Thoughts on the ‘When’ and ‘How’ of Government Historic Heritage Protection

Research Report 1

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Preface

This research report has been commissioned by the Heritage Chairs and Officials of Australia and New Zealand to inform debate about:

- the circumstances when it is appropriate for government to intervene to protect historic heritage places; and
- the manner in which historic heritage is protected by governments.

The views in this report reflect those of The Allen Consulting Group, and not necessarily those of the Heritage Chairs and Officials of Australia and New Zealand or their respective governments.

The report is complemented by another research report that addresses the value of heritage protection.¹

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Executive summary

Heritage is what we inherit, but more specifically what we retain of this inheritance. The heritage value of a place is also known as its cultural significance, which means its aesthetic, historic, scientific, social or spiritual value for past, present or future generations. Cultural significance is embodied in the place itself, its fabric, setting, use, associations, meanings and records.

Historic heritage generates economic value in a variety of ways:

- The physical assets that embody historic heritage (e.g. houses, public buildings, etc) have a ‘use value’ like any physical asset. The heritage component may increase this use value, as people derive additional value from living or working in a heritage place, or simply visiting or seeing a heritage place.

- Beyond physical value, heritage assets are valued for a variety of intangible benefits. Indeed, people may value:
  - the existence of heritage; although they might never visit a given place, they would feel a quantifiable loss if it were destroyed;
  - the option to visit a heritage place, although they may not have immediate plans to visit; and
  - the chance to bequeath a heritage place to future generations, as part of a shared cultural legacy.

A major challenge is that places may have a range of values for different individuals or groups — heritage is in the eye of the beholder. Indeed, this personal element is a major factor that distinguishes:

- historic heritage, which includes people’s social values and their connection with past peoples, places and events (i.e. personal stories); from

- natural heritage, which is able to be defined through scientific principles.

The lack of an absolute reference standard (because of the inclusion of social values in historic heritage) means that there will always be debate about the degree to which individual places should be protected on heritage grounds (even with guidance provided by criteria developed by experts in the field).

There are a number of reasons — called ‘market failures’ — that may explain why, left alone, the level of heritage protected by the community will be less than optimal:

- public goods — a public good is a good that exhibits two particular features:
  - ‘non-excludability’ — this means that people cannot be excluded from deriving a benefit from the good (or that the costs of doing so are prohibitive); and

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– ‘non-rivalry in consumption’ — this means that the consumption of the good by one individual does not limit consumption by others (i.e. there is no scarcity).

It is the non-use benefits of heritage that exhibit public good characteristics; there is no feasible way of preventing people from benefiting from this knowledge, while at time such benefits are non-rivalrous;

• information asymmetries — in order to achieve an efficient outcome, markets rely on all parties having sufficient information to make decisions in their best interests. If the transaction costs of obtaining information for either buyer or sellers in the market are prohibitive, or if information is not sufficiently available to all parties, it is likely that behaviour will be non-optimal. In a heritage context, if people are incorrectly under the impression that the market does not value heritage then they will maintain less heritage than would be optimal; and

• externalities — positive externalities are those benefits that are consumed by third parties outside of the market. As such, these benefits are not accounted for in the market demand-supply decision, and may lead to a potential under-supply in the market. There are benefits from heritage places which accrue more broadly, including the contribution to cultural identity, the benefit from the place for a region, and the benefits to consumers of knowing heritage places are being preserved. A key aspect of historic heritage (in common with other types of heritage) is that intergenerational externalities are present. That is, the actions of current generations result in positive and negative spillovers for future generations.

This identification of market failures is important because Australian Governments are committed to the principle that government interventions in markets should generally be restricted to situations of market failure and that each regulatory regime should be targeted on the relevant market failure or failures. When intervention is justified there are a range of possible policy instruments, but these generally relate to a government’s ability to do at least one of the following four things: inform; spend; provide services; and regulate. The form of intervention will generally depend on the type of market failure present:

• The public good aspects of heritage (due to difficulties in excluding use and benefits derived from heritage buildings or places), are most commonly addressed through:

3 In contrast, for ‘use benefits’, where physical access is required to enjoy heritage, then it is likely that consumers can be excluded by restricting access (e.g. historic places with a gate entry fee, or privately occupied historic homes). These places will also likely exhibit rivalrous consumption (at least once congestion limits are reached).

4 The concept of externalities is closely linked to that of public goods; since third parties cannot be excluded from enjoying a good, they are able to extract benefits that are not reflected in market decisions (i.e. positive externalities).

5 Council of Australian Governments 1991, Report of Task Force on Other Issues in the Reform of Government Trading Enterprises, released as part of the first CoAG communiqué, Canberra. Also see sub-clause 5(1) Competition Principles Agreement.

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- spending instruments, which induce further private investment, or private ownership in a heritage building that would not have otherwise been a viable investment for the private sector; and

- services instruments, such as ownership of buildings and places, which move the ownership, and therefore the responsibility for investment in conservation, to government.

- Information asymmetry market failures in heritage are most clearly addressed through information instruments that provide signals in the market for heritage places and heritage conservation services to assist actual and potential property owners.

- Externalities in heritage conservation are primarily addressed through:
  - regulation instruments that ensure that the positive externalities of heritage buildings are taken into account by private owners. Regulation also addresses the risks of negative externalities in regions with particular heritage characteristics through zoning and other planning requirements;
  - spending instruments, which address the presence of externalities by providing targeted incentives for private owners to increase their investment in heritage conservation to a level which takes into account the positive externalities of heritage which accrue to society.

Thus, a range of instruments are necessary to ensure that the full range of market failures are addressed.

However, to date, government intervention has been relatively unbalanced:

- local, State and Territory governments have tended to rely on regulatory instruments; and

- the Australian Government’s principal intervention has been through grant funding as it has had little direct control over heritage assets and, until recently, has had little regulatory power over heritage places.

There has been an over-reliance on heritage listing as a tool to protect heritage places, without sufficient support from complementary policy instruments. Particular problems arise because:

- the lists are not yet comprehensive in all jurisdictions, as the thoroughness of the listing process varies from state to state and/or one local government to the next. This can lead to last minute heritage assessments when development of an unlisted place is foreshadowed, and thus to adversarial situations and adverse publicity;

- the public is not sufficiently aware of what listing entails — heritage listing is seen as an amorphous concept. The distinction between different heritage lists, and between different classifications within lists, is lost on the community, with the result that people have little perception of the actual implications of that listing; and
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... which can be addressed by broadening the forms of intervention undertaken by governments

The trend to favour market-based policy instruments ...

... should be treated with caution with respect to built heritage policy instruments

- the public has negative perceptions of the impact of listing — while listing may reduce the value of properties in some cases, the weight of evidence suggests otherwise.\(^7\)

Failure to adequately support listing with a comprehensive stocktake of the condition of Australia’s heritage places, funding support mechanisms/incentives, and effective public education programs has undermined both the effectiveness of listing and the public’s support of listing. Indeed, it is reasonable to suggest that the insufficiently supported emphasis on heritage listing has actually exacerbated existing information asymmetries. There is nothing wrong with listing serving as the centrepiece of heritage protection, and in fact it is important to get to the point where the lists are relatively comprehensive, but listing must be adequately supported with a broader range of policy instruments.\(^6\)

In thinking about the broader range of policy instruments to employ there is a temptation to move, as has happened in the field of natural protection, to embrace more market focused policy instruments. The scope for such a shift in historic heritage conservation is more limited than in the natural heritage context because:

- the level of homogeneity associated with heritage assets is often considerably lower than the homogeneity associated with natural environment assets; many historic heritage places are valuable for their absolute uniqueness and so there is not sufficient commonality to create a market of like assets; and

- it is often difficult to specify the historic heritage outputs. For example, while the concepts of ‘condition’ and ‘integrity’ are used to classify heritage outcomes,\(^9\) there appears to be considerable potential for variation in interpretation.

This is not to suggest that there is no increased scope for outcome-focused (i.e. market-based) policy instruments to facilitate improved heritage outcomes; market-based instruments should be seen as complementary tools in a broader suite of policy instruments, rather than a default approach.

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Part A

Background
Chapter 1

What is heritage?

This chapter briefly outlines what is meant by the term ‘heritage’.

Heritage is what we inherit, but more specifically what we retain of this inheritance. Heritage items and places are synonymous terms. They can include sites, areas and cultural landscapes as well as buildings and works (singly or grouped), relics and movable objects and may include components, contents, spaces and views.

The heritage value of a place is also known as its cultural significance which means its aesthetic, historic, scientific, social or spiritual value for past, present or future generations. Cultural significance is embodied in the place itself, its fabric, setting, use, associations, meanings and records. Places may have a range of values for different individuals or groups.

The discussion in this report relates specifically to ‘historic heritage places’, and includes:

- buildings and structures (e.g. houses, factories, churches, bridges, roads, monuments and cemeteries);
- physically-created places demonstrating ways of life, customs, land use or designs that are no longer practised (e.g. stock routes or gardens);
- physically-created landscapes with evidences related to particular activities (e.g. mining sites, sawpits or fishing areas);
- other places of historic significance (e.g. Captain Cook’s landing place as Botany Bay or the Leichhardt tree in Taroom).

This definition excludes natural, indigenous, movable and intangible cultural heritage. This report focuses on government protection of historic heritage protection.

Heritage significance in Australia is assessed under a three-tier legislative system that determines the local, state, national or commonwealth significance of an item. Heritage items can also be included on non-statutory listings (such as the Register of the National Estate and the National Trust).

Within these specifications, what is considered to be a heritage building or place is a relatively subjective decision. It is for this reason that criteria have been developed to address major concerns about subjectivity. Importantly, heritage is a broader concept than simply the age of the building or place. In terms of number of places, the vast majority of heritage places in Australia are listed at the local government level, and are buildings with primarily residential and commercial uses, or are community buildings (such as libraries or schools) or religious buildings.

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A cultural landscape is one modified by human intervention, or at least affected by human activity. This can range from minimal intervention such as open range grazing on pastoral properties to large-scale degradation such as mining landscapes.
Heritage places require conservation. Heritage conservation relates to those activities that are conducted with the specific objectives of retaining heritage significance of a particular building or place. Conservation may involve maintenance, repair, preservation, restoration, reconstruction or adaptation.
Chapter 2

Characteristics of historic heritage places and the heritage market

This chapter outlines a number of characteristics of historic heritage places that affect government and public attitudes to heritage.

It is important to recognise the particular characteristics of heritage places, and the market for heritage conservation, that set them apart from other goods and industries. For example, even in the arcane world of accrual accounting approaches it is acknowledged that:

heritage assets are very different from other types of assets. They have very long life cycles – generally measured in hundreds of years. Their value does not diminish over time due to wear and tear (but there can be significant upkeep costs); in fact, they are more likely to increase in value over time. Their acquisition costs are generally not known and are in most cases totally irrelevant for today’s valuation purposes. … And, by their nature, they do not have any replacement value.  

This chapter explores some of these, and other, differentiating characteristics associated with heritage.

2.1 The difficulty in gaining agreement as to what constitutes heritage

As alluded to in chapter 1, there is considerable scope for disagreement and uncertainty as to what constitutes heritage. In particular:

• the definition of heritage outlined in chapter 1 provides considerable scope for debate as to what exactly constitutes a heritage place at any particular time. Different people are likely to have different perceptions of a place’s value (discussed more in section 2.2); and

• in addition, some heritage places are appreciated as being of such a character after only a short time (e.g. iconic places like the Sydney Opera House), while it may be considerably longer for others that are less iconic or monumental (e.g. some residential areas).

These characteristics make heritage a matter for considerable community debate, and precludes a single community-wide view being formed.  


12 Of course, heritage is not unique in this, and other public good characteristics such as aesthetics provide considerable scope for community debate and disagreement.
2.2 ‘Shared’ use of heritage

Heritage is not a good or service in isolation, but rather is an attribute of a number of goods which have other attributes and uses. For instance, in Australia many historic buildings are residential properties or serve a commercial purpose, aside from being heritage items. The heritage aspect of these places is therefore, most often, the ‘secondary good’ being consumed.

As shown in figure 2.1, people gain a number of benefits from heritage places (the bottom bubbles in figure 2.1).

![Diagram of historic heritage value categories](image)

Note: While some may view the bequest value as being quite tangible, it is shown as being relatively more intangible because the value of the historic legacy cannot accurately be determined today (i.e. the value of existing conservation activities will only be accurately determined by future generations).


Aggregation of the benefits shown in figure 2.1 shows that heritage generates economic value in a variety of ways:
The physical assets that embody historic heritage (e.g. houses, public buildings, etc) have a ‘use value’ like any physical asset. The heritage component may increase this use value, as people derive additional value from living or working in a heritage place, or simply visiting or seeing a heritage place.

Beyond physical value, heritage assets are valued for a variety of intangible benefits. Indeed, people may value:

- the existence of heritage – although they might never visit a given place, would feel a quantifiable loss if it were destroyed;
- the option to visit a heritage place – although they may not have immediate plans to visit; and
- the chance to bequeath a heritage place to future generations, as part of a shared cultural legacy.13

It is important to acknowledge that the consumption of heritage is often a ‘shared experience’. That is, as more individuals ‘consume’ or ‘use’ heritage goods, or as they use them to a greater intensity, the greater is the collective benefit of these goods contributes to the common heritage value in a community. As a result, the proliferation of heritage knowledge and experience lead to common heritage value, social identity and cultural continuity.14

2.3 Reliance on a highly specialised labour market

A further characteristic of heritage, which impacts on market interactions, relates to the cost of conservation. Heritage conservation work, such as repair or conservation, can be a labour intensive activity where it is difficult to apply new technology or techniques. A number of market characteristics are particularly affected by labour issues:

- given its labour intensity, the master-craftspeople sector of the heritage industry is a relatively low productivity sector, with few potential avenues for productivity gains.15 As a result, prices for such skilled heritage services will rise relative to other prices because wages in low productivity sectors must keep up with wages in high productivity sectors. This characteristic is known as Baumol’s ‘cost disease’;16 and

- practical historic heritage conservation is a relatively specialised profession, and typically involves specific training and skills; there is an under-supply of such skilled workers in Australia and overseas.17

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15 While there have been some technological improvements, a master-craftsman repairing a heritage sandstone pillar is unlikely to do so more quickly than a craftsman at the time the building was originally constructed.
17 This problem has been identified in the United Kingdom, where it has been estimated that by 2006 there will be a need for an additional 6500 skilled conservation workers to service the over 4.4 million historic residential
2.4 Future cost pressures

While much attention has been paid to the cost pressures associated with the ageing of the population, in principle, such pressures are nothing compared to what is faced in the context of public funding for the conservation of built heritage.

Without change, the pressure on heritage related costs will continue to rise. This will occur because of the interplay between:

- increased demand for heritage protection — we are seeing this with the creation of new lists, and the addition of many properties to heritage protection lists. Thus, even though there is a natural attrition as some heritage places are demolished or fall into neglect, the stock of identified heritage properties increases;
- longer lived heritage properties — improved technology and awareness of conservation principles should mean that the stock of heritage places will last longer; and
- increased cost pressures because of the characteristics identified in section 2.3. In particular, if domestic markets fall below a critical mass they may disappear and conservation attempts will require resort to more expensive imported skills and products.

While health and aged care have sufficient profile to garner increased government spending, experience to date suggests that heritage protection lacks the necessary government support to be able to adequately meet these increased funding needs.

It could be argued that heritage conservation in Australia is characterised by a high level of deferred maintenance. Government subsidies for private conservation work are very low, and where they exist they are often directed towards ‘band-aid’ solutions for buildings in poor or neglected condition. Deferred maintenance increases repair needs on an accelerating basis, builds cost pressures, and makes long term conservation outcomes more difficult.

Part B

Assessing the case for government intervention
Chapter 3
Market failures and heritage

This chapter identifies the market failures that can be said to exist with respect to heritage places and their conservation, and the degree to which such failures justify government intervention.

3.1 Forms of market failure

The discussion in chapter 2 highlighted how heritage ‘goods’ have certain characteristics that can have an impact on how they are supplied and consumed. These characteristics are not, in themselves, failures in the market for heritage, but can contribute to, or exacerbate, market failures.

Market failures exist when there is a divergence between the marginal social costs and benefits and the marginal private costs and benefits of investing in conservation. In the presence of this divergence, there is a prima facie case for government intervention.

Public goods

A public good is a good that exhibits two particular features:

• ‘non-excludability’ — this means that people cannot be excluded from deriving a benefit from the good (or that the costs of doing so are prohibitive); and

• ‘non-rivalry in consumption’ — this means that the consumption of the good by one individual does not limit consumption by others (i.e. there is no scarcity).

These properties significantly limit the incentive for private providers to supply a public good, resulting in an undersupply or no supply at all.

Deciding whether something is a public good is not straightforward. Non-excludability is a function of technological, social and cultural constraints. For instance, broadcast television was once a public good, but with the advent of encryption technology, excludability became possible (e.g. allowing the development of satellite pay television, a club good). Similarly, non-rivalry may exist up to some point, at which point congestion results in rivalrous consumption. This is true of things like roads, airspace and radio spectrum. The result is that there is not a clear distinction between public goods and private goods, but a smooth continuum.

19 The effect of technology is not one-sided. For instance, the discovery of methods of breaking encryption means that satellite television is once again non-excludable, but non-excludability can in turn be restored by legal protections.
In practice, ‘pure’ public goods are relatively rare. A typical example is national defence — defending the country for one person defends it for everyone, and one person’s ‘consumption’ of defence does not reduce the ‘amount’ available to others. Other examples include public lighthouses, information goods and environmental goods such as clear air and water.

More common are goods that exhibit only non-rivalry (club goods) or only non-excludability (common goods), or exhibit these characteristics to a limited extent. An example of such a good would be a national park, since some of the benefits (e.g. recreation use benefits) are excludable, while others (e.g. carbon-dioxide absorption) are not, and the park is only non-rival up to a point.

Public goods result in market failure because of the ‘free rider’ problem. This is where a consumer can enjoy goods to which they have not contributed. This results in a market failure because the free-riding consumer places a certain value on the good, but the producer has no way of capturing this value and so will under-produce the good.

This concept of the public good can be applied to heritage. Some aspects of the consumption of heritage are excludable, have a scarcity value, or both. For ‘use benefits’ (see figure 2.1), where some degree of physical access or proximity is required to enjoy heritage, then it is likely that consumers can be excluded by restricting access (e.g. historic places with a gate entry fee, or privately occupied historic homes). These places will also likely exhibit rivalrous consumption (at least once congestion limits are reached).

Other aspects of heritage behave differently. Individuals also derive ‘non-use benefits’ from heritage, such as existence benefits — the knowledge that the heritage item exists and is being conserved, as well as the contribution that the particular heritage item makes to the overall cultural and architectural identity of a community. In this case, the loss of one particular place would lower the overall value of the heritage or cultural identity of an area. There is no feasible way of preventing people from benefiting from this knowledge, while at the same time such benefits are non-rivalrous.

Even in relation to use benefits, it is sometimes very difficult for private owners to exclude consumption. For instance, it is difficult to prevent neighbours from enjoying the visual amenity of an historic home.

A representation of the public good characteristics that apply to various benefits of historic heritage is provided in figure 3.1.
The presence of non-excludability and non-rivalry characteristics for heritage goods results make it difficult for private providers to operate in the market. While owners of heritage places may be able to recoup a proportion of their investment in the property through charging admission or entry fees (thereby capturing ‘use’ benefits), it is significantly more difficult for owners to charge for non-use benefits because consumers are able to free ride in these instances. For example, a person living in a non-heritage property located in a heritage precinct may nevertheless benefit from the heritage context in which their property sits.

The best way of overcoming market failure caused by public goods is to distribute some of the benefits received by free riders to producers. Depending on the good, it might be relatively easy to turn free riders into paying consumers; for instance, for use benefits, the addition of a gate and an entry fee will be effective.

In other cases it may be difficult or impossible; for instance, attempting to charge people for the knowledge that historic heritage exists and is being conserved.
Where benefits cannot be captured directly, there may be a role for government in capturing those benefits. Government can tax individuals or groups in society, and may therefore extract payment for diffuse benefits (such as existence benefits) received by taxpayers, and distribute it to producers as subsidies (or channel it to direct production). Compared to directly charging for use, this method is a crude way of alleviating the problem. The involvement of government weakens the nexus between production and consumption, introduces substantial transaction costs, and may suffer from various government and regulatory failures. It is also likely to have unintended equity effects, because the funding profile is unlikely to match the pattern of benefits of heritage (e.g. heritage conservation may be funded out of income tax, in which case two individuals with similar incomes may contribute the same amount to conservation, although they value it to different degrees).

Information asymmetries

In order to achieve an efficient outcome, markets rely on all parties having sufficient (but not necessarily perfect) information to make decisions in their best interests. If the transaction costs of obtaining information for either buyer or sellers in the market are prohibitive, it is likely that no exchange will occur.

In other cases, information is not just imperfect, but is asymmetrical. Information asymmetries occur when one party in the market, usually the buyer, does not have sufficient information about the good they are considering purchasing, or the actions of the seller, to make a decision in their best interest. The information asymmetry problem creates a situation of ‘adverse selection’.

Adverse selection occurs when a buyer is not able to differentiate between high quality and low quality goods in the market at the time of purchase, and perhaps also not until a significant period of time after purchase. In the presence of this uncertainty, high quality products can be driven out of the market.

This phenomenon is known as the ‘market for lemons’, first noted by Akerlof, who explained how the pressure of competition, in the presence of information asymmetries, may cause quality to deteriorate to such low levels that the market may fail to exist. This concept is most commonly described using the example of a used car market, where there are both good quality cars and poor quality cars (‘lemons’). Purchasers know that there is a risk that they will purchase a lemon, but they have no reasonable means of identifying the lemons from the high quality cars until they have driven the car for several months after purchase (in the absence of any other third party assistance). This scenario can lead to a less than efficient social outcome because:

- buyers do not have sufficient information to make a rational informed decision about quality of a good, and therefore risk inadvertently purchasing a ‘lemon’;
- as a result, consumers will offer a price which is less than what they would be willing to pay for the high quality product, as they are uncertain as to the quality of the product that they will receive; and
- this, in turn, drives higher quality goods out of the market (as the price is too low to make a positive return).

The result is that consumers, by offering a lower price given the risk of purchasing a ‘lemon’ inadvertently increase their chances of purchasing a ‘lemon’, as at the lower price only ‘lemons’ will be sold. At the extreme, only the lowest quality products will be sold, and all higher quality products will be removed from the market.

Adverse selection is most common for those products where it is difficult for consumers to ascertain quality at the time of purchase (and even for some period after purchase), and they do not have sufficient prior experience on which to base their decision.

There are a number of characteristics of heritage places that increase the risk of adverse selection in the market for heritage places:

• heritage is a difficult attribute to define in any absolute way (and is often related to tastes and values), and as such can also be difficult to identify and value within a good, such as a home. For instance, a purchaser of a home may be informed that the home has (or does not have) heritage value, but it may be relatively difficult to assess this claim; and

• properties tend to be large, one-off or low frequency investments where the purchaser cannot rely on significant previous personal experience to determine the quality of the good.

Box 3.1

OTHER BARRIERS THAT APPROXIMATE INFORMATION-RELATED MARKET FAILURES

There are a number of perceived barriers in the provision of heritage conservation that are common to decision making elsewhere in the economy, and include:

• heterogeneity — where, despite a heritage investment being cost effective on average, it is not cost effective for all users due to their specific characteristics;

• risk — to the extent that heritage investments are discounted for risk at the same rate as investments of equivalent risk elsewhere in the economy, leading to high discount rates; and

• access to capital — to the extent that heritage investments are constrained by capital scarcity in similar fashion to investments of equivalent return elsewhere in the economy.

It is likely, however, that some of these barriers are actually more pronounced in the market for heritage protection. Fundamentally, these additional risks can be classified as information-related information asymmetries and so may take on the characteristics of a market failure.

As a result, adverse selection may manifest itself in a number of different ways — because of the difficulty in determining the true value of a heritage property a person:
who has conserved the heritage characteristics of the property may not be able to fully recoup their investment because the market may not be able to fully distinguish between higher quality and lower quality heritage properties. Thus, if an investor has an opportunity to invest in conserving or upgrading a heritage home, but has limited ability to signal the quality of this property over and above others in the market, the investment is less likely to take place; and

- who wishes to sell, for development, a property with little apparent heritage value may have to discount their property to account for the risk that a development application will raise heritage issues.

Adverse selection appears to be most relevant to residential heritage properties where investors may wish to purchase a residence with a heritage component, but have difficult in assessing and comparing the relative value of the different heritage attributes of the available properties:

- It is difficult to determine, without incurring significant costs, the validity of heritage claims on properties. The costs of such inquiries are generally beyond the financial capacity of individual personal buyers.

- While listing of heritage properties does provide some signal to purchases, the prevalence of heritage listing in many jurisdictions reduces this value (as listing does not provide a signal of quality between listed properties).

**Externalities**

Externalities are those benefits (or costs) that are consumed by (or incurred by) third parties outside of the market. As such, these benefits or costs are not accounted for in the market demand-supply decision, lead to a potential under-supply or over-supply in the market.

The concept of externalities is closely linked to:

- public goods (see above) — since third parties cannot be excluded from enjoying a good, they are able to extract benefits that are not reflected in market decisions (i.e. positive externalities); and

- merit goods (see box 3.2).

**Box 3.2**

**HERITAGE AS A ‘MERIT GOOD’**

Heritage also has characteristics of what is known in the literatures as a ‘merit good’. In the case of a merit good, the community as a whole desires, and benefits from, a higher output of the good than would be supplied by the private market.

The concept of a merit good is a relatively controversial one in economic literature because it relates to governments identifying goods, perhaps on the basis of support from groups within society, which produce sufficient benefits to society to warrant government funding, even though individual preferences and demand for these goods does not appear to justify such support. In the case of heritage, this may be in relation to preserving a particular building or attraction, on the basis of the value that government considers the place provides to the community, even though visitation to the place or knowledge of the place is relatively low.

In the presence of positive externalities, the market will supply a lower level of the good than would be socially optimal. Consumer demand will reflect the private benefit a consumer receives, but not the additional social benefit that might result from consumption or production of the good. If these third-party benefits were taken into account, consumers would be willing to pay more and a higher level of the good would be produced. This is represented in a simplified way in figure 3.2. Conversely, negative externalities will result in the marketing oversupplying the good, as supply will reflect private costs to producers, but not additional costs that result from production or consumption of a good.

In the case of heritage, there are privately captured benefits of owning a heritage place, and investing in heritage conservation, such as the ability to charge the public for access to the place, or the increased value of the property that comes from emphasising its heritage qualities. Equally, there are benefits from heritage places which accrue more broadly, including the contribution to cultural identity, the benefit from the place for a region, and the benefits to consumers of knowing heritage places are being preserved. In cases where these externalities are not captured, private owners of heritage places will only invest in conservation of the place to the point where they can realise benefits from this investment.

In theory, externalities could be resolved privately between stakeholders. For such private resolution of externalities to work, three conditions must exist:
• property rights must be well-defined;
• the number stakeholders must be small; and
• transaction (negotiation) costs must be small\textsuperscript{21}.

Unfortunately, the second and third conditions rarely hold for heritage goods (even the first condition sometimes fails if ‘rights’ to heritage may not be clear). Externalities are diffuse, so the number of stakeholders is large and the transaction costs very high, in comparison to the efficiency loss due to externalities. Also, because of the public good nature of heritage, some of the stakeholders can free ride on the actions of others. As a result, situations in which private parties spontaneously resolve heritage externality issues are rare.

A key aspect of historic heritage (in common with other types of heritage and other environmental issues) is that intergenerational externalities are present. That is, the actions of current generations result in positive and negative spillovers for future generations. The degree to which future benefits and costs should be discounted is controversial. Nevertheless, a fundamental premise of heritage conservation is that heritage should be preserved for future benefit. If we accept that this includes future generations, then intergenerational externalities must be considered in choosing appropriate policy action.

3.2 The significance of the market failure

The presence of market failures is a necessary but not sufficient condition of government intervention. Government involvement in markets can lead to costs and inefficient outcomes. These need to be recognised in an assessment of policy instruments to ensure the instruments are the most appropriate and effective for the specific market failure that they are targeting, and that they do not create unintended consequences.

The mere presence of information asymmetries or externalities does not automatically justify government intervention. Market failures are an everyday event; buyers are rarely as informed as sellers, and most transactions have consequences for third parties. For example, the Wallis Inquiry noted that:

There is nothing unusual about asymmetry of information available to a supplier and a consumer. Many products or services are complex, difficult to compare, have considerable importance for the well-being of their customers or are provided over a period of time.

Furthermore, in the context of consideration of professional regulation, the Productivity Commission has noted that:

The need for government regulatory intervention does not immediately follow from the identification of information deficiencies: information deficiencies are pervasive yet most markets continue to function reasonably efficiently. … it is not generally efficient to eliminate all negative externalities or promote infinitely large quantities of positive externalities. In many cases, externalities do not create significant problems.\textsuperscript{22}

\textsuperscript{21} This insight is known as the ‘Coase Theorem’: R. Coase 1960, ‘The problem of social cost’, Journal of Law and Economics, no. 3, pp. 1–44.

\textsuperscript{22} Financial System Inquiry 1996, Discussion Paper, Canberra, p. 97.

\textsuperscript{23} Productivity Commission 2000, Inquiry Report: Review of Legislation Regulating the Architectural Profession, AusInfo, Canberra, pp. 64 and 76.
It is almost accepted as a truism that the free market will fail to provide satisfactory conservation of heritage places as private owners will make investment decisions based on private valuation and preferences and generally disregard the ‘existence value’ of any candidate for heritage conservation. In particular, the market will likely fail to adequately protect intergenerational benefits associated with the conservation of heritage places.

Yet, there are notable exceptions to this line of reasoning; many privately owned houses have been painstakingly preserved; more often than not without public support, and with private incentives as the dominant force. Private owners often take personal pride in their stewardship over historical houses and have, rationally or not, invested considerable sums to conserve them.24

Thus, in addition to considering if government intervention entails any risks (see box 3.3), government intervention might be justified where the potential harm is significant (e.g. where the nature of the risks posed by a particular transaction would have serious consequences). In assessing the significance of the harm,25 there must be consideration not only of the potential consequences, but also:

- whether or not the impacts are reversible;
- whether the risk is involuntary or voluntary; and
- the likelihood of that harmful outcome occurring.

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24 This point is reinforced in C. Hjorth-Andersen 2004, The Danish Cultural Heritage: Economics and Politics, Discussion Paper 04-33, Institute of Economics, University of Copenhagen, Copenhagen.

25 The significance of the harm can refer to significant harm to a few people or moderate harm to a large number of people.
Box 3.3

RISKS ASSOCIATED WITH GOVERNMENT INTERVENTION

Just as markets fail under certain circumstances, governments, and government initiatives can also fail to address a problem effectively (or can make a market failure worse). Such failures may arise as a result of:

- political and electoral pressures — the pursuit of self-interest amongst both politicians and bureaucrats rather than operating on behalf of citizens leads to a misallocation of resources. Further, electoral pressures can lead to inappropriate government spending and tax decisions (e.g., boosting public spending in the run up to an election, or decisions to bring forward major items of government capital spending on infrastructure projects ahead of an election without the projects being subjected to a full and proper cost-benefit analysis). Political pressures can also lead to a tendency to look for short term solutions to economic problems rather than making considered analysis of long term considerations. The risk is that myopic decision-making will only provide short term relief to particular problems but does little to address structural problems;

- regulatory failure — in some cases regulation may actually have a negative impact on the incentives to invest in heritage. Later chapters discuss how an unsupportive emphasis on heritage listing may be one such example;

- risk of low additionality from direct expenditure, grants and loans — direct or indirect funding of projects by government may sometimes simply replace funding that would have otherwise been provided by the private sector (e.g., from private investment, sponsorship or donations). This is an issue of instrument design and targeting (as well as understanding the problem being addressed);

- information asymmetries — while it is often assumed that governments know everything, they do not. As a result, there may be circumstances whereby government decisions are made on the basis of inadequate information, leading to a sub-optimal outcome; and

- sovereign risk — this is effectively a moral hazard problem whereby governments can change their position to heritage even though people have made decisions on the basis of statements, commitments and existing regulatory arrangements.

In the case of heritage, the key issue is that loss of built heritage is irreversible. In this regard it is important to distinguish the built heritage from natural heritage; the problems are more challenging with built heritage. There may be some possibility of regrowth of native vegetation, whereas historic heritage places, once gone (i.e. demolished), cannot be replaced.

Even though a number of potential market failures may not seem significant *per se*, they may be exacerbated by external organisational failures. As observed by Golove and Eto in the context of organising energy efficiency across a chain of players, small imperfections can combine to create a substantial market failure:

An intriguing illustration of the magnitude question [of the energy efficiency gap] examined from the point of view of transaction costs suggests that market barriers can sometimes accumulate and reinforce one another …. the idea of chains of market barriers refers to small imperfections, any of which individually represents an insignificant distortion to efficiency, but which in combination are of a magnitude sufficient to be considered a market failure. … The chain of market barriers phenomenon explicitly recognizes that there are series of decisions, actions, and transactions between the production of goods and their ultimate sale to the end user.

For example, the householder seeking to sympathetically conserve a heritage home will need to coordinate with the architect, equipment suppliers, the local council, and their builder. While it is true that this combination of complexity and small information asymmetries is a feature of the home building process, if any party in this chain of coordination lacks interest in the heritage component of the renovation, then optimal investment in heritage can become much harder to achieve. For a larger project which may also involve a developer, project managers, and financiers, and other levels of government the problem is amplified.

3.3 Summary

The economic case for government involvement to conserve heritage places is clear; without intervention the level of historic heritage protected by the community will be less than optimal. Such an outcome arises because of the presence of a number of ‘market failures’:

- public goods — it is the non-use benefits of heritage that exhibit public good characteristics; people may not be excluded from enjoying the intangible benefits of heritage, and the enjoyment of heritage by one person does not stop enjoyment by another person;

- information asymmetries — if people are incorrectly under the impression that the market does not value heritage then they will maintain less heritage than would be optimal; and

- externalities — there are a number of benefits derived from heritage places which accrue to people other than the owner of the heritage place (e.g. including heritage’s the contribution to cultural identity, the benefit from the place for a region, and the benefits to consumers of knowing heritage places are being preserved). A key aspect of historic heritage is that intergenerational externalities are present. That is, the actions of current generations result in positive and negative spillovers for future generations.

While these market failures justify government intervention, it is important to look at the individual circumstances for which a failure is claimed to determine if the failure does in fact mean that the market is noticeably ‘broken’ (i.e. are the market failures material?). If the market failures are a real impediment to the provision of the optimal level of heritage conservation then the forms of intervention described in Part C should be explored.
Part C

Possible forms of government intervention
Chapter 4

The range of potential policy instruments

This chapter categorises and describes the range of policy instruments available to governments to manage Australia’s historic heritage.

As the discussion in chapter 3 highlighted, markets in which heritage is a component share certain characteristics that may justify government intervention. Having established a case for action, the question then arises: what action should be taken? This is not a simple question. Even assuming the problem itself is well-defined and a consensus exists about the desired outcomes, there exists a range of possible actions that may contribute to achieving the outcome, with varying degrees of success.

An instrument (or tool) of public action can be defined as ‘an identifiable method through which collective action is structured to address a public problem.’

While there is a broad range of available policy instruments for government, these generally relate to a government’s ability to do at least one of the following four things: inform; spend; provide services; and regulate.

In relation to heritage, the extent of government involvement in supporting and encouraging heritage protection and conservation can be determined by the total expenditure by the Commonwealth and State and Territory Governments on all such heritage interventions is shown for 2001-02 and 2004-05 in table 4.1. The table shows that nominal expenditure by State and Territory Governments increased from $53.2 million in 2001-02 to $58.5 million in 2004-05 (i.e. just keeping pace with inflation).

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Table 4.1

EXPENDITURE BY AUSTRALIAN GOVERNMENTS ON THE HISTORIC ENVIRONMENT

<table>
<thead>
<tr>
<th></th>
<th>Expenditure</th>
<th>Expenditure per capita</th>
<th>Expenditure</th>
<th>Expenditure per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2001-02</td>
<td></td>
<td>2004-05</td>
<td></td>
</tr>
<tr>
<td>Commonwealth</td>
<td>$103 million</td>
<td>$5.24</td>
<td>Not available</td>
<td>Not available</td>
</tr>
<tr>
<td>NSW</td>
<td>$29 million</td>
<td>$4.37</td>
<td>$29.5 million</td>
<td>$4.35</td>
</tr>
<tr>
<td>Victoria</td>
<td>$9 million</td>
<td>$1.85</td>
<td>$8.2 million</td>
<td>$1.63</td>
</tr>
<tr>
<td>Queensland</td>
<td>$3 million</td>
<td>$0.81</td>
<td>$4.1 million</td>
<td>$1.05</td>
</tr>
<tr>
<td>WA</td>
<td>$3.4 million</td>
<td>$1.76</td>
<td>$6.1 million</td>
<td>$3.08</td>
</tr>
<tr>
<td>South Australia</td>
<td>$3.6 million</td>
<td>$2.37</td>
<td>$4.1 million</td>
<td>$2.66</td>
</tr>
<tr>
<td>Tasmania</td>
<td>$2.4 million</td>
<td>$5.08</td>
<td>$2.5 million</td>
<td>$5.30</td>
</tr>
<tr>
<td>ACT</td>
<td>$1.8 million</td>
<td>$5.59</td>
<td>$1.4 million</td>
<td>$4.20</td>
</tr>
<tr>
<td>NT</td>
<td>$1 million</td>
<td>$5.05</td>
<td>$2.6 million</td>
<td>$12.60</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$156.2 million</td>
<td>$7.95</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note for 2001-02: The Commonwealth value includes $70 million of Federation funding. The NSW value includes only expenditure by the Historic Houses Trust ($20 million) and the Heritage Office ($9 million which includes a one-off grant program of $1.7 million). The Victorian figure represents only the combined operating and project budgets of the Heritage Council and Heritage Victoria. Abnormal items not included: one-off State/Commonwealth funding of $33 million for National Heritage Trails in Queensland; and $8.3 million in one-off grants to the National Trust of WA.

Note for 2004-05: The NSW value includes only expenditure by the Historic Houses Trust ($21.8 million which includes a capital amount of $2 million for the conservation of the Mint buildings) and the Heritage Office ($7.7 million). The Victorian figure represents only the combined operating and project budgets of the Heritage Council and Heritage Victoria. The ACT value reflects actual expenditure for 2004-05 rather than the combined budget estimates for $1.629 million for 2004-05 comprising the heritage component of the Department of Urban Services (up to November 2004) and the Chief Minister’s Department (from November 2004). The WA figure includes a $1.45 million grant to the National Trust.


In this chapter policy instruments — categorised into the four identified categories of intervention: informing, spending, providing services, and regulating — are described, evaluated and compared.

4.1 Information

Information is a powerful tool in society that can assist individuals and governments in decision-making. As discussed in chapter 4, where there is insufficient information in a market, or where there is asymmetrical information, a less than efficient outcome will be achieved. Given the value of information in market decisions, there are a number of information instruments that are used by governments to address market failures.
Features of information instruments

Governments use information as a tool to achieve a desired outcome; the idea being that in the presence of new or more accurate information, individuals or firms will change their behaviour (perhaps to minimise risks to themselves, or reduce the cost of their own actions on others in society).

Information instruments are primarily useful in situations where there is an information asymmetry in a market, where one actor (usually the consumer) does not have sufficient information to make an information decision of the relative quality of the products on the market (as discussed in chapter 3). In these instances, information instruments can be effective where they provide a signal to the consumer, such as by establishing labelling or disclosure processes, or by setting up endorsement schemes.

Information instruments can be considered in two broad categories:

- public information services or campaigns, where governments provide individuals with information that they believe will assist in decision making;
- public information disclosure requirements, where governments require the private sector to provide information in markets to inform consumers.

Limitations of information instruments

Information instruments work in a relatively indirect manner — essentially working to change behaviour through more informed decision making. Information instruments are, however, limited by the extent to which consumers, and in some cases suppliers, act on the information provided.

The effectiveness of information instruments rests on the ability and willingness of consumers to use the information in the way that was intended under the instrument design. In some cases, where relatively straightforward messages are being conveyed, it is likely that the majority of consumers will use the information correctly (e.g. warning labels on dangerous goods). In other cases, the information provided requires greater interpretation, and existing knowledge, and it is less certain that individuals will respond in the manner that was intended.

Individuals do not have a limitless capacity to absorb and process incoming information, or an endless motivation for continually updating their knowledge on all issues relevant to their lives. It cannot, therefore be assumed that individuals are continually seeking the best information in making purchasing or investment decisions, or equally, that they are able to judge what the ‘best’ information is.  

Information instruments for heritage

While many examples of information policy instruments are related to public risks, the role of information instruments in addressing heritage market failure has a different focus. For heritage, information instruments have the potential to:

- provide signals in the market for potential investors in heritage;

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• promote the heritage values to the public more broadly to encourage greater recognition of heritage and increase the use of heritage places, such as through visiting places or other adaptive re-use; and

• provide information to owners of heritage properties on conservation practices.

Providing signals in the market for heritage

As discussed in chapter 2, it can be difficult for purchasers of heritage properties to clearly identify the heritage value of the properties they are considering purchasing. One instrument used to identify properties with heritage value is through listing by government agencies (usually local governments). Listing of buildings is typically used to support regulation development of heritage places, however, listing can also provide a signal to potential purchasers of heritage properties.

If applied in this way, listing can act as a disclosure instrument, whereby information is provided to potential buyers on the heritage attributes of the property (e.g. certificates under the Victorian Heritage Act). Government accreditation of this information provides greater certainty to buyers of its authenticity.

Schuster compares the need for greater certainty by consumers as being similar to the role of certification in the art market, citing Mossetto:

Consumers in search of a higher level of certainty on the quality of the goods they are going to resort to institutional solutions. They explicitly ask ‘someone’ for a previous judgement on their quality. ‘Someone’ who has to be trusted not because he represents any sort of public interest or collective willingness, but because ‘he knows’ what other people do not know about quality.

Listing of heritage buildings by government authorities can work as a signal of quality or accreditation for potential investors in heritage buildings, though to date it has not typically been used in this way (but rather is used as a basis for regulation of heritage development). As Schuster notes, decoupling listing from other instruments (such as spending or regulation instruments), emphasises the role of the information in the list, and the need for the list to be developed in such a way that will maximise its effectiveness as an information instrument.

Promotion and recognition of heritage places

A challenge of heritage conservation is ensuring that the value of heritage places is recognised and understood sufficiently across the community.

Greater awareness of heritage matters will:

• encourage use of places, which may provide financial support for heritage conservation (if access to the place is sufficiently excludible). Community interest in heritage places can lead to greater political support for conservation, and potentially increased membership in volunteer networks and not-for-profit organisations who support conservation; and

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• make the tourism industry and the broader community more aware of the impact of heritage tourism activities. The provision of such reliable information ‘would assist in effective policy development, raise awareness in tourism and in government of the economic benefits which accrue from Australia’s heritage assets’. 32

These promotion activities can be conducted by governments through broad public information campaigns, promotion of special events supporting heritage awareness. Not-for-profit agencies, such as the National Heritage Trust, also have a role in heritage promotion.

Heritage listing can also play a role in this context, as it can provide a signal to the broader public of the importance of the place. In particular, listing by external agencies, such as international organisations, can provide a degree of recognition to heritage places that can lift the profile of the place. For example, in a natural heritage context:

World heritage List designation quickly became an important symbol that could be used effectively by many different interests to bring a wide variety of political pressure and a wide variety of resources to bear on the protection and preservation of these internationally recognized sites. 33

More broadly, listing can provide a signal to the community of the importance of heritage:

All characterizations of what lists do emphasize the same thing: the information that is communicated by the list, information that, it is hoped, will be sufficient to change citizen’s and owners’ behaviours with respect to listed properties. The message is: ‘These are important; you should be respectful and careful and do your utmost to preserve them’. 34

**Technical advice on heritage conservation**

An impediment to greater investment in heritage conservation is the limited knowledge of owners of heritage properties on technical conservation matters. This lack of knowledge, coupled with the under-supply of skilled tradespeople in conservation trades (see chapter 2), limits the ability of owners, particularly residential owners, to properly conserve the heritage attributes of their property.

Information instruments can assist in this area by providing accessible information and support for property owners on conservation. 35 Indeed, a number of manuals are currently provided by heritage authorities to assist industry participants.

**4.2 Spending**

Spending and other fiscal measures are a key instrument by which government seeks to influence behaviour in many areas (e.g. health, education and the environment) and this is increasingly true of heritage conservation as well. Fiscal measures are typically used to address the following market failures in heritage conservation:

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34 Ibid.
 Thoughts on the ‘When’ and ‘How’ of Government Historic Heritage Protection

The Allen Consulting Group

• inadequate incentive for private investment in historic heritage, due to the inability of private owners to capture externalities flowing from heritage investment;

• inadequate incentive for private owners to refrain from activities that may damage heritage values (in effect, disinvestment), due to the difficulties in imposing these negative externalities on owners; and

• limited access to financial capital for investment, for reasons of information asymmetries, valuation risk and shallow markets for heritage places.

The first two categories of failure can be rectified by engineering incentives that alter the cost/benefit equation for investment in heritage. This is typically administered through the taxation system.

The third category requires government to play the role of financier (or augment private finance), providing grants, loans and loan subsidies, or establishing pools of reusable financial capital.

**Tax expenditure**

Tax expenditure instruments work by deferring, reducing or eliminating an eligible entity’s tax obligation. Such instruments include deductions, rebates, abatements and credits.

These instruments have traditionally been popular because of a high degree of automaticity (the tax system is familiar and already has an extensive administrative structure built around it) and because revenue foregone has, in the past, escaped the same budget scrutiny applied to revenue spent.

Tax expenditure typically reduces either the tax base (as in the case of an income tax deduction, which reduces taxable income) or the tax liability itself (as in the case of an income tax credit). Specific types of tax expenditure that have been used to influence heritage conservation investment in Australia and abroad include:

• property tax abatement — either a discount on the rate of property tax payable, or the use of a different valuation formula for heritage-listed properties, that takes account of actual use rather than ‘highest and best’ or potential future use;

• income tax credit — allows income tax payers to offset a percentage of expenditure on heritage restoration against their tax bill. Such a scheme, *Tax Incentives for Heritage Conservation*, operated in Australia from 1994 to 1999;

• income tax deduction — two variants exist:
  - tax deductibility of donations to approved non-profit historic heritage organisations (deductible gift recipient status in Australian Taxation Office parlance). Of particular relevance is the tax deductibility of donations of property, which provides a flow of heritage capital to historic heritage trusts and (potentially) revolving funds; and
  - tax deductibility of the imputed value of property devaluation incurred as a result of entering into a conservation covenant (which could include
In effect this is simply a variant on donations of property, where the donor is deemed to have donated some value in his or her property to the co-party to the covenant; and

- various other concessions including, stamp duty exemptions, accelerated depreciation schedules, sales (or goods and services) tax exemptions and capital tax exemptions.

As the above list demonstrates, the category of tax expenditure hides a great deal of variety. Some of the concessions, for instance income tax credits and sales tax exemptions, directly encourage investment in heritage conservation. Others conserve heritage less directly, by encouraging owners to voluntarily submit to restrictions: property tax abatements (encouraging listing which in turn usually comes with a variety of statutory restrictions on modification to property) and tax treatment of property under a conservation covenant fit this category. Others, such as deductibility of donations, are even less direct, increasing the flow of funds to non-profit organisations, which are then assumed to use those funds in a way that conserves historic heritage.

Taxation measures are often considered to be beneficial because of their ease of use (taking advantage of the existing taxation system) and their relatively low visability. There are, however, a number of difficulties with taxation measures:

- Tax expenditure has drawn criticism for a lack of transparency compared with other forms of spending, such as grants or loans.\(^{37}\)
- Tax expenditures may not be as efficient to administer as they first appear. In particular, compliance costs for taxpayers may be high and revenue authorities may not have the organisational capacity to exercise the discretion that many policy instruments require. In the historic heritage context, however, eligibility is often tied to the listing status of the heritage property concerned, which goes some way to reducing administrative discretion and overcoming capacity issues.
- Tax expenditures may ‘confer windfall benefits, rewarding taxpayers for actions they would have taken anyway’.\(^{38}\) This is of particular concern for heritage conservation because, while a tax deduction for investment expenses may assist a community group in conserving a local hall, the same eligibility criteria may allow a hotel operator to claim the deduction for work done on a historic building (although it would have carried out the work even in the absence of the deduction).

Despite these potential disadvantages, tax expenditures may be appropriate in some situations. They have been used extensively in the past in Australia, continue to be successfully used abroad and benefit from substantial domestic and international experience and experimentation.\(^{39}\)

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\(^{37}\) The National Commission of Audit criticised tax expenditure on the grounds that it is ‘less transparent’ than positive departmental expenditure. This argument has been weakened at the federal level (which is responsible for the bulk of taxation) with the adoption of the *Charter of Budget Honesty*, which requires that Treasury account for revenue foregone as a result of tax expenditures.


\(^{39}\) National Incentives Taskforce 2004, op. cit.
Grants, loans, loan subsidies and loan guarantees

Grants, loans and their variants can be used to provide finance for heritage conservation projects. There are three reasons why government may provide funds to heritage stakeholders — to:

- encourage activities that would not otherwise occur because the incentives do not exist for the individual owner of a historic heritage place;
- correct capital market imperfections; and
- subsidise borrowers or other beneficiaries.

A case can be made that heritage conservation fulfils at least the first and second criteria. As discussed in chapter 2, imperfections in capital markets, including information asymmetries and valuation risk, may prevent potential investors in heritage from accessing private finance. Even if this is not the case, it could be argued that, to the extent that tax payers are willing to pay for heritage, using government revenue to finance heritage investment is in itself worthwhile (this must be the justification for grants, or else repayment would be expected).

Government credit programs present a number of difficulties. Like tax expenditures, credit programs may suffer from low additionality. It is expensive to monitor how funds are used, and even if public funds are used for heritage conservation, they may simply displace private funds that would have been used for the same purpose.

Importantly though, grants and loans are usually of a sufficient size to allow a reasonable level of discretion in their administration (unlike tax expenditures). This may allow the administering authority to reject applications for grants or loans where it is clear that conservation activities would occur anyway. Additionality problems can also be reduced by offering proportional grants, or requiring applicants to match public funding on a dollar for dollar basis.

Direct loan programs in particular can be difficult for government to manage. Government agencies rarely have expertise in areas such as credit risk analysis and compliance that are essential to running a successful lending institution. Furthermore, there may be problems of adverse selection, where private financial institutions reject applicants with a high credit risk, who then turn to government programs, resulting in a higher overall risk profile for government lending.

Loan subsidies and guarantees can overcome some of these difficulties, by co-opting the private finance sector to perform the technical functions associated with originating and servicing loans. They also have the advantage over direct loans of leveraging private finance, so that each dollar of government funding undergoes a ‘multiplier’ effect that results in several dollars of conservation spending.

A number of historic heritage credit programs operate in Australia, including:

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40 To some degree, however, these risks can be reduced through the provision of smaller loans: small loans are easier for the creditor to pay back, limiting the potential for default; and the smaller value of each loan limits the potential loss for government if any particular creditor is unable to repay their loan.

41 Loan guarantees invariably lead to problems of moral hazard, where either financial institutions are willing to take on excessive risk (knowing that they are protected by the loan guarantee) or individuals are more willing to default (suspecting that the government will be less willing to recover the debt that a bank would be). Such concerns are likely to be greater as loan guarantee schemes expand (i.e. rather than in the context of their limited use to date in Australian heritage circles).
grant and loan programs operated by the state heritage agencies — these are typically discretionary schemes where applications are judged against fixed criteria. Examples include the NSW Heritage Incentives Program (grants and loans),\textsuperscript{42} the Western Australian ‘Valuing Our State’s Heritage’ Grants\textsuperscript{43} (grants funded by the state lottery) and the South Australian State Heritage Grants Program (grants);\textsuperscript{44}

- similar schemes operated by various cities, including the City of Adelaide Heritage Incentives Scheme (grants),\textsuperscript{45} the Melbourne Heritage Restoration Fund (matching grants and loans)\textsuperscript{46} and the Brisbane City Council Community Grants (grants);\textsuperscript{47} and

- innovative loan subsidy arrangements including the Western Australian Heritage Loan Scheme (a partnership between various WA local councils and StateWest Credit Society).

**Revolving funds**

Revolving funds are an alternative mechanism for providing capital for heritage conservation. While principally a funding mechanism, they also rely on some degree of direct or indirect service provision and some degree of regulatory control.

Revolving funds follow a acquire–protect–resell model, in which properties are:

- purchased for sale in the open market, or acquired through bequests and donations;
- potentially restored to remediate damage and protect against imminent threats;
- protected through the use of legal covenants to ensure future use and development is heritage-compatible; and
- resold in the open market to sympathetic buyers (who are then bound by any attached covenants).

The idea for revolving funds originated as a way to conserve the natural environment (several such schemes exist in Australia) but it is gaining currency within the heritage community.\textsuperscript{48} Revolving funds offer several advantages over other comparable funding and ownership structures (such as the traditional National Trust model), including:


efficiency — revolving funds do not ‘lock up’ capital in heritage assets, allowing them to protect a larger volume of properties than an ‘acquire and hold’ trust;

increased equity, through reduced cross subsidisation — any loss of value attributable to heritage restrictions is borne by the fund when it resells the property, rather than by a private owner (this is a more equitable outcome, assuming the fund’s capital is sourced from the beneficiaries of conservation); and

reduced coerciveness — although a conservation covenant may itself be coercive, buyers purchase properties freely and in full knowledge of this encumbrance.

Revolving funds require start-up capital in order to acquire properties, and may also require maintenance funding for management and transaction costs (although depending on market conditions at the time, purchase and resale could be self-funding). Although philanthropy is an important source of capital for many funds overseas, government funding remains the foundation.

As a variation, the fund may lend money for the purchase and conservation of heritage properties. As the loan is repaid, the capital becomes available for investment elsewhere.

Revolving funds have been successfully used abroad for many years. An example of a successful Australian heritage revolving fund is provided in box 4.1.

Box 4.1

REVOLVING FUNDS FOR NATURAL HERITAGE — A SUCCESS STORY

In 1992, Trust for Nature (Victoria) established a revolving fund designed to ‘move areas of high conservation and biodiversity values away from land managers whose practices may be deleterious to the maintenance of these values to owners who positively maintain such values’. Initial capital was provided by a government grant of $250,000. A 1998 paper produced by the Department of Environment and Heritage highlighted a number of critical success factors from the experience of the fund:

• Support from the government of the day was a critical factor in a fund’s success.
• The fund targeted a niche market; a similar structure may not be appropriate in all circumstances.
• A strong network must exist to connect sellers and buyers with the fund.
• The administering agency must have skills and experience in conservation for input into purchase and sale decisions.
• Operating at arms-length from government resulted in individuals having greater confidence in the process.
• Non-government operation also allowed greater flexibility and simplicity in administrative procedures.
• Sympathetic buyers may require short term finance; on the other hand, considerable effort can be wasted where buyers are ‘sympathetic’ to conservation goals but lack the financial strength to complete purchases.

At the time of the 1998 study, the fund had purchased and resold over $0.6 million worth of environmentally significant land. According to the Trust for Nature’s 2003-04 Annual Report, the fund now holds assets worth $2.755 million.

4.3 Services

Some of the market failures associated with heritage conservation may be best addressed by government providing services directly, through departments of environment, heritage and other agencies. Direct service provision is the traditional model of delivering government policy. While less popular in recent times, it may still be appropriate where:

- there are political or cultural sensitivities which mean that society would not accept private ownership of the heritage asset;
- private markets would not develop for certain services; or
- direct provision is more cost-effective than other mechanisms.

The most obvious example of direct provision of services is government ownership and management of heritage properties.

Government ownership and management

In general, Australian governments do not seek to own or manage property. They may, however, own property for commercial reasons, or where ‘public interest’ considerations are involved. For historic heritage properties it is usually the latter category that is relevant. Public interest considerations relevant to heritage may include:

- symbolic significance — some historic heritage is of such a symbolic nature that private ownership would simply be politically unacceptable. For instance, many would consider private ownership of national icons such as Parliament House to be inappropriate;
- access — government ownership can ensure equitable public access to places which might otherwise be priced too high for broad access or closed to the public entirely. For instance, public ownership ensures public access to Melbourne’s Royal Exhibition Building (although it can still be use as a private venue); and
- compatible use — for significant public properties, government ownership may serve as a guarantee that any uses will be compatible (both physically and culturally) with the heritage value of the place. For instance, in private hands the War Memorial in Canberra could provide an appropriate venue for a department store, although many could consider this offensive to its heritage value.

Services that facilitate private ownership

In the majority of cases, where public ownership is not justified, the government can still provide services that encourage private ownership of historic heritage. These services are typically quite general, but may have particular significance where heritage is involved.

For example, land title registries are an established feature of property law in all jurisdictions with a well-developed system of private ownership. Nevertheless, particular features of the land title system facilitate ownership of heritage properties. Registration of covenants against a property (and the ability to search for such covenants) provide certainty to potential buyers about any restrictions that may apply. This provides the legal basis on which revolving conservation funds are able to operate.

**Services that facilitate investment**

Market failures in the primary market for heritage investment may prevent the development of secondary markets in heritage advice, heritage trades and heritage training. In turn, the lack of heritage services may discourage potential investors from owning and conserving/improving heritage properties. Even in the absence of significant market failures, it may be the case that the Australian market is too small to make the provision of certain services economic — particularly given that Australia has a smaller stock of historic built heritage than many other countries.

In the absence of private provision, the government may provide:

- technical advice — concerning techniques and materials used in heritage conservation work. The New South Wales Heritage Office provides such advice through its Technical Advisory Service;
- heritage conservation services — the government may directly employ heritage architects, buildings and tradespeople to work on government-owned conservation projects; and
- trade and professional training and accreditation — the government may provide (or subsidise) training in heritage skills. For instance, TAFE NSW offers certificate courses in heritage skills such as brickwork, carpentry, painting, plastering and stonemasonry.

**4.4 Regulation**

Regulatory policy instruments use laws or other government ‘rules’ to influence the way that people behave. Regulation essentially involves ‘control of behaviour by directive means, imposed by an authority asserting the state’s role to act when private behaviour may not be in the public interest’.

Regulatory instruments differ in their approach to other instruments in setting a requirement of action, and establishing negative consequences to not complying with this requirements (i.e. rather than purely setting an incentive for action, as with spending instruments).

Regulatory instruments are typically considered under two broad categories:

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prescriptive (i.e. ‘command and control’) regulation — whereby governments sets a prescribed level of a particularly activity in society, and prescribes particular action in managing this level. Command and control regulation is common for environmental problems, such as pollution, where the regulator tells the polluter how much can be emitted and how pollution should be controlled; and

- performance (our outcome) based regulation — where compliance is specified in terms of regulatory outcomes, rather than by prescribing a process for compliance. While command and control regulation prescribes how a business or individual should act, performance-based regulation sets objectives on the basis of outcomes.

There has been a shift in Australia in the recent period towards performance-based approaches to regulation, where appropriate — as recognised by COAG:

> Regulation should have clearly identifiable outcomes and unless prescriptive requirements are unavoidable in order to ensure public safety in high-risk situations, performance-based requirements that specify outcomes rather than inputs or other prescriptive requirements should be used. This principle should also apply to any standards that might be referred to in regulation.  

In effect, we have seen a preference for regulatory approaches that provide flexibility in compliance, and, where possible, reinforce markets in doing so.

**Regulation instruments for heritage conservation**

In the heritage context, regulation instruments aim to address the market failure that occurs when positive externalities from heritage places are not taken into account in private decisions of heritage investment. In the absence of government intervention, private owners of heritage places will invest in conservation to the point where the private return justifies the investment, but not to the level that recognises the social benefits associated with the heritage building.

While spending instruments seek to address externalities by providing financial incentives for greater investment in heritage conservation (by lowering the marginal cost of additional investment), regulation instruments more directly address externalities by requiring that the cultural and environmental value of heritage buildings are considering in heritage investment decisions (by setting requirements for, or restrictions on, particular actions).

Regulation of heritage conservation tends to be associated with the listing of buildings by various levels of government. It is important to note that listing of heritage buildings by government agencies is not, in itself, a regulatory instrument for heritage conservation. Listing is, however, the foundation of each of the four roles of regulation in heritage conservation, as it allows governments to identify the group of buildings or places, to which regulation will apply.

Listing of heritage buildings without regulatory controls, is effectively an information instrument, providing a signal to the market of the heritage value of the building. At this level, it is the foundation of many other policy instruments discussed in this chapter. In the regulatory context however, listing is used as a signal to governments to apply controls over development.

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In his study of the use of regulation in heritage protection, Throsby identified the following four main roles of regulation for the conservation of heritage buildings and places.

**Ensuring the existence of heritage buildings**

Governments use regulation instruments, such as conservation orders, to ensure that private owners of heritage buildings to not demolish heritage buildings. In this case, governments recognise the importance to the broader society of the existence of the heritage building, and over-ride the private owner’s rights as the property owner to demolish the building.

Possibly the most obvious move to a performance based approach in this regard is the use of tradeable development rights to ensure the existence of a heritage building. Tradeable Development Right (TDR) schemes are a planning tool that allows development pressure to be redirected from high value heritage places to other more suitable places. They operate by a planning authority designating the places that it wishes to protect and allowing these ‘donor’ property owners to forgo future development by placing a covenant on their title. In return, the property owners receive transferable development rights which they may sell to owners in non-designated places. Ideally, TDR programs create a win-win outcome by compensating the owners of conserved properties, permitting developers to profit from higher densities and retaining key heritage places for the benefit of the community at minimal cost to the government. In a heritage context the focus has been on providing transferable floorspace entitlements.

To be effective, a TDR scheme must:

- have some degree of scarcity and demand;
- have rights that are well defined, tradeable and enforceable;
- have sufficient buyers and sellers; and
- low transaction costs.

All such requirements have been met in the City of Sydney heritage TDR. In particular:

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It is also reasonable to suggest that the revolving funds is an outcome based approach, although the regulatory component is relatively small.

• the City of Sydney has two limits to floorspace in the inner city; with and without the purchase of TDRs. The demand for inner-city development space in Sydney has created a sustained demand for TDRs under the Heritage Floor Space (HFS) scheme; between 1990 and 2001, around 78 sales of HFS took place under the scheme accounting for 119,000 m². Sale prices varied, but averaged around $608 per square metre in 2000 and $450 per square metre in 2001, and

• the use of floorspace (measured in square metres) is an easily measured commodity and so its definition and protection is relatively straightforward and transaction costs kept to a minimum.

Regulating the conservation and use of heritage buildings

Governments can also use regulation to control the conservation and use of heritage buildings. This role recognises that the cultural and environmental benefits of heritage relate not just to the existence of the place (as addressed above), but also to whether the character of the building is maintained. Governments also seek to control to use of the place to ensure that is it in keeping with its cultural value. This type of regulation typically involves the requirement that government (usually local governments) approve any development of heritage buildings (identified through listing), or any adaptation of use of the building.

The rationale for regulation in this context is similar to that of government ownership of heritage places, but uses regulation (with the weight of legally enforceable penalties) as a means of imposing cultural and environmental values and preferences on private owners of heritage properties. In this way, regulatory instruments avoid the costs associated with ownership of places, effectively transferring the costs of restrictions on development and adaptation of use to the private owners of the place.

Regulating land use in heritage precincts

Regulation can also the land use in particular precincts, or zones, which are recognised as having heritage value.

Zoning by local governments divides a jurisdiction into geographically regions on the basis of land use. Zoning can provide benefits where the actions of some owners can cause spillover effects on their neighbours — both positive and negative. Zoning has most obvious uses in relation to separating industrial and residential land use, or zoning to mitigate noise or air pollution in relation to environmental externalities.

57 In contrast a Brisbane and Adelaide heritage TDRs have no effective limit on building heights and so there has been little incentive for TDR exchanges.
In the case of heritage, zoning can be used to capture potential positive externalities of heritage properties in particular neighbourhoods, and encourage greater investment in heritage properties in the region given the recognition that zoning provides. Zoning can also block land use proposals that would lessen the heritage value of the area (because it would not be consistent with the overall character of the region). In addition, governments can work to ensure that current zoning practices are not working against conservation of heritage building (e.g. in inner city areas where high density zoning is generally incompatible with older style heritage buildings).

**Setting decision making and approval processes**

The fourth role for regulation identified by Throsby is establishing protocols and processes which provide a system of ‘checks and balances’ for development of heritage buildings or places. This includes establishing requirements for public consultation and comment on potential development of heritage buildings, or changes within a recognised heritage neighbourhood.

**Limitations of regulation instruments**

Regulatory instruments are potentially very effective at altering behaviour by individuals or firms in society, given appropriate monitoring and enforcement with appropriate penalties for non-compliance. In addition, it is easy to see how regulation instruments are attractive to governments, especially local governments with limited funding to providing incentives or own heritage places. Regulation therefore appears, on the face of it, a relatively low cost instrument (aside from costs associated with administration, monitoring and enforcement).

It is important to note, however, the cost impost of regulation on impacted parties in society (primarily property owners), related to:

- compliance costs associated with the regulation, including administrative costs and time costs of needing to be aware of legal obligations; and

- opportunity costs for property owners, to the extent that the regulation requires them to move away from the most efficient use of their property (e.g. where owners of a commercial property are restricted in developing the place for its most profitable use due to heritage regulations).

The cost transfer aspect of regulation is a major concern of regulation, with governments listing and regulating of heritage properties while not directly incurring the costs of such action. As was the concern expressed by the British Secretary of State for the Environment:

I have a recurring nightmare that sometime in the next century the entire country will be designated under some Conservation Order or other. The people actually living there will be smothered with bureaucratic instructions limiting their freedom.

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The literature also points to concerns over the effectiveness of regulation for heritage conservation. While statutory listing, with the associated controls on development, is a direct instrument to protect heritage buildings from demolition or major re-development, it does not induce investment by the owner in conservation or maintenance of the building (beyond what the building owner would undertake for their own private benefit).

4.5 Summary

This chapter has set out a framework for considering policy instruments for heritage across four broader categories. Armed with this information, it is necessary to identify:

• the extent to which these instruments address those market failures discussed in chapter 3; and

• the respective strengths and weaknesses of the instruments on the basis of a set of broad criteria.

Such assessment is necessary to inform governments on which instruments are most suited to addressing specific market failures, and, in turn, how each instrument performs in addressing these market failures.

**How policy instruments address market failures in heritage**

Table 4.3 provides an indication of how each of the broad categories of instruments addresses those market failures in heritage conservation identified in chapter 3.

<table>
<thead>
<tr>
<th></th>
<th>Public Goods</th>
<th>Information Asymmetries</th>
<th>Externalities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information</td>
<td>Low</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Spending</td>
<td>Medium</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Services</td>
<td>Medium</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td>Regulation</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
</tbody>
</table>

As indicated in table 4.3:

• The public good aspects of heritage (due to difficulties in excluding use and benefits derived from heritage buildings or places), are most commonly addressed through:
  
  – spending instruments, which induce further private investment, or private ownership in a heritage building that would not have otherwise been a viable investment for the private sector; and

  – services instruments, such as ownership of buildings and places, which move the ownership, and therefore the responsibility for investment in conservation, to government.
Information asymmetry market failures in heritage are most clearly addressed through information instruments that provide signals in the market for heritage to assist potential investors.

Externalities in heritage are primarily addressed through:

- regulation instruments that ensure that the positive externalities of heritage buildings are taken into account by private owners. Regulation also addresses the risks of negative externalities in regions with particular heritage characteristic, through zoning;

- spending instruments, which address the presence of externalities through providing incentives for private owners to increase their investment in heritage conservation, to a level which takes into account the positive externalities of heritage which accrue to society (over and above the private benefits on which the private investment decisions is based).

Assessing policy instruments

While particular instruments have been designed with the intent of addressing market failures, it is important to recognise that, in practice, there may be limitations to these instruments meeting this objective. Equally, an instrument may be effective in addressing a particular market failure, but have other consequences that make it a less desirable instrument for governments. This section provides an initial discussion and assessment of the instruments for governments identified in this chapter.

Effectiveness. The fundamental criteria for assessing a policy instrument is effectiveness — whether an instrument actually works in addressing the problem is was designed to address. It can be assumed that an instrument that is not effective should not be implemented. That said, it is important to note that some instruments are more direct or imposing in nature, and therefore will rate higher on an assessment of effectiveness, but are also likely to have other consequences. For example, as shown in table 4.4, regulatory instruments are identified as being more effective than information based instruments, primary due to the different mechanisms of the instruments. Regulation sets requirements for public action, whereas information seeks to encourage particular public action through providing information for decision making. Spending instruments are considered to be moderate in their effectiveness. They, like information instruments, seek to encourage a particular public action, but this encouragement is based on financial incentives, which are more likely to achieve a response than information alone. It is important to note that the effectiveness of an instrument relies not just on the nature of the instrument, but also on the circumstances in which the instrument is implemented (whether is was applied in the appropriate context).\(^{61}\)

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Thoughts on the ‘When’ and ‘How’ of Government Historic Heritage Protection

- **Efficiency.** The efficiency criteria balances results against total (i.e. administrative and compliance) costs. This is important to consider, given that the most effective instrument may lead to considerable costs to individuals and firms in society. Instruments may also lead to considerable costs to governments in administration and management. Within the policy instruments assessed, efficiency is lowest for regulatory instruments, which involve greater compliance and opportunity costs on the private sector than other instruments, and government ownership or provision of services. Ownership is a less efficient instrument because governments are often not best qualified to administer and manage assets.

- **Equity.** Equity relates to the fairness of the instrument (in terms of the balance of costs and benefits of the instrument). It is also relates to the potential redistribution role of the instrument, with some instruments deliberately designed to divert resources towards those who lack them (where society views such imbalances in a negative way). For heritage instruments, equity issues are prominent in regulation instruments.

- **Manageability.** Manageable instruments require minimal effort by governments in terms of administration, monitoring and enforcement. Schuster terms this the ‘implementability’ of the instrument, referring to the ease or difficulty involved in operating programs. The more complex the instrument, such as with various levels of administration, eligibility or application processes, the more difficult it is to manage, and the greater the potential that the effectiveness of the instrument will be undermined. Manageability is a difficult aspect to assess at a broader policy instrument level, as the design features that impact on manageability can vary considerably with types of instrument (in most cases, ‘the devil is in the detail’).

- **Legitimacy.** Legitimacy for a policy instrument refers to the degree of political support the instrument has, which is necessary for its prospects for effectiveness. Some approaches are considered to be more legitimate than others, with the tendency for direct spending, ownership and support to be the highest.

Adopting these guides, table 4.4 provides a summary assessment of the range of policy instruments discussed in this chapter.

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It should be noted, however, that this is a generalised assessment, and assessments of individual policy interventions should ultimately be judged on their own merits.
Table 4.3

ASSESSMENT OF POLICY INSTRUMENTS

<table>
<thead>
<tr>
<th>Policy Instrument</th>
<th>Effectiveness</th>
<th>Efficiency</th>
<th>Equity</th>
<th>Manageability</th>
<th>Legitimacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promotion and technical advice</td>
<td>Low</td>
<td>Moderate</td>
<td>High</td>
<td>Moderate</td>
<td>High</td>
</tr>
<tr>
<td>Tax expenditures</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Low</td>
</tr>
<tr>
<td>Grants and loans</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td>Revolving funds</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td>Government ownership and management</td>
<td>Moderate</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Conservation services</td>
<td>Moderate</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Regulation</td>
<td>High</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>Moderate</td>
</tr>
</tbody>
</table>
Chapter 5

Selected observations about the choice of policy instruments for historic heritage

This chapter addresses a number of themes and trends associated with the choice of policy instruments.

5.1 The coerciveness of policy instruments

The concept of coerciveness

A recurring theme in the public perception of heritage protection is that governments are seeking to coerce them into behaving in a manner contrary to their own interests (even though coercion is a common feature with respect to land management more generally: land use controls, access requirements for people with disabilities, restrictions on land clearing, etc). This sense of coercion is particularly strong with respect to the regulation of one’s home given the common Australian understanding that a home is one’s castle in which they are master.

It is therefore relevant to consider the extent to which a policy instrument restricts group behaviour (i.e. is coercive) as opposed to merely encouraging or discouraging certain behaviours. Characterisation of instruments in this way is important because it measures the extent to which an instrument involves a deviation from reliance on the market as a mechanism to allocate resources and settle social roles.

Although almost all government action involves at least some degree of coercion, there are considerable differences among policy instruments in the extent to which they rely on it. This is apparent in table 5.1 (next page), which groups the various instruments of government intervention in terms of the degree of coercion they utilise. Thus:

• at the low end of the coerciveness scale are tax expenditures and public information campaigns. These essentially rely on the voluntary co-operation of individuals and groups for their effects;

• in a ‘medium’ category are a variety of instruments that deliver subsidies of various sorts; and

• in the ‘highly coercive’ category is regulation which imposes formal limitations on actions considered undesirable.

### Table 5.1
**POLICY INSTRUMENTS RANKED BY DEGREE OF COERCIVENESS**

<table>
<thead>
<tr>
<th>Degree of coerciveness</th>
<th>Policy instrument</th>
<th>Effectiveness</th>
<th>Efficiency</th>
<th>Equity</th>
<th>Manageability</th>
<th>Legitimacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Tax expenditures</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Promotion and technical advice</td>
<td>Low</td>
<td>Moderate</td>
<td>High</td>
<td>Moderate</td>
<td>High</td>
</tr>
<tr>
<td>Medium</td>
<td>Grants and loans</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td></td>
<td>Revolving funds</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td></td>
<td>Government ownership and management</td>
<td>Moderate</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>Conservation services</td>
<td>Moderate</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>High</td>
<td>Regulation</td>
<td>High</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>Moderate</td>
</tr>
</tbody>
</table>
It seems reasonable to hypothesise that, other things being equal, the more coercive the instrument, the more effective it is likely to be, and the more likely it is to yield redistributive results (as shown in table 5.1). These consequences flow from:

- the clear authority these instruments give governments to act;
- the tendency for coercive instruments, particularly regulatory instruments, to apply to a relatively large group of stakeholders (i.e. in comparison to the less coercive spending-related instruments which tend to address a relatively narrow group of stakeholders) and so provide a greater degree of horizontal equity; and
- the limited costs that governments incur in operating them since much of the burden is imposed on the public.

These characteristics mean that more coercive instruments are also more likely to generate political support among those most eager to engage government in a particular form of action. Indeed, these features may help to explain why many groups lobbying for protective regulation — whether it be the consumer, or the built or natural environment — has tended to insist on command-and-control regulatory arrangements, even though most economists have cautioned against the use of such instruments. After years of political struggle against often-powerful entrenched interests, advocates of protection typically want instruments that provide the maximum certainty that the goals they seek will actually be achieved. Less coercive instruments were often not able to provide this assurance.

The problem, however, is that coercive instruments have a number of prominent limitations:

- they often entail a loss of efficiency, for society at large if not for government. This has been a central theme of economic critiques of ‘social regulation’; the apparent efficiency this instrument enjoys from the point of view of government is misleading because it focuses exclusively on the government’s costs, which are relatively trivial, and overlooks the far more substantial compliance costs regulations impose on the private sector; and
- in some cases coercive instruments can also be more difficult to manage because they may require a relatively higher degree of ongoing regulatory oversight and control.

These limitations have lead to a shift to less coercive instruments that utilise market-like incentives and therefore make public use of private interest. Indeed, as noted earlier, this is precisely what COAG has suggested be the default approach:

Regulation should have clearly identifiable outcomes and unless prescriptive requirements are unavoidable in order to ensure public safety in high-risk situations, performance-based requirements that specify outcomes rather than inputs or other prescriptive requirements should be used. This principle should also apply to any standards that might be referred to in regulation.

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This approach builds upon COAG’s commitment to use less restrictive (i.e. less coercive) policy approaches wherever possible. In particular, in 1995 the Commonwealth, State and Territory Governments signed the inter-governmental *Competition Principles Agreement*, committing themselves to ensuring that new and existing legislation does not impose undue competitive restrictions unless:

- 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.

This commitment does not require all restrictions on competition be unilaterally removed. Rather, it requires consideration of the net public benefits, with the presumption that the restrictions will be removed unless the benefits to the community as a whole outweigh the costs.

To assist in conducting the cost-benefit analysis, sub-clause 1(3) of the *Competition Principles Agreement* provides guidelines for assessing the net public benefit. It sets out the circumstances in which the weighing up process is called for, and also some of the factors (i.e. on a non-exclusive basis) that need to be taken into account in making the decision. This is called the ‘public interest’ test.

It is most likely that any heritage-related restrictions will be justified under the public interest test on the grounds of:

- the efficient allocation of resources (i.e. correcting the market failures identified in chapter 3); and

- intergenerational equity.

Even then, in thinking about regulatory appropriateness, a preliminary issue is to determine the most appropriate regulatory style given that the least restrictive option should be preferred. There are three possible broad regulatory styles:

- prescriptive regulations — require the adoption of particular, often specific technologies and/or methods to ensure desired objectives or outcomes. Such requirements are often ensconced in approval processes;

- performance based regulations — specify desired outcomes or objectives but not the means by which these outcomes or objectives must be met; and

- process regulations — are essentially a method of achieving a performance outcome through specified procedures and processes used for specified operational areas. A process based approach emphasises a management approach that divides tasks into hazard identification, risk assessment, and risk control; where risk is defined as the product of hazard and the probability of its occurrence.

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66 Sub-cl. 5(1) *Competition Principles Agreement.*

67 Such regulation is often referred to as ‘command and control’ regulation.
In a heritage context: prescriptive regulations could entail specifying that a development cannot take place unless particular heritage features of a property are retained using defined tools, materials or techniques (i.e. specifying the inputs); performance based regulations would specify that development can take place as long as the ‘heritage character of the property is maintained’ (i.e. specifying the outcome); and a process regulation would specify what heritage conservation tasks would need to be satisfied so as to obtain development approval (i.e. specifying the process).

These approaches differ in the degree to which actions by regulated parties (e.g. the heritage properties and/or their owners) are specified by the regulator, and consequently how they are monitored and enforced.

The preferred type of regulatory style depends on the degree of homogeneity of the regulated entities (e.g. the heritage properties and/or their owners) and the ease with which their outputs can be measured. There are three broad possibilities:

• the easier it is to measure outputs (or well-correlated proxies for output), then the more likely performance based regulation will be a viable instrument for regulators;

• where the regulated entities are homogeneous (i.e. they have heritage characteristics and use patterns that are stable over time) the more likely prescriptive based regulation should be adopted, as it will be less costly to identify effective strategies for achieving the regulatory goal; and

• where it is not possible to easily assess outputs and the industry/users are dissimilar, then process based regulation should be preferred.68

This broad decision framework is represented in figure 5.1.

In policy-making circles there has been a temptation to simply advocate performance-based regulation as the default approach. However, heritage regulation is one policy area where this generalisation is less appropriate because:

- the level of homogeneity associated with heritage assets is often considerably lower than the homogeneity associated with, say, natural environment assets; and

- it is often difficult to specify the heritage outputs. For example, while the concepts of ‘condition’ and ‘integrity’ are used to classify heritage outcomes, there appears to be considerable potential for variation in interpretation.

In making these observations it is not being suggested that outcome-focused (i.e. market-based) policy instruments are inappropriate in all circumstances, but we are cautioning against making such approaches the default option.

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70 The similarities between historical and cultural heritage sites and natural resources, are often drawn on the basis of their value to the society as a whole, the non-use characteristics of the consumption of these goods (as discussed above). These comparisons mean that similar management and policy strategies are often implemented. It is important to recognise, however, how historic and cultural heritage differs from natural resources.

5.2 Who pays for heritage protection?

At present, heritage conservation (i.e. maintenance, repair and adaptation of use, etc) is overwhelmingly paid for by private interests (i.e. households, corporates and non-profit bodies) in a couple of ways:

- voluntarily — this may be as a result of:
  - a desire to have a heritage place to use. Such use may be in the form of ownership or through accessing the place. This is undertaken when the marginal benefit of such conservation exceeds the marginal costs (i.e. when it is in the owner’s interests to do so); or
  - some sense of altruism;

- non-voluntarily — through the process of listing, some owners will be required to expend resources in a manner that they would not choose to do. This may be either a positive requirement (e.g. to spend money to maintain the condition and integrity of the building) or a negative requirement (e.g. to not use the place in a way that they would otherwise choose to do).

As noted in chapter 4, heritage protection is also supported by spending by all three levels of government (see tables 4.1 and 4.2 details).

Concerns about cross-subsidies

There is a concern by some in the community that the current heritage arrangements result in a significant degree of cross-subsidy.

While difficult to define, the Productivity Commission has suggested that:

Cross-subsidies occur when one group of users pays more than the cost of the goods and services they receive, and the surplus is used to offset the cost of goods and services provided to other users.  

The existence of cross-subsidies can have an impact on the role and structure of government. If cross-subsidies exist, subsidised beneficiaries of heritage places (i.e. beneficiaries who capture use or non-use benefits) are likely to demand more heritage protection than they would otherwise. As Bird has stated:

An important advantage of pricing is thus to curb the demand for expanded public sector activities by making their real costs apparent to the prospective beneficiaries in a meaningful fashion. Correct pricing can alleviate … the pressures to expand government … If beneficiaries are not willing to pay what the expansion of a service will cost, then it should not be expanded; if they are, it should be …

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73 R. Bird 1976, Charging for Public Services: A New Look at an Old Idea, Canadian Tax Foundation, Toronto, p. 35.
A concern with the current arrangements is that involuntary payments by private landowners is being used to pay for non-use benefits captured by the community now and in future generations (i.e. the cross-subsidy is inter-temporal). In effect, owners of heritage properties provide a significant portion of funding for non-use benefits captured by other segments of the community.

However, this cross-subsidy may not be as broad or significant as it may first appear. This is because:

- the expenditure by the owner of the heritage place is incurred voluntarily (i.e. they are unconcerned that they cannot capture any spillover benefits);
- the costs associated with listing are likely to be a one-off occurrence:
  
  Where there is a fall in value associated with listing ... then this tends to be a one-time cost, normally borne by the owner of the building at the time of listing. After listing, the property market tends to inform itself of the implications of listing and factor this into value calculation.

- the community’s perception of the longer term costs associated with listing tend to be overstated, particularly if listing is part of a structured heritage strategy rather than an isolated one-off listing.

Generally, the removal of cross-subsidies is regarded as an attempt to charge people and organisations more directly for the goods and services they consume. By requiring a payment for goods and services supplied, they will better recognise the costs of the resources involved and gain an incentive to adjust their consumption in line with their willingness to pay. The cost of resources used in producing a product includes the foregone opportunity of using those resources elsewhere, so pricing based on costs helps to ensure resources are allocated more efficiently within the economy.

**Approaches to minimise cross-subsidies**

The question of who should pay for the cost of a public intervention is a complex one, but in general there are three approaches that can be employed:

- beneficiary pays — the ‘beneficiary-pays principle’, closely related to the ‘user-pays principle’, says that the beneficiary of a good or service should bear the costs of its provision. In effect, it encourages those who benefit from the good or service to recognise that there are resource costs involved, and it decreases the taxation burden on those who do not benefit;

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• damager pays — the ‘damager-pays principle’, drawn from the ‘polluter-pays principle’ in the environmental context, moves the financial burden onto those who are creating the ‘problem’ (i.e. in this case, degradation of heritage places). In effect, this principle reflects the commonly accepted position that someone who is causing problems for someone else should be required to make amends; and

• sharing costs according to the share of benefits — the ‘cost-sharing principle’ recognise that there can be multiple winners from some heritage protection, potentially including some benefits to the degraders.

While there is no definitively correct way to choose between these approaches (and others that may be suggested), in practice, the beneficiary-pays principle is the most widely accepted approach. However, it has a number of weaknesses in a heritage context, including:

• the practical difficulties that may be present in identifying beneficiaries and charging them (i.e. because of the public good characteristics of heritage as described in chapter 3); and

• addressing situations where ‘benefits’ arise through alleviating negative impacts on others (e.g. by conserving an industrial heritage place through the reduction in hazardous waste); and

• if beneficiaries paid for only the benefits they received, they may not recognise the possibility of spillover effects on others (e.g. positive externalities as discussed in chapter 3).

In these situations, it has traditionally been that the preference is to rely on taxation to fund interventions.

For example, grants may be provided to assist in the conservation of a heritage place on the basis that the taxpayers as a whole receive some non-use benefits from the place’s conservation. In this regard, in order to reduce non-use cross-subsidies, it is reasonable to suggest that local taxes (i.e. rates) would be most appropriately spent on places with local non-use benefits, state taxes on places with state or regional non-use benefits, and Commonwealth taxes used on places with national non-use benefits. Clearly, however, it will often be difficult to draw such clear distinctions.

However, as shown in box 5.1, market based instruments such as tradeable development right (TDR) schemes can also be structured to accommodate either the ‘beneficiary-pays principle’ or the ‘damager-pays principle’.
As noted in section 5.4, one approach adopted to protect heritage is the development of a TDR scheme. The impact of establishing such a scheme can be considered under both the ‘beneficiary-pays principle’, and the ‘damager-pays principle’:

- Under the ‘beneficiary-pays principle’, property owners who adopt practices or works that result in improved heritage outcomes would be awarded with heritage credits. Private individuals or corporations enjoying the benefits of heritage may buy these credits. For instance, tourist operators who rely on the conservation of a particular area as a basis for running walking tours may be willing to buy credits to ensure the maintenance of their business.

- Alternatively, if rights were established according to the ‘damager-pays principle’, property owners whose existing practices can be expected to cause heritage degradation would need to buy credits in order to continue their operations. The practicality of installing such a system of rights is limited by the ability of the property owners to pay for the credits, or to fund changes to their existing practices so they would no longer need to buy the credits. In the case of the Sydney tradeable floorspace scheme, additional floorspace is treated as a proxy for heritage degradation.

Under a beneficiary pays rights allocation, many of the beneficiaries of heritage conservation may ‘free ride’. The heritage benefits generated for the general public are unlikely to be matched by financial payment because of the difficulty of excluding people who don’t pay from enjoying the benefits. Therefore, a ‘damager-pays principle’ may be preferred.

However, it is not uncommon for governments to be key buyers of heritage credits to create beneficial heritage outcomes (i.e. with the government as a proxy for the community at large). This is exemplified by one type of economic instrument in the natural heritage context; the environmental auction. Under such schemes, governments allocate funding to achieve specific environmental goals. Members of the public are invited to bid for that funding in return for the implementation of projects that would help achieve the goals. The auction scheme is based on the ‘beneficiary-pays principle’ insofar as the government buys environmental improvements on behalf of the general public who enjoy them. This may be despite those who are being paid to provide the improvements being the same people who created the initial environmental degradation. The alternative is to institute the ‘damager-pays principle’ as the basis for rights determination but again, financial constraints faced by landholders may prevent society from achieving desirable environmental outcomes.

While it may be desirable to seek to adopt approaches that reduce cross-subsidies on efficiency grounds, care needs to be taken to not let this policy goal subvert the goal of heritage protection. To some degree, government heritage related interventions must involve cross-subsidies, even if just from current to future generations. In practice, however, government interventions are likely to also embody some degree of cross-subsidy between existing groups in the community so as to ensure the conservation of historic heritage places.

5.3 The need to rebalance the choice of policy instruments

A number of the observations from the previous sections suggest that effective heritage conservation management will require:

- the cooperation of different levels of governments (and even different agencies within the same level of government), and increasingly with private parties; and
- a range of policy instruments.
This is the case because the majority of heritage-related policy issues:

- arise as a result of more than one market failure; and
- no single layer of government has complete legislative authority, or ready-made ability to implement policies on the ground.

While undoubtedly a generalisation, it is reasonable to suggest that:

- local, State and Territory governments have tended to rely on regulatory instruments; and
- the Australian Government’s principal intervention has been through grant funding as it has had little direct control over heritage assets and, until recently, has had little regulatory power over heritage places.

The major problem is that there has been an over-reliance on heritage listing as an instrument to protect heritage places, without sufficient and necessary support from complementary policy instruments. In particular, the following problems are evident:

- the lists are not yet comprehensive in all jurisdictions, as the thoroughness of the listing process varies from state to state and/or one local government to the next. This can lead to last minute heritage assessments when development of an unlisted place is foreshadowed, and thus to adversarial situations and adverse publicity;
- the public is not sufficiently aware of what listing entails — heritage listing is seen as an amorphous concept. The distinction between different heritage lists, and between different classifications within lists, is lost on the community, with the result that people have little perception of the implications of listing; and
- the public has negative perceptions of the impact of listing — while listing may reduce the value of properties in some cases, the weight of evidence suggests otherwise.\(^\text{77}\)

Failure to adequately support listing with a comprehensive stocktake of the condition of Australia’s heritage places, funding support mechanisms/incentives, and effective public education programs has undermined the effectiveness of listing and listing’s public acceptance.\(^\text{78}\) Indeed, it is reasonable to suggest that the insufficiently supported emphasis on heritage listing has actually exacerbated existing information asymmetries. There is nothing wrong with listing serving as the centrepiece of heritage protection, and in fact it is important to get to the point where the lists are relatively comprehensive, but it must be adequately supported with a broader range of policy instruments.\(^\text{79}\)


\(^{78}\) While it is all to easy to suggest that more education is required, it is acknowledged that it may take a number of generations to change some public attitudes about heritage and the costs and benefits of its protection.

Without commenting on the merits of any specific recommendation, it is therefore pleasing to see that the Environment Protection Heritage Council (EPHC) has suggested that the ‘principal elements of best practice in incentives and other innovative policy instruments for historic heritage conservation’\textsuperscript{80} are a suite of policy instruments rather than any single approach:

i. Measures which provide effective support for owners of heritage places, provided either by the Commonwealth or States independently, or in partnership with Local Government, including:
   - Tax deductions for donations to approved funds;
   - Tax concessions for owners that enter into Heritage Agreements or other conservation covenants;
   - Tax rebates for qualifying private expenditure;
   - Land Tax remissions;
   - Local government rate rebates;
   - Grants;
   - Loan subsidies; and
   - Revaluation provisions for heritage listed places, based on the NSW and Victorian model.

ii. Improved town planning practices at the state and local levels that promote historic heritage conservation by:
   - reducing disincentives to conservation in the form of incompatible zonings; and
   - making imaginative use of planning incentives wherever possible in sympathy with other planning objectives.

iii. Inclusion of historic heritage conservation as an integral element of Commonwealth, State or Local sustainability policies or strategies.

iv. Provision of an effective network of specialist heritage advisory services.

v. Ensuring information, promotion and awareness activities are given a high priority, with cooperation between States wherever possible.

vi. Establishment of special funding sources for heritage programs to supplement consolidated revenue appropriations (such as a share of lotteries or gaming revenue; or a share of Land Tax or another suitable tax).

vii. Establishment of Revolving Funds for the acquisition, restoration and disposal-undercovenant of historic heritage places.

viii. Mechanisms for measuring the effectiveness of financial incentive schemes for historic heritage in Australia.\textsuperscript{81}

Given that most of these recommendations relate to the provision of increased incentives it is important that they are complemented by the full spectrum of potential government interventions (i.e. with governments acting to inform; spend; provide services; and regulate).


Part D

Appendices
Appendix A

Abbreviations

ACT Australian Capital Territory
COAG Council of Australian Governments
EPHC Environment Protection and Heritage Council
HFS Heritage Floor Space
NSW New South Wales
NT Northern Territory
OECD Organisation for Economic Co-operation and Development
TDR tradeable development right
WA Western Australia
Appendix B

Sources


