

Submission to the Public Accounts and Estimates Committee – Inquiry into findings of the Victorian Auditor General Reports 2007

by: Save Albert Park Inc. October 24, 2008

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This submission relates to the VAGO report 'State Investment in Major Events', presented to the Victorian Parliament in May 2007.

The main and most important of this report concerned the economic evaluation of the 2005 Formula One Grand Prix, and central to this evaluation was an existing economic impact assessment of the event carried out for the Victorian Government by the National Institute of Economic and Industry Research (NIEIR), and issued in August 2005.

The 2006 annual report of the Australian Grand Prix Corporation contained the following statement (Report of the Chairman, page 3):

The 2006 Formula 1 Foster's Australian Grand Prix continues to provide an outstanding return on the Victorian Government's investment in the event. The National Institute of Economic and Industrial (sic) Research (NIEIR) report on the 2005 event showed that a gross economic benefit of \$174.8 million was delivered to the Victorian economy as a result of the event, far in excess of the government's investment.

This statement appears highly dubious from the outset, as the NIER report provided an assessment of 'gross economic impact', not an assessment of net economic benefit.

VAGO's task was to challenge the statement, and to show whether or not the Grand Prix event did in fact produce an economic benefit which justified the government's investment.

VAGO carried out their task and found that '*... according to the study's best estimate costs exceeded benefits by \$6.7 million.*'

So, instead of producing an economic benefit of \$174.8 million, the 2005 Grand Prix produced a net economic loss of \$6.7 million.

The VAGO report also stated (page 37):
'... if costs exceed benefits there is a negative net social benefit and the project should be modified or not supported.'

Government reaction

This VAGO report should have demonstrated to the Victorian Government that the Grand Prix event does not justify further investment. However, in July 2008 the government announced that the contract with Formula One Management to stage an annual race in Albert Park Reserve had been extended to 2015.

This decision was made in the face of not only the VAGO findings but the annual operating losses, expected to be \$40 million in 2008 and escalating rapidly thereafter.

Event operating losses from 1996 to 2008 total \$160 million. By 2010 the cumulative losses will have reached about \$245 million. By 2015, the cumulative losses, that is the government 'investment' over the years, will exceed \$500 million. The race licence fee (payable to Formula One Management in US dollars) is a major negative economic effect and is now believed to be running at about \$A35 million a year, with annual increases of 10-15% cumulative.

As operating losses have sharply increased since 2005 (from \$13.7 to \$40 million), in line with falling attendances and corporate support, the net economic losses will also have escalated. The current bleak world economic outlook, with sharp cut-backs in corporate

sponsorship of sporting events, indicates that future Grand Prix events are highly unlikely to produce improved results.

Economic millstone

By extending the contract the Victorian Government has saddled Victorian citizens with a economic millstone. VAGO might have prevented this if its report on major events had been presented the way it should have been: as frank and fearless advice, authoritative, clear, and unequivocal.

Instead VAGO issued what amounts to a discussion paper on the subject, leaving the reader in limbo as to where the truth might lie.

The VAGO report

VAGO was provided with the opportunity of creating a definitive set of rules for the economic assessment of major events in order to provide proper guidance to governments on investment in major events. VAGO had the opportunity to engage the leading Australian consultants on the subject and to clearly and unequivocally state their findings and stand by them.

There is certainly argument among economists about some aspects of the evaluation of major events, but there is overwhelming agreement about the basic facts. One basic fact is that economic impact assessments, such as those carried out by NIEIR should not be used to guide decisions on investment in major events. This is because economic impact assessments do not consider the costs of staging the event, or the costs of providing services to the visitors whose spending creates the economic impact. The result is therefore always positive, and always misleading.

The report failed to set down such basis facts, and failed to provide an adequate glossary of terms. This meant that the government departments who should have been properly informed by the report could use their own interpretation of the findings and ignore the true implications.

The report gave the impression that it was produced not independently, but in partnership with certain government departments. The opinions of these departments were presented alongside VAGO's, and thereby given equal weight.

VAGO went some way to provide a critique of the NIEIR report, but it gave much space in the report to allow NIEIR to reply. It was self-evident that the NIEIR report was totally inadequate as a guide to government support of the event. The NIEIR report was limited by being only an economic impact assessment, and it contained unjustifiable assumptions, which VAGO identified (see pages 147, Section B4.6).

However, VAGO failed to point out that the NIEIR report contained a glaring error by including expenditure by interstate and overseas visitors on Grand Prix tickets (about \$10 million) in the total of 'economic benefits'. This expenditure appears in the race operating accounts and including it as a 'benefit' is double counting. VAGO did not repeat this error, but its report included expenditure by Victorians on Grand Prix tickets as revenue in the race operating accounts. As this expenditure is likely to represent spending switched from other activities within the state, it will have no impact on the economy. In a strict study of costs and benefits of the event to the community, it would not be considered as an offset to race costs.

The VAGO report presented its findings in such a way as to blunt and blur any messages it wished to convey. The 'In brief' summary sheet accompanying the report (which few readers would go beyond) the Audit findings were presented in a vague, generalised manner, There was no list of clear, strong recommendations.

The result of the cost-benefit analysis was excluded from the major findings, and presented under the heading '*Results of commissioned studies*'. The summary sheet reported that the cost benefit analysis showed that '*... according to the study's best estimate costs exceeded benefits by \$6.7 million.*' Not shown was an all-important follow-up comment, which was buried in the body of the report on page 37:

'... if costs exceed benefits there is a negative net social benefit and the project should be modified or not supported'.

The report appeared to be anxious to avoid offending the government and to provide supportive statements. For example, in Section 2.1 Introduction:

Since the 1990's the Victorian Government has supported major events such as large scale high profile sports and cultural events to enhance Victoria's competitiveness for the tourist dollar and to generate significant economic, social and cultural benefits to the state.

The major events strategy has been successful in a diverse range of events. These include:

- *sporting events such as the Formula 1 Grand Prix, the 2006 Commonwealth Games and the 2007 FINA World Swimming Championships.*

In Section 2.1, the following statement appeared:

As well as increasing Melbourne and Victoria's international profile, major events provide economic benefits to the state.

The VAGO report presented no evidence to support this statement

Most significant was the comment which led off the 'Findings' of the VAGO report in the Executive Summary (Section 1.2), and was repeated in the Foreword :

Major events have undoubtedly delivered economic value to Victoria.

What was meant by economic value?

Save Albert Park wrote to VAGO on August 29 requesting clarification as to what was meant by 'economic value'. This term was not included in VAGO's glossary of terms. Did it mean economic impact, or net economic benefit?

We received a reply from VAGO dated October 10 which did not define the term, but offered the following comment:

A positive economic effect however does not automatically represent a net economic benefit to the Victorian economy. An audit evaluation in the form of a cost-benefit analysis suggested a negative overall net benefit for Victorians from the 2005 Formula 1 Australian Grand Prix of \$6.7 million, using the most reliable data and best estimates for benefits and costs.

This statement introduced a new term, 'positive economic effect', but it seemed to make it clearer that the 2005 Grand Prix was an economic loser for Victoria. The statement should have been in the forefront of VAGO's report. However, the emphasis given to the statement that '*major events have undoubtedly delivered economic value to Victoria*' has let the Victorian government off the hook, and provided ministers with a most useful quote to justify the extension of the Grand Prix.

Despite these criticisms, the VAGO report has provided some very valuable information, and there may be some government agencies, and even some politicians, which will have good sense to take note.

Following is a comparison of the findings of the VAGO economic studies of the 2005 Grand Prix, and those of the 2005 NIEIR report for the Australian Grand Prix Corporation 'Economic impact evaluation of the 2005 Foster's Australian Grand Prix', August 2005.

	NIEIR	VAGO audit
Economic impact (increase in GSP)	\$174.8m	\$ 62.4
Net economic benefit	Not determined	\$ 6.7m loss
Jobs created	3650	400
State tax receipts	\$15.2m	\$3.5m
Economic impact on Australia	\$54.2m	\$1.9m
Commonwealth tax receipts	\$9m	\$2.7m

The VAGO report was also notable for its inclusion of an abusive letter directed to the Auditor-General by the Executive Director of NIEIR, Dr Peter Brain.

Conclusion

The VAGO report was the first attempt in Victoria to conduct a comprehensive cost-benefit analysis of a major event. This was a great opportunity to establish sound economic assessment procedures for the guidance of governments. We are very disappointed that VAGO presented its findings in a manner which has allowed the Victorian Government to ignore the findings, to extend the Grand Prix contract, and even to use a quote from the VAGO report to justify its actions. Also there appears to have been little or no notice taken of VAGO's recommendations regarding pre- and post-event evaluation.

References: This submission has been informed by many sources, notably the ACT Auditor-General's *Performance Audit Report, V8 Car Races in Canberra – Costs and Benefits, July 2002*. This report appears to be an exemplar of a independent, disinterested audit, designed to educate and guide a government.

Also essential reading were the 2005-2006 papers by Larry Dwyer, University of NSW, Peter Forsyth, Monash University and Ray Spurr, University of NSW: *Economic Impacts and Benefits of Sports Events: A CGE Perspective*, and *State Investment in Major Events: Integrating CBA with Economic Impact Analysis*.

Signed: Peter Goad, President,
 For: Save Albert Park Inc.
 Direct contact: Tel/fax 9699 7932 email: pwgoad@melbpc.org.au