole better off – from that of fairness – that is, are the costs and benefits equitably distributed across the various groups in the impacted community.

The standard economist's defence of this separation is that policy makers should first of all be concerned with growing the welfare cake and, after that, devise appropriate taxation and compensation arrangements to make sure that the initiative in question is equitable. In observed planning practice, there is typically a reluctance to make this separation, partly because there are not the tools – within the planning regulation arena – to redress any adverse distributional impacts. In effect, planners are wont to apply the Pareto principle in preference to Kaldor Hicks in their assessments⁵.

Institutional inertia

The theory building behind CBA dates back to the mid 19th century. However, it is only over the past half century or so that the technique has become a pervasive and indispensable part of policy and project evaluation in many western countries. Planning regulation and the participative processes for evaluating town plans and development applications have been around for much longer, and they have developed a particular institutional approach to assessment of impacts.

Because planning regulations have taken a different evolutionary pathway, it has been exempted from the regulatory impact assessment (RIA) process that applies in virtually all other areas where government proposes to introduce new rules to modify markets or behaviours, such as liquor licencing, regulations on outdoor smoking, regulation of fees and charges in certain industries and licencing access to resources such as fisheries.

The 2013 Inquiry into the Regulatory Impact Statement (RIS) Process undertaken by the Victorian Legislative Council Environment and Planning Legislation Committee (Report No. 2, November 2013) agreed that

“subjecting planning scheme amendments to the RIS process would to some extent duplicate the existing assessment and consultation requirements of the Planning & Environment Act and has the potential to add unnecessary delay” (page 60).

However, the Committee concluded that the process for consideration of scheme amendments within the planning system should be amended to require the preparation of rigorous CBAs, as occurs in the RIS system. More specifically, the Committee recommended:

“That the Minister for Planning, in consultation with the Victorian Competition and Efficiency Commission, amend Ministerial Direction 11 (Strategic Assessment of Amendments) to require a cost-benefit analysis for significant changes to planning schemes.” (Recommendation 13, page 60)

This recommendation continues to fall on deaf ears. Planning has accreted a distinctive institutional structure which has proven highly resistant to reform on the matter of measuring NCB.

⁵The Pareto principle would deem a project efficient if it makes at least one person better off without imposing costs on any other member of the community in question.



Conclusions

Unlike all other areas of public policy regulation, the making of statutory town plans and the determination of development consents are not required to operate within a NCB framework governed by CBA. There appears to be no compelling justification for this. Rather, the explanation for the odd separation of planning regulation from all other forms of regulation in terms of judging net wellbeing and sustainability effects seems to be that planning legislation predates, by many decades, the advent of formal regulatory impact assessment (RIA).

The planning critique of CBA, revolving around questions of separating distributional from efficiency issues, the invalidity of monetising certain impacts and lack of consensus in defining 'community' for evaluation purposes amongst other issues, certainly has merit. However, these issues are not unique to planning policy and development approvals. They arise in other areas of public policy, where it is established practice to regard CBA as one, albeit essential and non-negotiable, input to the decision making process.

Indeed, in other areas of regulatory impact assessment, CBA at least provides one common reference point around which the debate about the net community merit of a particular proposal may be judged. This would appear to be preferable to a situation in which evaluation frameworks have to be re-litigated on a case by case basis, as seems to be the situation with planning regulation.

There is a strong case for extending the RIS process in Victoria to include regulations made under the Victorian Planning and Environment Act 1987, as recommended by the Legislative Council Environment and Planning Legislation Committee in its 2013 report.

This is not to say that the RIS process should replace existing review processes, such as Planning Panels, entirely. Rather, RISs including CBAs prepared in line with government guidelines should form one, routine, component of the evaluation of major plan making and development approval decisions.

The value of CBA in a planning context is not that it provides a definitive answer for the proposition under evaluation. Instead the principal contribution of CBA is in providing a flexible but consistent framework for ordering the arguments for and against the planning change. Undoubtedly, a conclusion on NCB based on the Kaldor Hicks principle which largely sets aside distributional impacts and which typically adopts a geographically large definition of 'community' will not satisfy all parties to planning deliberation. However, it provides a starting point for a focussed discussion on what distributional impacts are acceptable or not, what scale of community should be applied and what impacts should be admitted in assessing NCB.

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