



## Chapter Six

# Assessing the Department's Activities against the Roles of Government

### *What Rationales underlie the Government's Industry Programs?*

The following roles for government in managing the economy are adapted from Jackson (1980):

- Provide the legal framework, eg enforce contracts and recognise property rights.
- Stabilise the economy, eg minimise the impact of the business cycle.
- Maintain the efficiency of the economy by correcting market failure.
- Spend funds and redistribute income to address social issues.

The first two roles are outside the scope of the inquiry. The second clearly so, given it is the responsibility of the Commonwealth Government and the Reserve Bank. In respect of the third, the Committee has already stated the initial criterion for industry programs should be whether they improve economic efficiency. As noted earlier, four of the Department's eight assistance activities identified by the Committee have this goal.

The Department's mission is to advance the economic development of New South Wales and bring new business to the State. The Committee is of the view the Department can get the best value for money from its finite budget by improving the efficiency of the State economy. DSRD should make addressing market failure (see chapter four) its main priority.

The Government has also given DSRD a role in addressing social issues, in particular the effect of structural change on regional NSW. The Government's Directions Statement, *Rebuilding Country New South Wales* (1998), states the Government is prepared to offer strategic intervention because it believes markets alone cannot deliver capital and resources on a fair basis. The remainder of the Department's activities often relate to social issues in the regions and can be justified on this ground:

- Community growth strategies are designed to give guidance to regional communities on directions for future growth and how it might be best encouraged.
- A substantial proportion of the attraction and retention of economic activity has occurred in regional NSW.

The report will now examine the Department's activities that cannot be justified on either equity or efficiency grounds.



### *An Agreement to Reduce Bidding Wars*

As discussed earlier, Governments continue to provide financial incentives to attract investment because they are concerned they will miss out on investment, even though it is driven by market access, inputs, infrastructure, and the standard of government. A solution proposed by the Industry Commission (1996) was agreement by the States and Territories to stop this activity. Preliminary agreement on this issue was reached in 1995.

#### **Leaders' Forum, November 1995**

The meeting was attended by the Premiers and Chief Minister of the Northern Territory. Part of the communique from the meeting concerned industry assistance and bidding wars. The relevant passage read:

“Government policies to attract business investment to locate in individual States and Territories are an important aspect of competitive federalism. Premiers and the Chief Minister agreed that the most effective form of competition is the creation of an efficient business climate in each State and Territory, consistent with the commitment of the States and Territories to micro-economic reform.”

“Premiers and the Chief Minister agreed that any competition between the States and Territories for industry investment should be based on their respective established regional and strategic advantages rather than on financial incentives which distort such advantages.”

“Leaders noted that a forthcoming report of the Industry Commission may assist further consideration of this issue.”

Despite this start, progress has been limited. At the hearings, Treasury gave the history of the proposal:

**Mr JORDAN:**<sup>11</sup> The response of the Commonwealth Government to that inquiry report was, first of all, to delay its release far beyond the constitutional term in which it is supposed to do it - I think there was something like an eight-month delay before it was released - so they were in breach of their own guidelines in that regard. When it was released they took no action. It was released in 1996. As a result, in early 1997 we raised this matter in the Heads of Treasuries Forum to seek Commonwealth action in terms of brokering an agreement along those lines which would have avoided all the need for the sort of fund you are talking about. The other States were not at all in favour of this.

The meeting of the Australian Industry Ministers on 2 February 2000 discussed investment attraction, but no firm action was taken to restrict State activity. Attachment A from the meeting's communique is entitled “Operating Guidelines for

<sup>11</sup> Director Economic Strategy, NSW Treasury, transcript of hearing, 24 May 2000, p 8



Commonwealth, States and Territories on Investment Promotion, Attraction and Facilitation.” It states:

The principle role of the State and Territory agencies is to attract investment into their respective jurisdictions and to facilitate such investments in so far as State approvals and State interest considerations are involved.

By referring to “State interest considerations,” the Guidelines permit States to continue offering financial incentives to attract investment and special events.

However, in March 2001 the NSW and Victorian Governments announced agreement on reducing secret bidding wars.<sup>12</sup> The two States have agreed to do this through the formation of a Victorian/NSW Government working party on investment. Through the working party, the Governments will develop an action plan to:

- Establish protocols to share information on investor approaches (having regard to commercially sensitive information) on a case-by-case basis to eliminate unnecessary bidding wars and contain financial incentives;
- Share information on investment evaluation methodologies; and
- Examine opportunities to co-locate Governments’ overseas business offices and share resources to attract new international investment and events to Australia.<sup>13</sup>

The Committee would like to congratulate the Government on making these initial steps in addressing bidding wars. However, in its submission, the Department referred to previous efforts in the US to halt bidding wars through the use of guidelines. These failed because no consequences were attached to following the guidelines and the States were tempted to offer incentives to attract investment. Any arrangement in Australia would need to be reinforced by some sort of penalty (for breach) or benefit (for compliance).

The best outcome for both New South Wales and the rest of Australia is for an agreement to be developed to reduce bidding wars. The Committee wishes to provide every encouragement to the Government to build on its present arrangement with Victoria.

### ***Alternative Action in the Absence of an Agreement***

It is New South Wales Government policy to provide financial incentives to attract and retain economic activity in regional areas to redress social imbalance between Sydney and the rest of the State. The Committee is precluded from examining Government policy under the Public Finance and Audit Act 1983. However, the

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<sup>12</sup> Field, “Rival States call poaching truce” *Financial Review* 27 March 2001, p 3

<sup>13</sup> Information Paper presented by the Hon M R Egan, NSW Treasurer and Minister for State Development, to the Industry Ministers’ Meeting of 27 March 2001



Committee would like to note unemployment rates have been higher outside Sydney, as the following table shows.

**Table 7: Unemployment in Regional New South Wales**

Region	Unemployment Rate in May(%)		
	1998	1999	2000
Sydney MSR	6.2	5.2	4.6
Balance of NSW MSR	9.6	8.5	7.1
Gosford-Wyong SR	8.3	6.2	6.4
Hunter SR	10.2	9.2	7.5
Newcastle SRS	10.7	9.4	7.7
Illawarra & South East SRs	9.2	8.6	6.9
Illawarra SR	11.1	9.2	7.0
Wollongong SRS	12.3	7.5	6.8
Richmond-Tweed & Mid Nth Coast SRs	14.0	12.9	9.9
N'thern, Far West, North Western & Central West SRs	7.2	5.0	7.2
Murray-Murrumbidgee SR	7.0	9.0	6.5

Source is ABS, Cat No 6201.1, May 1998 and May 2000. Abbreviations are: Statistical Region (SR), Major Statistical Region (MSR) and Statistical Region Sector (SRS - part of a SR).

The Committee notes the Government has taken a policy decision to provide incentives to attract investment and economic activity into regional NSW. In relation to Sydney, however, the Committee has already noted providing such incentives is inefficient. Further, any benefits to New South Wales from using these incentives will be lower where the alternative demands for the resources are higher. For example, unemployment is lower in Sydney compared with the rest of the State so the benefits of providing incentives for investment are reduced. Accordingly, the Committee proposes DSRD no longer use such incentives to attract or retain economic activity to Sydney and divert the funds to this activity in regional NSW.

### **Recommendation 1**

In the absence of an inter-state agreement on financial incentives to attract investment, DSRD discontinue this activity in Sydney and divert the funds to investment attraction in regional NSW.

### ***Networking Assistance***

#### Overseas Trade Missions and Market Visits

The Department operates these trips for small and medium enterprises. By giving selected firms some initial experience in exporting, the aim is they will continue to



do so in the future. This program has two components: the overseas trip, and then funds to offset certain costs. The financial assistance is limited. It is capped at \$5,000 per firm, given on a dollar for dollar basis and can only be used for business matching, marketing materials, freight for samples and translation.

Although the trips give the firms involved a commercial benefit, they are also educational in nature. Exporting is a practical affair, and the best way of learning how to do it is probably through experience. The Committee accepts that accompanying firms overseas is a reasonable way of achieving this objective. In addition, some countries will only approve imports if the exporting firm has visited the country on a government-sponsored trip.

However, the provision of financial assistance is not warranted, given the firms involved are already gaining valuable experience, expertise and contacts from the trip. In fact, the Committee is of the view the firms involved on the trips should cover the cost of these visits. This will test whether the businesses value this Government service. To maximise the value of the trips, DSRD should base the itineraries on consultations with firms.

**Recommendation 2**

DSRD discontinue providing financial assistance to firms on overseas trade missions and market visits, but instead ask the firms to cover the trip's costs. The Department should also use private sector input in planning the visits.

Incoming Buying Missions

The Department also arranges for local firms to meet missions from overseas. The Committee acknowledges, if other countries wish to send trade missions to Australia, DSRD should make the most of the opportunity.

In order to get the most out of these occasions, DSRD should follow basic program design rules. The Department should advertise the trip, ask firms to apply, and select the best (ie, a competitive tendering arrangement). Because the firms selected stand to make profits from being involved with the mission, DSRD should seek to recover some of its costs. The simplest arrangement would be to charge participants a flat fee.

**Recommendation 3**

DSRD competitively tender for participants in incoming buying missions. DSRD also charge participants a fee.

***Assistance to purchase Business Advice***

The relevant programs here are the Small Business Expansion Program and the High Growth Business Program. They have a total expenditure of approximately \$2



million pa. Assisted firms are given grants on a dollar for dollar basis to purchase consultants' advice.

As noted in chapter four, education is often regarded as a positive externality. However, although this assistance might be regarded as education, the benefits of this program are tightly focussed on the assisted firm through increased profits and the externality is relatively small. Therefore, the Committee does not consider these programs to improve the efficiency of the economy.

In addition, the programs do not address equity concerns in regional NSW. For example, they are not mentioned in the Government's policy document, *Rebuilding Country NSW*. Given there are neither equity nor efficiency grounds for the programs, the Committee is of the view they should be wound up.

#### **Recommendation 4**

DSRD should discontinue programs that fund firms to purchase business advice from consultants (currently the Small Business Expansion Program and the High Growth Business Program).



## Chapter Seven

### Measuring the Department's Performance

#### *How is the Department's Performance Currently Measured?*

##### Budget Papers

The 2000/01 Budget lists only one program for the whole of the Department, which is "Development of the NSW Economy." The outcomes include jobs and investment facilitated for metropolitan and regional projects, growth in turnover of firms assisted, jobs created by Business Enterprise Centres (now called Small Business Service Centres) and import replacement. Outputs include the number of metropolitan and regional projects facilitated, visits to the Country Embassy, hits on the Department's Internet site and the number of small business clients.

The Committee is concerned the different roles of the Department are not reflected by one overall program. DSRD has two main functions: to improve the efficiency of the economy and to help regional NSW adjust to economic change. The Budget papers should list these as separate programs, with individually tailored outputs and outcomes.

#### **Recommendation 5**

Treasury to change the presentation of the Budget papers to present DSRD's economic efficiency and social roles as separate programs with individually tailored outputs and outcomes.

The Committee is also concerned about the outcomes in the Budget papers. As noted earlier, the value of attracting an investment to NSW should be calculated by reference to what economic activity would have occurred without intervention. Because the circumstances of each investment vary so widely, this adjustment would need to be done by examining each project individually.

The same principle applies to the outcome of increased growth of small and medium business clients. The Department selects these firms on their promising future, so they would be expected to grow strongly anyway. Statistically, a good way of extracting effect of the program would be to create a control group and compare its average performance with the assisted firms' growth. However, members of the control would be concerned about being denied assistance for an experiment.

An alternative would be to look at the growth of the selected firms in the year prior to them being assisted. Any increase the Department can achieve over the previous year's growth could be attributed to it after adjusting for any changes in the overall economy. For example, if GDP growth dropped by 2% between the two years, then it could be expected growth of the assisted firms would be similarly affected.



### Recommendation 6

If the Department continues with its Small Business Expansion and High Growth programs, DSRD use the assisted firms' growth rates in the year prior to assistance as a performance indicator. These comparisons to be adjusted for differing growth rates in GDP between the two periods.

#### Annual Report

The Department's 1999/2000 Annual Report lists its objectives and results for the financial year. It is essentially a list of outputs. For example, under the objective of developing enterprise, the report gives the following:

**Table 8: DSRD's Performance Indicators for the Objective of Developing Enterprise**

Program Area	Key Results and Achievements
Supporting Small and Medium Business	<ul style="list-style-type: none"> <li>Assisted 195 firms with business development projects.</li> <li>Conducted 8 Welcome to Business in NSW Seminars for recently arrived business migrants.</li> <li>Small Business Advisory Centres conducted 26,970 client contacts and responded to 103,230 enquiries.</li> </ul>
Aboriginal Business Development	<ul style="list-style-type: none"> <li>Maintained the Aboriginal Business Link Program to help Aboriginal businesses qualify for the Department's other programs.</li> <li>Organised the 1999 Aboriginal Employment and Business Awards in partnership with other agencies.</li> <li>Published three editions of the Aboriginal Business Newsletter, which was distributed to over 2,000 Aboriginal businesses.</li> </ul>
Women in Business	<ul style="list-style-type: none"> <li>336 women participated in the Women in Business Mentor Program.</li> <li>Extended the Program to Armidale, Albury, Port Macquarie, Illawarra and the Central Coast.</li> </ul>
Embracing Electronic Commerce	<ul style="list-style-type: none"> <li>Over 400 companies participated in initiatives encouraging greater access to and use of electronic commerce.</li> </ul>
Improving Access to Government Procurement	<ul style="list-style-type: none"> <li>Small IT companies' products and services showcased to major private and public sector purchasers.</li> </ul>

Source: DSRD Annual Report, 1999/2000.

The concern is there are no outcomes by which the public can determine the Department's effectiveness. Examples of possible performance measures include:





- As a result of the e-commerce program, what proportion of participating firms later established a web site, or put an ordering facility on a site they already had.
- What proportion of attendees at Welcome to Business in NSW seminars established firms and what proportion changed a business decision as a result of the Seminars.
- As a result of the Women in Business Mentor Program, what proportion of attendees changed their business strategy.

The only place where outcomes are discussed is for investment attraction programs. Information is usually reported on the number of projects facilitated, investment totals and total jobs. The comments made in relation to the Budget Papers on these claims also apply to the Annual Report.

#### **Recommendation 7**

DSRD develop meaningful performance indicators for its programs. These performance indicators be published in the annual report and budget papers.

#### The Benchmarking Study

In May 1998, DSRD completed a benchmarking study which compared it with other development agencies in Australia and overseas. Some of these agencies also handle tourism development and other functions outside DSRD's scope. The resources given to these functions were removed from the aggregates to provide comparable figures. Data for 1996/97 were used. The main results from the study were summarised as follows:

**Table 9: Results of DSRD Benchmarking Study**

Agency	Investment Facilitated per Unit of Budget Expenditure (multiple)	Budget Expenditure per Job Facilitated (\$)
DSRD	32	11,973
DSD, Victoria	16	23,077
Welsh Development Agency	15	24,077
Queensland	10	55,294
Scottish Enterprise	6	85,764
South Australia	3	23,263
Ontario	NA	14,392
Irish Development Agency	NA	29,732

Source: DSRD submission, citing Benchmarking DSRD with Similar Interstate and International Organisations, DSRD, May 1998.



This table presents the Department in a positive light, as DSRD has the highest investment-expenditure ratio and lowest cost per job created. However, this comparison does not consider the basic attractiveness of NSW compared with other locations.

For example, NSW has most of Australia's bank head offices, regional headquarters and international business traveller arrivals. It also has the largest State economy. This must give it a head start over other States. The Committee is of the view this study only reflects the reality that NSW needs to offer less to investors, if anything, to attract them here.

#### Comparisons with Total Outcomes for NSW

The DSRD submission compared the jobs and investment generated by the projects it had facilitated from 1992/93 to 1997/98 with the Australian Bureau of Statistics' measure of total investment and jobs growth in NSW over that time. The Department claimed it had facilitated 19% of NSW's new business fixed investment and 20% of all new jobs.

The Committee is concerned DSRD has overstated its contribution to economic growth. As stated earlier, the Department should compare its achievements with what would have happened in NSW without its intervention. Further, many proponents have a limited number of suitable locations, so there is a chance these firms would locate in NSW anyway.

Finally, the Department's analysis does not include cases where jobs were created, but were again lost when an assisted firm closed down. This is especially the case with micro and start up firms, which have a large failure rate in the first few years. DSRD needs to evaluate its actions on a medium to long term basis, including the long run success of start-ups it has assisted.

#### **Recommendation 8**

As a performance indicator for investment attraction programs, DSRD discount investments in relation to alternative activities and the likelihood the project would have located in NSW anyway.

#### ***Internal Comparisons within the Department***

Although the Department might develop performance indicators and targets for its programs, it is difficult to determine whether a particular target is reasonable or achievable. In order to help establish some more objective benchmarks for the Department, the Committee considers DSRD should, where appropriate, establish internal business units and compare performance between them, given the staff and program funding available to each.



This approach would be most practicable where the divisions are homogenous, so comparisons between business units are meaningful. The obvious candidate for this is the Investment Division. The Department could create five business units (from approximately 25 staff), each with its own budget, and determine which unit performed best.

When each unit claims a “win” for New South Wales, the claim is independently valued with a final audited “value index” declared. Any performance measure will have problems. However, provided each unit is treated equally in determining the “value index” of their claim, the performance of each unit can be compared, creating competitive tension.

Current claims of victories for New South Wales are shrouded in mystery, not independently audited and appear designed more for press release than the honest economic amelioration of the State.

DSRD can provide incentives to staff for this initiative by giving internal awards and prominence for high achievers. The advantages of this scheme include:

- It places extra pressure on staff to seriously consider whether a project really warrants financial assistance. The more jobs and investment they can generate without assistance will put them ahead of other business units.
- The Department will also be encouraged to determine the relative effectiveness of staff against attraction funding. It may be more efficient to reduce the financial incentives and increase staff, or vice versa. This has not occurred to date.

The committee remains concerned performance measurement is difficult in business development. Consequently, the Committee is unconvinced about any of the Department’s performance claims and measures. As performance will always be difficult to measure, another option to ensuring performance is to create a structure conducive to it. Creating separate units engaged in the same activity is one means of generating a competitive dynamic where results can be compared.

**Recommendation 9**

DSRD establish five business units, complete with their own budgets, in the Investment Division. DSRD provide internal awards and recognition to the business units that perform the best. DSRD publish a summary of these internal comparisons in its annual report.

***Evaluations***

The Mortimer report (1997) noted that reviews of business programs have been *ad hoc* and use inconsistent methodologies. It recommended reviews be carried out regularly according to an accredited process. It suggested a review cycle of five years for programs and three years for sub-programs.



The Committee requested information on nine programs from the Department, including reviews of programs. Four of the programs in the sample are relatively new, and are not yet due for evaluation. DSRD has completed reviews of the other five programs, but the Committee is concerned three of these reviews were insufficient. For example, the Department only used participant surveys to review the Regional Business Development Scheme. This review was discussed in evidence:

**Mr CULLEN:**<sup>14</sup> ... In terms of how we look at some of that feedback, we have a survey of a whole set of companies that we do twelve months after drawdown of assistance. The sort of things that we are looking for from that survey is what they thought our service was like, and generally, if you wanted a bit of a view on that, generally the service was okay, but there are always areas of improvement, and we certainly look to pick those up.

Most importantly, whether the location is working. I have got to say one of the really good feedbacks is that about 85% to 90% of the firms we surveyed actually say they made the right location decision. That is really important to us, because getting someone to the wrong location is actually - that is the antithesis of what we are trying to do.

**Mr GLACHAN:** On that survey issue, you only survey the ones who decide to go ahead with something, you do not survey the ones who walk away, do you?

**Mr CULLEN:** Well, in term of surveying people that we have given money to, which is part of the service obviously, they are people who have drawn funds twelve months after, and what we are trying to do is match what they said they would do with what they actually did.

**Mr GLACHAN:** But it is a bit of a self fulfilling prophecy, if you ask someone who have been beneficiaries of the system whether they like the system. You do not ask the ones who walk away. It is not a good cross section, it is not representative of the service you are providing, is it?

**Mr CULLEN:** I think in terms of the service you provide, in terms of the financial assistance end, it is really the only benchmark you have got about if they meet their targets, and whether in fact the service is good, and obviously some of those companies close as well. So it is not just a situation there, but generally we get feedback from firms --

**Mr GLACHAN:** You are not going to catch the guys who walk away, are you, the ones who say --

**Mr CULLEN:** Not in this sort of survey, no, but we do capture some of those at the front end in terms of, you know, if someone tells us we stink, they will tell us front end, and they usually write a letter to someone. So you do capture those sorts of complaints and things as well...

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<sup>14</sup> Executive Director Regional Development, DSRD, transcript of hearing, 27 April 2000, p 57



Surveys of clients are only one component of a proper review. The Committee proposes DSRD implement the Mortimer Report's recommendations in relation to program reviews.

**Recommendation 10**

DSRD comprehensively evaluate its programs on a three to five-year cycle. Reviews should use accredited or widely acknowledged procedures and involve external expertise.



## Chapter Eight

### Should Business Assistance be Commercial-In-Confidence?

Although DSRD discloses assistance for programs involving community groups and councils, it provides very little disclosure of its assistance to businesses. The extent of disclosure is usually:

- the names of some individual firms that have been assisted;
- the number of firms assisted under a particular program;
- total expenditures for overall program areas in the financial statements; and
- totals of jobs and investment facilitated.

Most of the previous reviews in this area, including that by the New South Wales Auditor Office, recommended details of assistance be published. The Committee agrees with this approach:

- The generally accepted principle about public money is governments should be accountable for how it is spent. As the WA Chamber of Commerce and Industry noted, “the price of dealing with the government is to deal with the public.”<sup>15</sup>
- Greater secrecy increases the possibility of corruption.
- Non-disclosure reduces the need for DSRD to show it has bargained well.
- Firms adversely affected by assistance to their competitors are unaware of government actions affecting their profitability.
- It appears some recipients of assistance publish details on assistance received from NSW.<sup>16</sup>
- Tourism NSW publishes grants made to attract special events in its Annual Report. For example, in 1999/00, it paid \$1.26 million for the NFL American Bowl, \$200,000 for the Bledisloe Cup, and \$300,000 for the Greg Norman Holden International.
- Other Australian Governments publish various industry assistance details:
  - The Northern Territory publishes details of all assistance.
  - WA publishes details of all R&D assistance and gives the total amounts paid under its business development programs, including the number of firms assisted.

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<sup>15</sup> WA Public Accounts and Expenditure Review Committee (1996), p74

<sup>16</sup> The Director General of DSRD stated in evidence he had heard of this practice without knowledge of examples, transcript of evidence, 3 May 2000, p 119



- Victoria provides details of all industry and enterprise improvement grants. Firms that receive investment grants are listed, including the program total.
- The Commonwealth publishes the details of assistance given under its R&D Start Program.

The Committee found support during hearings for the disclosure of assistance:

**Mr COLLIER:** ... The Department of State and Regional Development generally does not disclose specific information about direct industry assistance. It has advised the Committee that that is partly due to commercial in confidence. What is your organisation's view, the BEC's view, regarding the current level of information provided by the Department of State and Regional Development?

**Mr MOIN:**<sup>17</sup> I think it leaves a lot to be desired.

**Mr COLLIER:** Why do you say that?

**Mr MOIN:** Well, this is public money we are talking about. It is not transparent. It cannot be if there are issues of commercial in confidence. Lawyers deal with commercial-in-confidence matters every day. They can be overcome if at the time of engagement you say to a person, "The assistance that we as a government will be providing to you will be made public. If you do not like it, you do not get the assistance." I really cannot understand why there is any necessity to hide behind the cloak of commercial in confidence. If someone does not want government assistance, then they should find private assistance.

DSRD's arguments in favour of confidentiality are examined below:

### *Commercial Sensitivity*

DSRD is concerned publishing package details would reveal too much about a client's business plans and financial position to the advantage of that client's competitors. Its submission states on page 9:

...publication may prejudice the position of a particular company. Publication would expose a company's forward business plans, its cash flows and its financial position. Not unnaturally, companies are concerned to deal with the Department only on a commercial in confidence basis.

The Committee does not accept this argument. Firstly, all of a client's initiatives would be physically apparent by the time the project was operating. Any firm in that industry would be able to make a reasonable assessment of the client's operations. However, the Committee accepts details of assistance should remain confidential while the proponent is still putting the project together. For example, if the assistance was announced while the proponent was still trying to purchase a site, it could place that firm at a disadvantage.

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<sup>17</sup> Chairman Business Enterprise Centre Limited, Armidale, transcript of hearing, 28 April 2000, p 78



The Committee is concerned there may be some confusion about the extent of disclosure being envisaged. In its response to the Auditor General’s report, DSRD stated enterprises are very sensitive about the information they provide to government when seeking assistance. Disclosure of this information would lead these firms to only seek assistance where such assistance is secure.

The Committee appreciates the Department would be concerned about the disclosure of this type of information. However, it is only the disclosure of details of the assistance that is being discussed, not the firms’ key financial and business planning strategies. For example, if a company called ABC Projects was receiving payroll tax rebates of \$500,000 over five years, then that is all DSRD needs to state.

***Benchmarking***

DSRD’s submission presents this argument at page 9:

...such information could be used by other firms to set a base for their own negotiations for funding from the Department. Its revelation, therefore, would hinder the Department’s ability to obtain the best outcomes at minimum cost.

The Committee does not accept this argument because:

- A number of agencies are already releasing details of assistance.
- Every potential investor will have a minimum figure it is prepared to accept, based on the profitability of the project. In many cases it will be zero. Releasing information on the assistance other companies received will not increase the minimum. Given DSRD regularly negotiates with these firms, it should be able to accurately assess what that minimum is.
- Compared with other States, the incentives offered by DSRD are small. Releasing details will prevent investors interstate from talking up the amounts provided in NSW, which could help bring down assistance levels generally.

The Committee raised some of these issues with the Department:

**Mr GLACHAN:** What about advertising after the assistance has been given and after they are established, so that the taxpayers of New South Wales know what is happening to their money?

**Mr HARRIS:**<sup>18</sup> So long as the taxpayers know it has grossed up. All the way through our Annual Report we list what funding we have provided.

**Mr GLACHAN:** Why not name the companies?

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<sup>18</sup> Director General, DSRD, transcript of hearing, 3 May 2000, p 61





**CHAIR:** It is not going to affect the decision, is it?

**Mr HARRIS:** No.

**Mr GLACHAN:** The decision has already been made, they are here and they are established and they are working.

**Mr HARRIS:** There is quite probably a mechanism by which you could name companies with which we have worked. Again in this circumstance right now I would want to retain my reservations about nominating what amount of money was provided to individual companies.

**Mr GLACHAN:** Why?

**Mr HARRIS:** Because I think that it sets benchmarks that other States will use against us. I think it sets benchmarks for people who are in the business of advising companies and it has been a growth industry in the last four years, with advisers and consultants and accountancy firms that have complete sections that do nothing but try to ratchet up the dollar benefit of incentives from various government agencies.

**CHAIR:** But you are tough enough to say no.

**Mr HARRIS:** We say no a lot. We say no more than anybody.

**CHAIR:** Exactly. You can handle that.

**Mr HARRIS:** I think it puts you at a disadvantage when it is something you are trying to win.

**Mr GLACHAN:** But this is after you have won.

**Mr HARRIS:** Yes, but the next time around, that information is out there and they know exactly what we are going to do.

**Mr GLACHAN:** It is on a case-by-case basis.

**Mr HARRIS:** It is.

**Mr GLACHAN:** And your assistance is tailored to the individual case, so it is not always the same for everyone.

**Mr HARRIS:** No it is not, but if, for example, you have a consultant working with different companies, he goes through the process once and there is material that is published.

**Mr GLACHAN:** But then you say to him, "For these reasons we are not giving you the same assistance this time." He would ask.

**Mr HARRIS:** Yes, of course he would.

**Mr GLACHAN:** If he is worth his salt he will ask for that and a bit more.

**Mr HARRIS:** They always do.



**Mr GLACHAN:** But you are worth your salt, and you would say no.

**Mr HARRIS:** I think it does put us at a disadvantage in the marketplace.

And further:

**Mr GLACHAN:** I think you might have said too that some companies report the assistance they receive in their annual reports.

**Mr HARRIS:** <sup>19</sup>Yes, I have been advised of that. I have not actually seen this.

**Mr GLACHAN:** If they do that, that is public knowledge.

**Mr HARRIS:** Correct.

**Mr GLACHAN:** Why is the benchmark issue you were talking about earlier so important if they are allowed to do this? Does that not destroy your argument?

**Mr HARRIS:** Well, I have to say that I would prefer they did not publish it.

**Mr GLACHAN:** But could you stop them?

**Mr HARRIS:** No, and it would be improper to do so.

**Mr GLACHAN:** What is the point of your argument about that, then? If you made it available publicly, you would establish a benchmark for other States? Does that not destroy your argument?

**Mr HARRIS:** No, it does not, because I think when they publish it in their annual report their competitors read it, and they probably do, and it does establish a benchmark to some degree, but the greater amount of material that is out there, the greater certainty you can get on the benchmark.

**Mr GLACHAN:** I think it sort of destroys your argument a bit. However. Now, would you say that New South Wales generally offers lower amounts of financial assistance compared to other States to attract projects?

**Mr HARRIS:** Yes.

**Mr GLACHAN:** If that is the case, then, would it not be to your advantage to make that public so that people could see that New South Wales was offering lower amounts? Surely that establishes a benchmark, anyway. People know. Do the consultants not get used to the fact that you are offering lower amounts, and would that not lead them to take people down to Victoria instead of coming to you?

**Mr HARRIS:** It does in some instances, but the fact that it is not a benchmark number means that most companies making a decision cannot really afford to leave us out of the calculation. The fact that they do then find that they have to enter into dialogue with us often allows us to provide resources and support other than financial that we otherwise might not get the chance to pitch to the company.

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<sup>19</sup> Director General, DSRD, transcript of hearing, 3 May 2000, p 118



The benchmarking argument only applies to attracting or retaining investment. For example, it does not apply to business advisory programs. Victoria has recognised this distinction. It discloses details of all assistance except for investment related grants. For the latter case, it lists all the firms assisted (37 in 1998/99) and gives a total amount of assistance (\$11.4 million in that year). If the Department does not accept the Committee's arguments in relation to benchmarking, it should at least adopt the Victorian approach.

#### **Recommendation 11**

DSRD should amend its assistance and funding contracts to state the Department's annual report for that financial year will list the amount of assistance, its purpose and the recipient. The contracts should also state that if publishing details of the project will harm the commercial interests of the proponent or DSRD, then only the amount will be given. Full details will be published in the following annual report.

Alternatively, DSRD adopt the Victorian practice of publishing details of all assistance except for investment attraction grants. For these items it should list, program by program, all the firms that received assistance and the total financial commitment for each program.

#### ***Distribution of Assistance***

Just as it is important to be aware of who received assistance, it is also important for the community to know where it was distributed. For example, the UK publishes an Annual Report covering assistance provided under the Industrial Development Act 1982. This report lists the total assistance by UK region. DSRD can adopt this practice.

At the hearings, Treasury argued against the public release of this kind of information, at least in relation to investment attraction programs ("bidding wars"):

**Mr JORDAN:**<sup>20</sup> The difficulty with regional breakdowns...is that the sorts of projects we are talking about are fairly lumpy. They come along at odd intervals and at any point in time you can get a very distorted picture about where the investment is going. The nature of things is that people looking at that information will say, "At this point in time all of the money is going to Wollongong; very little is going elsewhere. There is something wrong here. We are going to turn it around."

But it may be that the only project that came along that was worthy of support was a Wollongong project...So you have a lot of difficulty in looking at a short-term, cross sectional picture and making a lot of sense out of it without creating a situation where you put a lot of political pressure on what is happening...

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<sup>20</sup> Director Economic Strategy, NSW Treasury, transcript of hearing, 24 May 2000, p 11



The Committee is concerned by this attitude. A key principle of democracy is voters must be informed about what governments are doing so they can make informed decisions at the ballot box. If people are concerned some areas are not receiving business assistance, then governments need to explain why this is so.

**Recommendation 12**

The DSRD annual report provide a breakdown of financial assistance by region.



## Chapter Nine

### Arrangements for Regional Development

A theme from the Committee's visits to regional NSW was the large number of regional development organisations. These include:

- *DSRD Regional Offices:* There are 18 regional offices, which provide all the Department's services. Decisions on business assistance must be referred to the head office in Sydney.
- *Premier's Department Regional Coordinators:* The eight coordinators (plus three in Sydney) provide liaison across state government agencies on important projects (eg the Bombala sawmill). Their work includes environmental, social and justice issues. The 2000/01 Budget allocated \$2.9 million to the program.
- *Regional Development Boards:* In 1998/99, DSRD provided \$2 million to the 13 Boards.<sup>21</sup> They do not give direct assistance, but aim to provide a strategic framework for growth, develop local leadership and advise the Government on development issues.
- *Small Business Service Centres:* Provide basic business planning and start up advice to small businesses. In 1999/2000, DSRD allocated \$4 million to partially support 48 centres. These facilities were previously called Business Enterprise Centres.
- *Local Governments:* Many councils provide financial incentives. Incentives include rates holidays, below market price land, reduced rents, free civil works, landscaping, free architectural design and waiver of planning and approval fees. Through their role as a consent authority, councils are often the first point of contact for businesses commencing in a region.
- *Independent Development Bodies:* Councils occasionally divest their industry development roles to these groups. Examples are the Armidale Development Corporation and Investment Albury Wodonga. Their activities are typically area promotion and project facilitation.
- *Area Consultative Committees:* These Commonwealth bodies do not provide direct industry assistance, but develop regional strategic growth plans, identify Commonwealth programs to support the strategic plans, promote Commonwealth programs generally and advise the Commonwealth on local needs. The Commonwealth's website lists 14 Committees in NSW, including Sydney and the ACT. Each has a base allocation between \$200,000 and \$300,000.

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<sup>21</sup> DSRD's 1999/2000 accounts in its Annual Report state \$1.2 million was provided that year.



### *Are there too many Regional Development Groups?*

This large number of groups raises issues of coordination, duplication and excessive bureaucracy. It appears some local bodies have resorted to creating additional groups to coordinate the groups. For example, the Committee in its Armidale hearings was advised of the Northern Inland Regional Alliance, which meets every two months. Its membership includes the Area Consultative Committee, the Regional Tourism Association, all Small Business Service Centres in the region, the Regional Coordinator, Arts North-West, a Regional Arts Development Officer and Inverell Shire Council.

There are a number of reasons why there is a large number of groups:

- three layers of government: national, state, and local;
- the large number of government programs;
- displeasure with current bodies leads to the creation of new bodies;
- regional development is a high profile issue, suggesting the need for new bodies;
- lack of coordination and information transfer between groups allows duplication;
- these groups can access local resources, often on a voluntary basis; and
- different groups created to support differing views on local development.

There were a wide range of views on this issue at the Committee's regional hearings. A sample of the evidence gathered from regional organisations during the hearings is presented overleaf. Many organisations in Goulburn and Armidale said there were too many development groups. However, organisations in Albury said current arrangements were satisfactory. Possibly, more effort has been put in by local groups in coordinating their activities in Albury.

Some of these development groups also exist in Sydney. There are councils, Small Business Service Centres (previously known as BECs), DSRD's head office, and Premier's Department Coordinators. There is even a Regional Development Board for Greater Western Sydney.

The Department's overall view is it supports communities in establishing their own economic development groups:

**Mr GLACHAN:** Why do you think that many communities in country areas have found it necessary to establish their own economic development group?

**Mr HARRIS:**<sup>22</sup> I think because they feel they are closer to the issues, and I think that is something to be encouraged, to be honest, because I think there is a pretty poor history of imposition of likely solutions from the top. I think that if you can engage local knowledge it is incredibly valuable.

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<sup>22</sup> Director General, DSRD, transcript of hearing, 3 May 2000, p 117



**Are there too many Regional Development Bodies?**

“Because we have got multiple players there is a range of what I would call institutional impediments to the delivery of services, and they include the demarcation of responsibilities between agencies...”<sup>23</sup>

Christopher Berry  
Business Sector Manager, Armidale Dumaresq Council

“...I do think that there is a degree of protection of one’s own patch.”

William Carson  
Chief Executive Officer, Armidale Development Corporation

“I think that there are too many bodies, and that is part of the problem that I think small business people face within this region – who does one go to, where does one obtain assistance?”

Gregory Moin  
Chairman, Business Enterprise Centre Limited, Armidale

“I do not think that there is enough, actually...I think that each community that can afford to should have those things in there fighting for it...”

Michael Montgomery  
Chairman, New England North West Regional Development Board

“I certainly agree with the point that there are a lot of organisations out there, and the communication between those bodies and various organisations is fairly poor, because they are parochial in nature and they like to protect their own.”<sup>24</sup>

Donald McKay  
General Manager, Southern Business Enterprise Centre, Goulburn

“I do not see any overlap that causes this region difficulty.”<sup>25</sup>

Geoffrey Smith  
Chairman, Investment Albury-Wodonga

“It is a very subjective assessment on whether there are too many players. As a Council part of our objectives is to promote industrial development and investment opportunity in the City and to make tourism prosper. We have chosen to divest some of that responsibility to Investment Albury Wodonga...”

William Warne  
Director, City Administration, Albury City Council

<sup>23</sup> Evidence from Armidale witnesses recorded in transcript of evidence, 28 April 2000, pp 2, 42, 63 & 82

<sup>24</sup> Transcript of evidence, 3 May 2000, p 23

<sup>25</sup> Evidence from Albury witnesses recorded in transcript of evidence, 27 April 2000, pp 22 & 42



### Independent Development Organisations

These groups are usually created by councils devolving their economic development roles. The Armidale Development Corporation, for example, considered it was more effective than the local council:

**CHAIR:** And if they [a prospective business] had gone to Armidale council, Armidale council would have done what you have done.

**Mr CARSON:**<sup>26</sup> Yes, they may have, but they have not had the experience in doing that that I have had or that our organisation has had.

**Mr DUCAT:**<sup>27</sup> Can I say that for the Armidale council to do that it would have to employ an employee to do that job.

**CHAIR:** It does. You.

**Mr DUCAT:** It employs Bill indirectly, but it is far more cost efficient as we see it for the volunteers, like myself and the other businessmen who put their time in to do a lot of the legwork, and the amount of money that the council puts into our organisation is far less than it would have to pay for the wages of one person, employ an officer to do what Bill is doing, and that person would not have the involvement of the local businessmen on the voluntary basis that ADC does.

However, the Committee is not convinced independent development bodies, such as the Armidale Development Corporation, are warranted. There was no compelling evidence these functions could not be provided by councils, nor that councils cannot form links with the business community. The only condition is to ensure transparency is maintained.

In addition, independent development bodies tend to develop as separate entities and develop contrary views to their originating council. This was confirmed during evidence:

**Mr GLACHAN:** If you could change the way things were done here in Albury Wodonga as far as development is concerned and have it done the way you would like to see it done, what sort of changes would you like to see?

**Mr WARNE:**<sup>28</sup> That is a far reaching question, but I think personally I would like to see our Council having a far greater role in economic development, I think that may mean a fundamental shift away from Investment Albury Wodonga.

I have been particularly concerned about our tourism initiatives. Since Tourism Albury Wodonga was absorbed into Investment Albury Wodonga I feel our tourism effort has stagnated and not progressed. I think within Council if we had an economic development section with one or two good key staff and good tourism staff

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<sup>26</sup> Chief Executive Officer, Armidale Development Corporation, transcript of hearing, 28 April 2000, p 45

<sup>27</sup> Chairman, Armidale Development Corporation

<sup>28</sup> Director City Administration, Albury City Council, transcript of hearing, 27 April 2000, p 53





we would probably achieve a lot more for less than what we are paying now, but that is just a gut feeling, I have not really researched it to any great extent.

However, the Committee recognises Investment Albury Wodonga is a special case because it serves councils on either side of the NSW-Victoria border. It was created to reduce cross-border problems.

**Recommendation 13**

DSRD advise councils, except those in cross border towns, against setting up independent development organisations. Councils should develop transparent ways of forming links with business to promote and encourage local development.

Regional Coordinator Program

The Committee recognises the value of the Regional Coordinator Program in improving cooperation between agencies to improve government service delivery. There were discussions in evidence whether regional coordinators duplicated the role of DSRD, but it appears regional coordinators are better suited to bringing a whole of government approach:

**Mr STEELE:**<sup>29</sup> ... in Bombala for example, there are key issues of bringing the range of agencies together - roads, sewerage and water - and all the things which come out of different bits of agencies. My role is to ensure that they actually work together, that they are delivered at the same time that the company is ready to start, to start digging the dirt and putting the mill in. For example, the provision of water to the Bombala mill is very difficult...

My role was to bring all the players together – the company, Land and Water Conservation, Public Works, council – bring everyone together in the one room and say, "Well, how do we actually resolve this?" The resolution that we came to was that we were going to rebuild the council sewerage works to tertiary treatment and use that water for the mill.

**Ms ALLAN:** Stop there. Why is that not State and Regional Development's job? To answer my own question, is it because Premier's has more clout and therefore will be able to suffocate the objections of those other agencies? I would have been led to believe in the inquiry that we have been conducting here that State and Regional Development had that role. Are you saying that you had that role?

**Mr STEELE:** No. They have the role of assisting the industry and bringing the industry in.

.....

**Ms ALLAN:** So why is your job necessary?

<sup>29</sup> South East Regional Coordinator, Premier's Department, transcript of hearing, 3 May 2000, p 5



**Mr STEELE:** In this particular case there is not only the water issue but the whole issue of building the town as well. This is a major development for this community.

**Ms ALLAN:** That is State and Regional Development's job. I am happy with that and I accept that you play an absolutely invaluable role, but I am interested in why you have that role in addition to State and Regional Development.

**Mr STEELE:** I would not actually see it as additional; I would see that it is parallel to State and Regional Development, the reason being that State and Regional Development work very hard on the delivery of the industry. They do not have a specific role of working with the police, with the Department of Education to ensure that for the 120 people who are immediately going to start up there will probably be about 30 new families with children and they are going to have an impact on the schools, clearly, a positive impact. So it is not the role of State and Regional Development to work with Education to ensure that the school is ready.

Although the Committee accepts the role of the regional coordinators, it is concerned about the lack of reporting on the coordinators' results. No performance indicators are listed in the Budget Papers. Premier's Department's annual report for 1999/2000 lists seven projects as examples, but it is likely the network of 11 coordinators achieved a wider range of results.

The Committee notes the program has very general criteria. The only two criteria coordinators must adhere to are projects must have a closure strategy and they must have approval from the relevant line agencies. The Guidelines state project development should "take the following into account:"

- significant issues identified by other organisations;
- the requirements of all localities in the region;
- the mix of factors relevant to community well being (social, economic and environmental); and
- a balance of long and short term projects.<sup>30</sup>

Tighter program criteria would help focus the program and provide the basis for developing appropriate performance indicators.

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<sup>30</sup> See Regional Coordination Program Guidelines (2000), p 5



**Recommendation 14**

Premier's Department should review the program criteria for the Regional Coordination Program to sharpen its focus. It should use the review to develop appropriate performance indicators. Possibilities include types of issues resolved and what percentage of time is spent on social, economic and environmental issues.

Regional Development Boards

The Committee has reservations about the Boards:

- As noted in the Mortimer Report (1997), government programs should fund activities, rather than providers. Creating a Board does not, of itself, generate benefits for regional NSW. It only creates another layer of bureaucracy.
- Councils already have the role of local leadership and strategic economic planning. Regional Development Boards duplicate this role.
- Many of the Boards' outputs are strategies. The Productivity Commission's criticisms of Regional Development Organisations also apply to the Boards: "Considerable time and resources were spent on meetings, travelling, studies and consultancies with little to show in terms of measurable benefits to business in the region."<sup>31</sup>
- DSRD already has a network of regional offices to advise it on regional development issues.

A representative from a Regional Development Board put its case in evidence:

**Mr GLACHAN:** If your organisation suddenly went out of existence, would this region be worse off?

**Mr MONTGOMERY:**<sup>32</sup> Yes.

**Mr GLACHAN:** In what material way?

**Mr MONTGOMERY:** It would not have the planning focus, the ability to plan as well as it does now, and I do not think it would have the leadership to get back out and report on what has been done in the past and how successful it has been.

**Mr GLACHAN:** But you do not actually do anything, do you?

**Mr MONTGOMERY:** We do. We do the planning and we do the co-ordinating.

However, planning and coordinating can and should be done by local councils in collaboration with State Government agencies. The Committee is of the view the

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<sup>31</sup> Productivity Commission (1999), p 363

<sup>32</sup> Chairman, New England North West Regional Development Board, transcript of hearing, 28 April 2000, p 67



Boards should be wound up. In the spirit of the Boards, the funding should be applied to improve the leadership and development capabilities of councils and regional organisations of councils. Possibilities include subsidising business courses for council development officers and cooperating with TAFE and universities.

### Recommendation 15

DSRD should wind up the Regional Development Boards. The funding should instead be applied to training and other methods of improving the leadership and development capabilities of councils and regional organisations of councils.

### Small Business Service Centres

These facilities were previously known as Business Enterprise Centres (BECs). There is a network of approximately 50 centres across NSW that provide advice to small businesses and people thinking of setting up a small business. In response to the issue of the number of regional development organisations, one representative of a BEC thought the Government should make more use the BEC network:

**Mr MOIN:**<sup>33</sup> I think there are too many bodies, and that is part of the problem that I think small business people face within this region - who does one go to, where does one obtain assistance? People in the country work on personal relationships, so if you have established a personal relationship, say with our CEO, then you are far more likely to go to him to say, "We are heading down this direction. Is there any assistance that you are aware of that can help us?" If he does not know, then he is going to say, "I do not know", and that is going to be the end of the story, the person is not going to go and seek out this organisation or that organisation.

Without pushing the BEC barrow too much, it seems to me that the Government has a perfect organisation in the BEC network, in that you have got 50 or more organisations in rural and metropolitan New South Wales that could be used as a means of disseminating information to small business people. At the moment it does not happen because people do not know where to go.

However, evidence was received that councils are usually firms' first port of call:

**Mr COLLIER:** Which organisation would you consider should have the role of co-ordinating and assessing what you have said?

**Mr McKAY:**<sup>34</sup> I think the council to begin with, because in a lot of cases businesses that come into a region, or someone who wants to start a business, generally go to the council as the first port of call, the first stop. From there, unless the council knows what is available through State and regional help – we get a lot of businesses passed off down the line when the council says, "Go down and see the Business Enterprise

<sup>33</sup> Chairman, Business Enterprise Centre Limited, Armidale, transcript of hearing, 28 April 2000, p 82

<sup>34</sup> Deputy Mayor, Goulburn City Council & General Manager, Southern Business Enterprise Centre, transcript of evidence, 3 May 2000, p 24



Centre" or "Go down and see the State and Regional Development" – nothing specific, just "Go down and see them."

The Committee agrees more use should be made of the council network in promoting and encouraging investment. Incorporating Small Business Service Centres into the council network would reduce duplication and bureaucracy, probably without sacrificing the standard of service.

However, in March 2001, DSRD through NSW Supply issued a tender for the provision of Small Business Service Centres. The Department has switched to three-year contracts, which puts the amounts per centre above \$100,000. This means formal tendering is now legally required. The Committee gives in-principle support to DSRD putting out this service to tender.

The tender closed on 10 April 2001 and any comments the Committee may make probably would not apply until new tenders are sought in 2004. However, the Committee views councils as an ideal location for this service and would like to see this recognised some way in future arrangements.

**Recommendation 16**

In relation to future tenders for Small Business Service Centres, DSRD either encourage councils and regional organisations of councils to apply or give them preference.

***Dissemination of Assistance Information***

In hearings, representatives from development organisations in Albury, Armidale and Goulburn stated there was a low level of awareness of the Department's services. However, some people did not regard this as a problem. Some examples are given overleaf.

The Committee is of the view, as a general rule, government agencies should adequately promote their services. Government client groups should be aware of what the Government can do for them and voters should have a general idea of Government functions so they can make informed decisions at each election.

**Should Assistance Information be widely available?**

“...there will always be those that will not help themselves. I think number one, businesses if they are worth nurturing, surely they are proactive enough to come forward and investigate what is available.”<sup>35</sup>

Ulf Ericson  
Chairman, Albury-Wodonga Area Consultative Committee

“...I think there is an incumbent responsibility upon any organisation who is wanting to achieve the goals that are on their agenda...to let us know what their schemes are, not us to ask for them.”<sup>36</sup>

William Carson  
Chief Executive Officer, Armidale Development Corporation

“Councils are often in the front line because they have to come to us for development approval, so as long as we are aware that assistance is available we can steer them in the right direction or play that facilitation role and then the company can be introduced to the right people.”<sup>37</sup>

Peter Veneris  
Director of Operations, Hume Shire Council

“Local Government is the first port of call. If we had all of that information...at our fingertips and we were not sending people off to other places not knowing really where to go or which one to hit out of the list that have got before us in order to find some assistance, then I think some of those industries would not have been lost.”<sup>38</sup>

Peter Monley  
Mayor of Armidale Dumaresq Council

“...we get a lot of businesses passed off down the line when the council says, ‘Go down and see the Business Enterprise Centre’ or ‘Go down and see the State and Regional Development’ – nothing specific, just ‘Go down and see them.’ If the council had more knowledge about what was actually available, it would be able to provide a better service as well, and that may short-circuit the whole thing, rather than people getting duck-shoved from pillar to post.”<sup>39</sup>

Donald McKay  
Deputy Mayor, Goulburn City Council and  
General Manager, Southern Business Enterprise Centre

<sup>35</sup> Transcript of evidence, 27 April 2000, p 6

<sup>36</sup> Transcript of evidence, 28 April 2000, p 56

<sup>37</sup> Transcript of evidence, 27 April 2000, p 81

<sup>38</sup> Transcript of evidence, 28 April 2000, p 17

<sup>39</sup> Transcript of evidence, 3 May 2000, p 24



The Committee is reluctant to suggest DSRD should embark on a costly publicity campaign. However, program information should be reasonably available to potential clients. Although the Department's web site is reasonably thorough, it should be supplemented by the distribution of physical information. The Internet is readily accessible, but firms need to be aware DSRD exists and its information is on the web. The penetration of the Internet is probably not yet sufficient to fully rely on it for promoting Government programs.

The Committee agrees with Councils' opinion they are a suitable vehicle through which DSRD can promote its programs. Not only are councils a first point of call for many firms due to their building approvals function, but there are approximately 200 local councils across NSW, compared with DSRD's 20 offices.

**Recommendation 17**

DSRD distribute copies of its corporate, regional and small business publications to all local councils in NSW and require councils to exhibit the information to likely beneficiaries.

***Local Autonomy***

Investment Albury-Wodonga and Albury City Council raised concerns about the lack of autonomy at DSRD's regional offices:

**Mr COLLIER:** Mr Scott, looking at the submission you speak of a perceived lack of autonomy and delegation at the State Regional Office level, excessive referral reliance on the capital city decision makers who are not in touch with the regional issues.

Given if you believe there is a perceived lack of autonomy at the State regional level and the regional development office between those two, what we would be interested to know at least is how this lack of autonomy results in the regional office of State & Regional Development not effectively providing the area with assistance?

**Mr SCOTT:**<sup>40</sup> If I could respond to that. The information that I have got from my staff is it generally affects the timing, in other words the timing of the response. The view of my staff is if the regional office had a pre-approved budget then they could be quicker on their feet in terms of responding to individual company requests. So from my point of view it is a matter of timing.

There are several arguments against this. Firstly, DSRD's Albury office advised it could get a 24-hour turnaround from the head office if a matter was urgent:

**Mr COLLIER:** Are there cases where something has been lost and the general opinion is that we have moved too slowly on it in this area?

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<sup>40</sup> Chief Executive Officer, Investment Albury Wodonga, transcript of hearing, 27 April 2000, p 25



**Mr GRANT:**<sup>41</sup> I cannot remember one that we have lost from being too slow. I have found that when I perceive there is an issue and we need an instant answer I have been able, with the support of head office, to be able to accelerate it and I have had responses with Michael's support in certainly under 24 hours. So it can be done quickly if that speed is needed.

Secondly, there is an issue whether local staff become too close to prospective firms:

**Mr GLACHAN:** We heard from people here earlier today the view that although on a local level State Development work very hard but they were sometimes locally let down by a slow reaction from head office in Sydney, do you think that is the case? Do you find that yourself?

**Mr GRANT:**<sup>42</sup> ...In terms of the relationship between the regional office and the head office, I think Michael has probably answered that. I think in the responsible use of Government funds and ensuring there are checks and balances, I would not like to have the delegation to sign off on grants from here because I am too close and my staff are too close. I am not casting any aspersions on my staff at all, but it opens up the potential for some kind of special relationship between the business and the client manager and I think that final decision should be at arms length somewhere with a fairly defined process. From a pure due diligence point of view I do not think there is any other way it can be done.

Thirdly, DSRD can prevent bidding wars from happening internally within NSW. Considering these arguments, the Committee agrees with the Department there is no need at this stage to increase the autonomy of regional offices.

### ***Relationships with Local Development Organisations***

#### **Investment Leads**

DSRD refers investment leads to local organisations, especially when it considers a local body could provide the best services to a proponent. For example, DSRD fed a lead from Lockheed Martin to local organisations in Armidale that resulted in the establishment of a satellite-tracking project nearby. The project involved an investment of \$25 million and created 10 permanent jobs.

However, the Armidale Development Corporation at the hearings was critical of DSRD in its distribution of leads:

**Mr COLLIER:** Are you aware of other cases where it has passed on the leads directly to you?

**Mr DUCAT:**<sup>43</sup> I am not aware. Bill might be aware of some.

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<sup>41</sup> Regional Manager Southern, DSRD, transcript of hearing, 27 April 2000, p 68

<sup>42</sup> Id, p 67

<sup>43</sup> Chairman, Armidale Development Corporation, transcript of hearing, 28 April 2000, p 48





**Mr CARSON:**<sup>44</sup> I think it is fair to say that in the two and a half years that I have been here there have been two or three particular opportunities and I think two of those at least have been ones that we stood no chance of getting in the first place.

The Corporation judged itself very effective in handling potential investors, but stated it needed national and international leads from DSRD from which to start. The Department's response was it can be criticised whether it passes on a lead or not:

**Mr COLLIER:** The comment was made this morning that your department had passed on two possible leads to the Armidale Development Corporation, which the witnesses said had absolutely no possibility of ever getting up. Would you care to comment on that?

**Mr CULLEN:**<sup>45</sup> Sure. Without knowing which ones they are, it is really hard for me.

**Mr COLLIER:** But I am just concerned that that is their opinion.

**Mr CULLEN:** From our end what we rely on often is what the company actually specifies in terms of its requirements for a location. Now, that can come from a number of parts of our department. If it was a call centre operation, for instance, which Armidale is a candidate for, you are sort of damned if you do and damned if you do not pass on the lead and allow people to be lateral in terms of how they present.

The Committee accepts DSRD is in a no-win situation. However, part of the Armidale Development Corporation's complaint probably stems from the secrecy involved. Part of the value of leads is they may not be widely known and the Department needs to protect this information. However, this secrecy denies any scrutiny of its partnership with local groups and allows DSRD's clients to think the worst of it.

If the Department states it wants local organisations to take ownership of their development issues, it should publicly demonstrate how it does so. The Committee proposes DSRD publish information on its provision of leads.

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<sup>44</sup> Chief Executive Officer, Armidale Development Corporation

<sup>45</sup> Executive Director Regional Development, DSRD, transcript of hearing, 28 April 2000, p 91



### Recommendation 18

DSRD publish information on the leads it gives to local development organisations, including councils, in its annual report. The Department should list the following:

- the number of leads each town or area received;
- the number of successful leads for each town or area; and
- whether leads were duplicated.

### Coordination

Local groups expressed a range of views on whether they adequately coordinated their actions. For example, Goulburn BEC (now a Small Business Service Centre) was very supportive of co-locating with DSRD and other agencies:

**CHAIR:** ...Could you please give us a brief outline of your organisation's role in regard to industry assistance in the region and the relationship between your organisation and the Department of State and Regional Development?

**Mr McKAY:**<sup>46</sup> Well, if I can answer the last part first, the relationship between the Business Enterprise Centre and State and Regional Development is that we both co-exist in one building. My office is probably as far away as you are from the Department of State and Regional Development.

My principal role in terms of industry is not so much in industry but more in small business...

We basically trade off with State and Regional Development. If they get an inquiry that is sort of below their par line, they send it down the line to me and vice versa. If I get an industry or a business that is bigger than my expertise or the organisation's can handle and it fits the criteria of State and Regional Development, it just gets passed up the hallway.

However, a lack of coordination was also acknowledged in Goulburn:

**Mr TORBAY:** ...Do you think there are too many organisations and sufficient communication within those bodies to provide information as to what is available, what is not available, how it works? I would be interested to hear your views on that. Secondly, how do you think the provision of better co-ordination can be addressed in the future?

**Mr McKAY:**<sup>47</sup> I certainly agree with the point that there are a lot of organisations out there, and the communication between those various bodies and various organisations is fairly poor, because they are parochial in nature and they like to protect their own. They have their own particular expertise that they provide, and they do not share that

<sup>46</sup> Deputy Mayor, Goulburn City Council and General Manager, Southern Business Enterprise Centre, transcript of hearing, 3 May 2000, p 18

<sup>47</sup> Id, p 23



with anybody. So I think that is where the breakdown comes in the first instance. Because they are so secretive, no other organisation knows what is going on.

Basically, the left hand does not know what the right hand is doing. As a result, the amount of assistance that is available and should be given just doesn't get out there. How you can overcome that is probably by reducing the number of organisations that are out there supplying the information or by ensuring that there are communication links between the organisations that are supplying the services and each one knows.

Although representatives from Albury reported they did not consider there were too many development groups, the Council gave an example of where poor communication led to a project locating out of NSW:

**CHAIRMAN:** In your submission the Council advised of a possible problem where New South Wales does not provide assistance to a New South Wales business considering relocation within New South Wales. For example, a Taree company which went to Gippsland due to Victorian assistance; New South Wales would not offer assistance to go to Albury, which apparently was a choice...

Are you suggesting that the State government of New South Wales should be funding bids between regions, or are you suggesting that because the reality of it going to Victoria existed, that really it was an interstate bid anyway, but the Department would not listen to that?

**Mr WARNE:**<sup>48</sup> No, I do not think that is the case at all. In regard to the National Foods proposal, as I understand it the company was consolidating its yoghurt making activities, and they were closing the plant in northern New South Wales, and we put in a bid for relocation and centralisation of those activities to Albury Wodonga.

The Development Corporation had been the owners of the industrial land, had the sites, we did not have the sites. The Victorian site was not a good one, principally because in Wodonga they did not have the water and sewerage infrastructure to support what was needed for the plant, whereas in Albury we had that infrastructure, and there was a site available that could have been used for the purpose.

But I believe it was not considered any further because there was no support forthcoming from the New South Wales Department because it was seen as an intrastate move rather than one from one particular region to another region.

Communication was also an issue in Armidale:

**CHAIR:** Could you advise the Committee on how this co-ordination problem impedes the effective development of the region?

**Mr BERRY:**<sup>49</sup> Because we have got multiple players there is a range of what I would call institutional impediments to the delivery of services, and they include the demarcation of responsibilities between agencies - the what-is-my-turf and what-is-your-turf sort of thing - and the narrow focuses of those agencies and their

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<sup>48</sup> Director City Administration, Albury City Council, transcript of hearing, 27 April 2000, p 47

<sup>49</sup> Manager Business Sector, Armidale Dumaresq Council, transcript of hearing, 28 April 2000, p 2



organisations. They are usually set up for a particular function, and assistance may be only part of that function rather than the core of it.

There is often poor communication because of different agencies and different organisations. It depends a lot on networking and interpersonal relationships between those organisations. When they are physically separated from each other, again, it becomes a communications issue.

I think there is a tendency as well to be inward-looking. Organisations tend to be inward-focused rather than looking outward to the communities that they are supposed to be servicing. I think that at the regional level we become isolated from our communities of interest. To some extent at the local level the recent merger negotiations that have happened are an endeavour to bring us back towards what our current and contemporary communities of interest are. Perhaps we have only gone part of the way. Perhaps we have not gone far enough at this stage at the local level, but certainly we need to get back to what our communities of interest are and then structure our service deliveries around those communities.

Groups in the Armidale area recognised coordination needed to be improved and created the Northern Inland Regional Alliance to address the problem. This group meets every two months and includes representatives of local development groups. However, it does not appear to have universal support:

**Mr GLACHAN:** What has it achieved so far?

**Mr MONTGOMERY:**<sup>50</sup> Well, basically, it brings together all of those regional players so that we all know what we are doing. We have a memorandum of understanding signed by all of those groups that we will work closely together on regional development issues.

**Ms HODGKINSON:** What about the Armidale Development Corporation?

**Mr MONTGOMERY:** The Armidale Development Corporation has not signed up because it has not been to a meeting.

**Mr COLLIER:** Have you asked it?

**Mr MONTGOMERY:** Yes. I think you have to understand that not everyone goes to every meeting as well.

The Committee's view is these regional bureaucracies are aware of each other's existence, but the problem is getting them to communicate. However, the Committee is reluctant to recommend coordinating groups for each region in NSW, as this would impose another layer of bureaucracy.

The cheapest, most flexible form of communication today is the Internet and DSRD's website has a page for each region. The Committee proposes these pages

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<sup>50</sup> Chairman, New England North West Regional Development Board, transcript of hearing, 28 April 2000 at p 60



be expanded by including a directory of all the development groups in the region with links to their sites (eg, Premier's Department, Small Business Service Centres, independent development organisations, and councils).

Further, each of DSRD's regional offices should ring these groups on a monthly basis and request informal updates on their activities. This information, including what DSRD's regional offices are doing, should be posted on the site, along with suitable disclaimers due to the informal source of the information.

#### **Recommendation 19**

DSRD liaise monthly with other regional development groups. DSRD to place this information, a directory and links to the groups on each region's page on its website. The pages should include information on the work of DSRD's regional offices.

The value of co-locating the Department's offices with other local organisation was recognised in evidence:

**Mr McKAY:**<sup>51</sup> ... I might add that I think that the co-existence between State and Regional Development, the Department of Education, Employment, Training and Youth Affairs, the International Supply Office, the Business Enterprise Centre, the Department of Fair Trading and the Chamber of Commerce all in the one office complex is probably one of the few in the State. I think probably with the ones that are in the State this is probably the one that works the best, and it works exceptionally well.

The Committee supports agencies co-locating. It is a simple and efficient method of improving coordination between departments.

#### **Recommendation 20**

DSRD review its accommodation arrangements with a view to co-locating with as many relevant agencies and local groups as possible across the State.

### ***Country Industries (Payroll Tax Rebates) Act 1977***

Payroll tax is paid by all firms in New South Wales that have a payroll in excess of \$600,000. In 2001, the new rate is 6.2%.<sup>52</sup> The Act provides an automatic right to regional manufacturers and food processors for payroll tax rebates. Its key features:

- Companies within the Sydney, Liverpool, Camden, Penrith, Wollongong and Newcastle local government areas are excluded completely.

<sup>51</sup> Deputy Mayor, Goulburn City Council and General Manager, Southern Business Enterprise Centre, transcript of hearing, 3 May 2000, p 19

<sup>52</sup> Budget paper No. 2, 2000/01



- Companies close to these centres (eg in the Blue Mountains, Cessnock, Maitland, Gosford or Kiama) are entitled to only 50% of the rebate.
- Retailing, distribution, servicing and associated activities are excluded.
- Since 1989, the amount of the rebate has followed a formula that gives the firm a 100% rebate in year one, 50% in year two, 33% in year three, 25% in year four, 20% in year five and negligible thereafter.<sup>53</sup>

The phase out did not initially apply and was introduced by the Greiner Government to control costs and to better target assistance. According to the Standing Committee on State Development, the aim of the Act was to “encourage firms to locate in country regions and to remove a perceived disincentive to employment in those regions, viz payroll tax.”<sup>54</sup> Two attempts to repeal the Act have failed.

The system is cumbersome. The Department prefers to shift eligible firms to the Regional Business Development Scheme, which can also provide tax rebates. The 2000/01 Budget had a contingency of \$150,000 in case any firm wished to receive assistance through the Act.

The legislation is attempting to target its aid. It focuses on manufacturing and food processing outside the built up areas of Sydney, Newcastle and Wollongong. However, the way it targets aid needs to be improved:

- The economy has developed and it is recognised that services can provide just as much wealth, if not more, than manufacturing.
- Patterns of economic growth are much more patchy and diverse than assuming all areas outside Sydney, Newcastle and Wollongong must be doing poorly. For example, some regional centres are developing well.

The Audit Office noted the automatic entitlement to assistance meant the Department’s negotiating position was weakened and offered little incentive to effectively use its funds. Further, any agreement by assisted firms to waive their right to the rebate in return for assistance under the RBDS may not be enforceable. It recommended the Government develop options for reform.

The Act is listed for a competition policy review. The NSW Government Policy Statement on Legislation Review (1996) initially scheduled the Act’s review in 1996/97, but it does not appear to have commenced. The basic test is an Act that restricts competition (such as this one) should be repealed or modified, unless the restriction is for the public benefit. Given this Act distorts economic forces and is barely used, one might expect a competition policy review to recommend its repeal, or at least a substantial modification. The review would provide an appropriate method to communicate with stakeholders.

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<sup>53</sup> Standing Committee on State Development (1991) p12

<sup>54</sup> Id, p5



Some jurisdictions carefully target their aid using needs criteria. In the European Union, only 28.7% of a country's population is eligible for regional aid. Further, the areas eligible for the most intensive type of aid must have a per capita GDP of less than 75% of the EU average. Such needs criteria would help DSRD better target its regional assistance.

**Recommendation 21**

DSRD commence the competition policy review of the *Country Industries (Payroll Tax Rebates) Act 1977* without delay. The review to include consideration of using a needs index to allocate regional assistance.



## Chapter Ten

### Management of the Industry Assistance Fund

The Industry Assistance Fund (IAF) is one of the main means for the Government of providing financial assistance to attract or retain firms to NSW. In 1999/00, it is estimated \$11.2 million was spent from the Fund for this purpose.

#### *Current Arrangements*

Incentives are paid from the Fund to firms as payroll tax rebates. Payroll tax is paid by firms with a payroll of \$600,000 or more at approximately 6% of wages, of which the Department rebates a proportion. The proportion varies from case to case. A typical example would be to spread the assistance over five years, rebating 90% of payroll tax in the first year, 70% in the second, 50% in the third, and so on.

At the end of each financial year, DSRD determines an assisted firm's wage expense and makes the appropriate rebate at the start of the following financial year. Due to this fixed payment date and the startup time involved in many projects, there is often a lag of a year or two after the agreement is signed before payments are made. By keeping track of the commitments, the Government can usually predict each annual set of rebates.

The Fund has two components:

- A \$3 million pool, which the Department can allocate as it wishes. The main restriction is the net present value of the assistance to any one firm cannot be greater than \$1 million. The Committee understands that from July 2001, there will be a \$5 million pool with a ceiling of \$2 million.
- A Treasury funded component. Where DSRD proposes to offer assistance with a net present value greater than \$1 million, it applies to the Treasurer for approval. The new cutoff will be \$2 million.

Although the two parts are added together and reported singly as the IAF, they are in effect two separate programs. DSRD manages its \$3 million pool and ensures future annual commitments stay under this limit. However, the Treasury funded part fluctuates according to assistance approvals and is limited by the restraint of DSRD and the Treasurer. Total IAF expenditure over the last four years is as follows:

**Table 10: Annual Expenditure under the Industry Assistance Fund**

	<b>1996/97</b>	<b>1997/98</b>	<b>1998/99</b>	<b>1999/00</b>
	(\$ million)	(\$ million)	(\$ million)	(\$ million)
IAF Expenditure	15.8	17.6	11.4	11.2

Source: DSRD





One of the features of this system is Treasury and the Treasurer can review the major assistance packages. At the hearings, Treasury stated it also allows the Government the flexibility to respond to unexpected large projects:

**Mr JORDAN:**<sup>55</sup>...Where the difference occurs is on larger projects that look to be receiving more than \$1 million worth of assistance in NPV terms. The difficulty with these projects is that they come out of the woodwork. They cannot be scheduled. You do not know when they are going to come along. They often are fairly sensitive-type projects. When you are giving approval you are entering into some sort of commitment that could affect you in future budget years.

The Treasury funded component is sometimes referred to as supplementation, ie DSRD's budget is "topped up." This is technically incorrect, as each financial year's rebates are accurately predicted during the preceding Budget:

**Mr GRAHAM:**<sup>56</sup>...I think the other thing is that it is only on a very rare occasion that there is actually a supplementation because what we are seeking approval for is to enter into a binding commitment, to enter into negotiations and sign a contract with a company.

The appropriations normally do not actually get appropriated until the next year, and that will be in the budget process. It is only in very rare circumstances that you might get requirements for expenditure in the year of the project coming forward. Normally it is a time-phase thing.

So our view is that the reference to supplementation in the traditional sense is normally that you have to supplement in the year of the budget. What we are dealing with is should it be appropriate to forward allocate the amounts of money we are talking about in terms of the budgetary sense, and that is why they are coming to us and saying, "We have been making forward commitments of this nature. How is that going to impact on the budget and so forth"

**CHAIR:** So most of the expenditure or sometimes denied revenue that is actually expended would be the product of negotiations in the previous year or two years?

**Mr WADDINGTON:**<sup>57</sup> That is correct, yes.

However, this process shares some of the characteristics of supplementation because the Department is not trying to work within a fixed budget.

### *Audit Office Report*

The Office had a number of concerns about the Treasury funded component:

- Treasury is not required to consent to DSRD's requests.

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<sup>55</sup> Director Economic Strategy, NSW Treasury, transcript of hearing, 24 May 2000, p 2

<sup>56</sup> Principal Advisor Infrastructure, NSW Treasury, transcript of hearing, 24 May 2000, p 18

<sup>57</sup> Principal Financial Analyst, NSW Treasury



- The funding requests are not considered by the Cabinet Budget Committee.
- It provides little incentive for DSRD to prioritise assistance.
- It encourages DSRD to pursue larger projects.
- It could encourage the Department to inflate the proposed level of assistance.

The Audit Office recommended DSRD consider combining the two components of the IAF to reduce volatility in expenditure and improve budgetary management. The Department later advised the Audit Office it was negotiating with Treasury with a view to combining the pool and supplementary funding for over 80% of the projects to which financial assistance is provided. It appears the new system with a \$2 million cutoff is the product of the negotiations.

At the hearings, the current Auditor General did not consider funding for the IAF is open ended because any Minister has the right to request supplementation:

**Mr COLLIER:** ... As you know, the Department of State and Regional Development is currently negotiating with Treasury to increase the direct allocation to the IAF, and also to increase the assistance limit of \$1 million to \$2 million before the assistance proposal is required to be signed off by the Treasurer... To what degree would this address the Audit Office's concerns about the open-ended nature of IAF expenditure?...

**Mr SENDT:**<sup>58</sup> ... My difficulty is that I have a slightly different view than what that report said at the time about the open-ended nature. The purpose of the threshold was not that it was regarded as exceeding the budget estimate, but that for projects of significance in terms of the amount of assistance being provided, Treasury wanted to be part of the game, if you like, in making the assessment. So the rules were established that for projects over a certain size Treasury had to be involved.

To say that it is open ended could equally apply to any budget allocation to any department, given that any department or Minister has the right to come along and ask for supplementation. So, I have some difficulty with the view that it was open ended. Nevertheless, the changes that are being proposed ... were designed in some ways to place a greater onus on the department to make decisions on more of the applications that came before it...

Another issue from the hearings was Treasury's role in advising the Treasurer on the Department's assistance proposals over \$1 million. The Committee was interested to learn how often the Treasurer had declined applications by DSRD on Treasury advice:

**Mr GLACHAN:** How often would Treasury oppose your application?

**Mr HARRIS:**<sup>59</sup> Quite often.

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<sup>58</sup> Auditor General, transcript of hearing, 3 May 2000, p 39

<sup>59</sup> Director General, DSRD, transcript of hearing, 3 May 2000, p 50



**Mr GLACHAN:** And what is the result then? Does the Treasurer agree with you or with Treasury?

**Mr HARRIS:** A bit of both, to be honest. It has happened less, I have got to say, in the last two years, and the reason I say that – and I give a lot of credit to Warwick and his colleagues – is that I think we have become much tougher in the way we evaluate these things. We have probably moved closer to Treasury's position than they have to ours.

In relation to this issue, Treasury was non-committal:

**CHAIR:** When Treasury recommends against any form of assistance, how often does the Treasurer accept the recommendation? Is there a pattern there where he supports one department over the other more consistently or it often does not arise or it gets drawn to his attention?

**Mr JORDAN:**<sup>60</sup> We have a situation now where the Treasurer and the Minister for State Development are one and the same. We would probably have the same process anyway. It might have to have a slight amendment but it is why we have separate advice come from the Treasury portfolio and from the State Development portfolio. The Treasurer and the Minister for State Development - I guess there is a hat-jumping exercise there as to how a decision then gets made. Were that not the case, let us take a case where the Treasurer was separate entirely and the Minister for State Development was a Minister. I think we would probably follow a fairly similar process.

Where the department thought there was merit in entering into negotiations to assist a particular project that would be of benefit to the State, we would want to have a look at that. We would look at our competitive neutrality; we would want to look at footlooseness, the amount of money that was being entered into, all those sorts of things, and we would provide our advice.

That advice would go to the Minister for State Development and he would be having to make his decision in the context that this was Treasury's consideration of the matter. He would make his decision, but in that circumstance, were it to occur, of the two Ministers being separate, the Minister for State Development would then have to approach the Treasurer in getting his okay on this. The Treasurer would then probably seek our advice independently, so it is a little bit bureaucratic, but we would, again, have an opportunity to talk to the Treasurer or give advice to the Treasurer. It is very hard to say how the process would work in terms of what the end results would be, but that is how the process would certainly work.

### *Discussion*

Good financial management requires agencies to operate within a budget and get extra funds to handle unforeseen emergencies. DSRD is not being encouraged to work in this manner. Running the entire IAF as a pooled fund would achieve this result. Based on previous use, a pool of \$12 million per annum appears reasonable.

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<sup>60</sup> Director Economic Strategy, NSW Treasury, transcript of hearing, 24 May 2000, p 19



Because of the structure of the payroll tax rebate system, the Department can usually plan future expenditure. Any “blowouts” will usually be spotted well before a Budget is prepared. However, the Department needs a mechanism to handle a rush of large projects that could squeeze its budget in later years. The Committee suggests DSRD be given an extra \$5 million in the first year only to act as a buffer, along with the ability to roll over any unpaid rebates each financial year.

The Committee acknowledges the new system with a \$5 million pooled fund and a Treasury funded component for packages with a net present value above \$2 million partially addresses the concerns raised by the Audit Office. However, if attracting unexpected large projects is one of the Department’s core functions, then so should be managing the financial implications of this task. The entire IAF should be managed as a pooled fund.

It is unclear what value Treasury is currently adding to the process. The Treasurer appears to generally approve the Department’s proposals and the Department states it has become more rigorous in developing assistance packages. The main value of these checks seems to be keeping Treasury informed of future commitments, which can be done through normal reporting procedures.

#### **Recommendation 22**

The entire Industry Assistance Fund (IAF) should be operated as a pooled fund under the Department’s control with an annual allocation of \$12 million per annum. An extra \$5 million should be allocated to the fund in the first year of this arrangement and annual rollover provisions applied.



## Chapter Eleven

### Competitive Tendering

#### *Views of the Audit Office*

In its report, the Audit Office noted DSRD's Industry Assistance Fund, Regional Headquarters Scheme and Regional Business Development Scheme assessed assistance for projects individually, ie on a case by case basis. The Audit Office argued DSRD should be attempting to maximise the economic benefits to NSW and a better way of doing this would be to use a system where firms had to bid against each other for assistance, possibly every three months. This proposal was also discussed in evidence:

**Mr SENDT:**<sup>61</sup> ... In some parts of industry assistance that might be difficult, because the tendency is for the requests to be sporadic and large. I am thinking here perhaps more of the regional headquarters type case. But in the normal industry assistance fund operations I would assume that there are enough applications assessed and granted each year that there could be a periodic stacking up of all the applications that someone runs a ruler down to decide which are the most worthy. Whether that is a monthly basis or a two-monthly basis or whatever, I think the flow is sufficient that you could do that on a regular basis without holding up the process or holding up applicants unduly.

And further:

**Mr JAMBRICH:**<sup>62</sup> ... I think that the report also said that the department really does not have the mechanism and the ability to determine whether in fact you are achieving the best benefit for the dollar. At the end, they do not do either very well at this stage but at the end they can try to evaluate whether there is a benefit flowing from it, and that is great, it is good to know that there is some benefit, but when taxpayers' dollars are involved we want to make sure that you get the greatest benefit that you can possibly get.

The Audit Office accepted a simple tender arrangement would not work in all cases, but stated DSRD should attempt to develop a new system to generate competition between businesses for the assistance dollar.

#### *Department's Response*

The Department's submission to the Committee responds to this proposal:

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<sup>61</sup> Auditor General, transcript of hearing, 3 May 2000, p 38

<sup>62</sup> Assistant Auditor General, Audit Office of NSW, transcript of hearing, 3 May 2000, p 42



Requests for assistance, however, do not arise at a particular time but are driven by the location decision process amongst target companies. Therefore, at no stage are all the possible projects “on the table” for consideration at the same time. Thus it is not possible to prioritise them or use a tender process. Once the economic analysis has been completed, project officers determine a negotiating upper limit ... Setting up a competitive bidding process has been considered, but a model that would encompass the Department’s activities has not been found nor devised. None of the other economic development agencies in Australia or overseas of which the Department is aware use a bidding process.<sup>63</sup>

It should be noted the Department uses competitive tendering for some other programs (eg the Business Retention and Expansion Program).

### ***Pros and Cons of Competitive Tendering***

The advantages of competitive tendering are:

- It is easier for DSRD to compare different projects and prioritise them.
- Competition forces firms to reduce their requests for assistance.
- Advertised Invitations to Tender are advertised, so anyone can apply.
- Firms cannot demand an assistance package based on precedence.
- The Department does not have to look for leads, as firms will come to it.
- It puts DSRD in touch with new potential clients, and helps prevent the establishment of an “assistance clique.”

The disadvantages of competitive tendering are:

- Requests for assistance are often driven by investing firms looking for a location. Possible projects are on the table for a limited period, reducing the opportunity for comparison.
- It has little application where a firm has decided to establish in Australia, but is yet to decide on a location, and is encouraging State governments to compete against each other for the investment.
- Investing firms generally look for a quick response from government on all issues. Funding cycles might introduce an unacceptable delay for a project.

### ***Discussion***

The arguments against competitive tendering do not apply to DSRD’s non-attraction programs. However, considerable efficiencies can be generated by establishing a tender process for them. The Committee is of the view that where firms gain a

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<sup>63</sup> Department’s submission, p 11



significant benefit from these programs (financial assistance would automatically qualify), DSRD should adopt competitive tendering.

As noted in chapter nine, the Department has introduced tendering for its Small Business Service Centres (previously known as BECs). The Committee gives its in-principle support for this new system and hopes more programs can be managed in this way.

In relation to attraction programs, the Committee recognises the validity of both the arguments in favour of competitive tendering and those against. Waiting for a tender period to close might disadvantage the Department in negotiating with a potential investor. On the other hand, DSRD should be trying to generate more competition for its funds. The Committee, therefore, proposes to divide DSRD's investment attraction funds into two halves, one to be used as before, and the other to be made available on a competitive tendering basis.

The Department will need to coordinate the applications between the different investment attraction programs. For example, the Regional Business Development Scheme is used by DSRD in place of the Country Industries (Payroll Tax Rebates) Act, where some firms have a legislative right to assistance. Competitive tendering may not be applicable. In addition, there is the possibility of overlap between the Industry Assistance Fund, the Hunter and Illawarra Advantage Funds and the Regional Headquarters Scheme.

In all cases where competitive tendering is used, the Department will need to adequately advertise the programs to increase competition for the funds. The extent of advertising required will depend on the program in question. For example, small business programs would only be advertised in NSW, but the investment attraction programs would be advertised more widely.

**Recommendation 23**

DSRD commence tendering for its non-attraction programs immediately. DSRD should also split its investment attraction funds into halves. One half can be used as before, but the second half should be used on a strict competitive tendering basis. Programs that use competitive tendering must be adequately advertised to develop sufficient competition for the funds.



## Chapter Twelve

### A Case Study of Competitive Neutrality: Abattoirs and Meat Processors

#### *The Concept of Competitive Neutrality*

Competitive neutrality refers to the negative effect on a firm when a government provides selective assistance to its competition. Many people would consider it is unfair for taxpayers' money to be used to support one business in preference to its competitors. Further, there is a risk the Government is only shifting business between existing firms, rather than creating anything new.

DSRD admitted in evidence the losers from breaches of competitive neutrality are unlikely to be identified:

**Mr GLACHAN:** You might assist business A to come and establish here and manufacture a certain item. In 12 months time, as a result of that, business B that you have never known about may be forced out of business.

**Mr HARRIS:**<sup>64</sup> I certainly recognise the dilemma.

In its report, the Audit Office found DSRD's guidelines require competitive neutrality to be considered before giving assistance. This was confirmed during evidence:

**CHAIR:** So if I produce widgets and you decide you are going to help some widget producers, should it not be fair that I get a chance to say, "Why are you helping them and you are not helping us, given that we have been paying taxes all these years, we have been employing these people, we have gone through the hard times and the good times and been good corporate citizens but you are deciding to support a Korean company to come into Australia and produce something that competes directly with me?" Do you not think I should have the right to say, "Do not give them my tax dollars so they can come in here and throw me out of business"?

**Mr HARRIS:**<sup>65</sup> I understand the argument. Can I just make one comment on that? The premise that we do not consider competitive neutrality is, quite simply, wrong. In the modelling material that we produce there are, I think, four or five separate sections where competitive neutrality is mentioned.

Every model that has been done by the department since, I think, the end of 1995 includes a special section on competitive neutrality. If the Auditor-General is of the view that that is not considered, then, indeed, I am perfectly happy to provide the documentation that demonstrates that we do consider it.

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<sup>64</sup> Director General, DSRD, transcript of hearing, 3 May 2000, p 59

<sup>65</sup> Id, p 58





However, the point that the Audit Office made was, although competitive neutrality is technically considered, it does not appear to change any of the Department's decisions. The Audit Office stated:

From the documentation reviewed, several examples were found where assessment of proposals indicated that provision of assistance could breach competitive neutrality. No examples were found where this led to either rejection of the proposal or, apparently, to any reduction of the estimated maximum assistance to be provided. When a likely breach of competitive neutrality was identified by [DSRD], the only justification for proceeding to provide assistance found by the Audit Office was the claim that if NSW did not provide the assistance another State probably would and competitive neutrality will be breached.<sup>66</sup>

The Committee discussed the issue of when competitive neutrality became sufficiently serious that the Department would withhold assistance. However, DSRD was non-specific on this matter:

**Mr GLACHAN:** Competitive neutrality, I suppose, you would say, by definition is breached every time you provide someone with assistance because if you help one company, it might be in banking and that would make it difficult for their competitors, the other banks already established here. At what stage do you decide that such a breach is considered large enough to prevent the project from receiving assistance?

**Mr HARRIS:**<sup>67</sup> It is a qualitative answer.

**Mr GLACHAN:** You would say, then, that if another bank were to come and establish here there are plenty of banks anyway but if there was only one bank here, someone else has come out and had a direct effect on them.

**Mr HARRIS:** You would be very careful. It is a qualitative issue.

As discussed in chapter ten, Treasury advises the Treasurer and Minister for State Development on large assistance packages. The role of competitive neutrality was also discussed with Treasury:

**Mr TORBAY:** The competitive neutrality is a major issue in regard to assistance. However, the Auditor-General commented that it is not given any specific consideration in arriving at any assistance to be provided. What would Treasury's views be to a scheme where competitors to an assisted business are allowed the opportunity to protest against the assistance on competitive neutrality grounds?

**Mr JORDAN:**<sup>68</sup> Well, on the first part of the question, when we look at projects that have more than \$1 million in NPV assistance involved, competitive neutrality is probably the most important criterion that we look at from a Treasury perspective, so I think we would dispute that allegation. We certainly take competitive neutrality

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<sup>66</sup> Audit Office report on DSRD, p 45

<sup>67</sup> Director General, DSRD, transcript of hearing, 3 May 2000, p 116

<sup>68</sup> Director Economic Strategy, NSW Treasury, transcript of hearing, 24 May 2000, p 14



into account. We look at footlooseness and we look at the viability sorts of things that Mr Graham was talking about. We have a very close look at all these projects and we put our advice back to the Treasurer as to what we think about the project.

However, as discussed in chapter 12, it is unclear to what extent Treasury advice is used to overrule an assistance proposal by the Department. The Committee will use the abattoir and meat processing industry as an example of competitive neutrality concerns not being given sufficient weight by the Department.

### ***NSW Meat Processors and Abattoirs***

The meat processing industry in New South Wales has been restructuring. The New South Wales Meat Industry Authority (1998) stated that in 1974, there were 95 licensed abattoirs in NSW and in 1998 there were only 47. Industry expectations were that up to half of the remaining works would close during the next five years. In 10 years, only a handful of large, efficient plants will probably be operational. There is over capacity in the industry, along with a number of old and inefficient plants.

The Authority noted processing costs in Australia are, on average, \$1 per kilo higher than in the United States. There were a number of reasons for this result, including the US plants' greater capacity and many of them work double shifts.

### ***New South Wales Meat Industry Act 1978***

The main cause of restructuring has been deregulation. The New South Wales Meat Industry Act 1978 and the Meat Industry Authority regulate the processing industry and the licensing of slaughtering premises. Under section 11(4)(c), it was required to refuse an application for a licence if the area to be serviced by a new abattoir was adequately served by other plants.

The NSW Government review of the Act in 1997 noted this provision protected established firms from competition. They were less likely to innovate, minimise costs or improve efficiency than if there were a competitive market. The review also suggested the over capacity in the industry could be due to the Act. There was less pressure on inefficient firms, making any rationalisation slower.

At the time, the Authority's policy was, if local demand was already met, new applicants had to demonstrate one of the following:

- the regional need for another plant;
- the proposed plant will use new technology; or
- the plant will be satisfying a special export need.

The Authority had used this power to restrict the number of licences. However, the review noted the application of the principles had been relaxed and no applications



had been refused purely on this basis. This relaxation by the Authority, along with the removal of section 11(4)(c) by the *Meat Industry Amendment Act 1998*, has prompted the restructuring of the industry.

### ***Interventions by the Department***

There have been a number of high profile interventions by the Department in the abattoir industry. In March 1996, the Treasurer and Minister for State and Regional Development announced the Government would provide \$1.05 million in tax concessions to prevent the closure of Gunnedah Shire Abattoir.<sup>69</sup>

Mr Egan stated the Government did not normally support troubled businesses. However, he made this case an exception because of the abattoir's contribution to the local economy and the Council's willingness to overhaul the abattoir's operations. The offer of assistance was subject to several conditions, including the corporatisation of the abattoir and the establishment of an independent board with suitable industry experience.

The intervention was also supported by Price Waterhouse, which wrote an independent report on the plant. The assistance package comprised a stamp duty exemption of \$250,000 for the corporatisation and two annual payroll tax rebates of up to \$400,000. However, despite this assistance, the plant closed in March 1998.

The Government announced another abattoir rescue in March 1998, this time in Grafton. The options raised by the Government included concessions on payroll tax and stamp duty. The plant is still operational, although the Committee understands there were impacts on nearby areas, including Casino.

During evidence, Treasury discussed the conditions where competitive neutrality would be of concern:

**Mr JORDAN:**<sup>70</sup> ...But coming back more broadly to the competitive neutrality issue, there is a spectrum, I guess, of projects that could come along. Ideally what you are looking to do when you are providing industry assistance is to attract a new industry to the State, not have a competitive neutrality interference, say, within an existing industry that may be doing exactly the same thing.

Clearly, the provision of assistance to individual abattoirs during the last five years has interfered with the restructuring of the industry, which has been a very sensitive time for businesses and employees in that sector.

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<sup>69</sup> Press release by the Hon M R Egan (1996)

<sup>70</sup> Director Economic Strategy, NSW Treasury, transcript of hearing, 24 May 2000, p 16



### ***NSW Meat Industry Restructuring Program***

In 1998/99, the Government established the Country Meatworks Working Party to examine the restructuring of the industry. The Working Party included representatives from the relevant State agencies, the Country Meatworks Association, the Country Mayors Association and the relevant unions. It was chaired by Premier's Department.

On 20 November 2000, the Premier announced the new program, which will involve new spending of \$8.4 million over three years and \$724,000 per annum for five years from the Regional Economic Transition Scheme (\$3.6 million), giving a program total of \$12 million.<sup>71</sup> The program has the following components:

- *Strategic Business Reviews*: DSRD will fund 75% of consultants' studies of individual abattoirs. Assistance capped at \$20,000 per firm. Total of \$840,000 allocated.
- *Industry Benchmarking Study*: The Government will fund a benchmarking study of the industry in NSW, so that operators may identify areas for improvement (\$50,000).
- *Value Adding Investments*: DSRD will provide incentives to encourage abattoir operators to further process meat past the carcass stage. Assistance will include payroll tax rebates, infrastructure and training (\$3.85 million).
- *Moratorium on Financial Assistance to Increase Slaughter Capacity*: For the next three years, DSRD will not provide discretionary assistance to increase slaughter capacity.
- *Accreditation of Employee Competencies*: Abattoir operators will be assisted to engage consultants to validate employees' competencies for accreditation (\$388,000).
- *Meat Processing Jobs Network*: The Government will fund a jobs service for abattoir work, which can be used by both operators and employees (\$100,000).
- *OH&S Management Systems*: The Government will fund abattoirs for 75% of the cost of consultancies to develop OH&S systems. Assistance capped at \$15,000 (\$630,000 total).
- *OH&S Performance Improvement Projects*: Dollar for dollar assistance will be given to individual abattoirs for specific OH&S measures. Assistance capped at \$50,000 (\$900,000 total).
- *OH&S Education, Training and R&D*: WorkCover will continue to work with the industry to improve its OH&S performance (no specific sum allocated).

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<sup>71</sup> Press release by the Hon R J Carr (2000)



- *Short Term Response Packages:* The Government will develop a standard package to cater for abattoir closures, which usually occur with little notice. They will largely consist of advice to employees (\$60,000 total).
- *Employee Relocation Allowance:* The Department of Community Services will provide up to \$3,000 to families to help them relocate following a closure (\$1.4 million total).
- *Assistance to Communities:* The Government will provide assistance to communities affected by abattoir closures to develop new investments. The Regional Economic Transition Scheme will be used for this component (\$3.62 million total).

### ***Discussion***

Selective industry assistance puts the selected firm's competitors at a disadvantage through no fault of their own. Such assistance in industries that are restructuring is even more contentious, because the Government has discriminated against firms that are on the margin and may have assisted in their closure. The Government should be very careful in how it interferes with this restructuring. The Productivity Commission in 1999 recommended governments concentrate on assisting individuals through change caused by competition, rather than assisting firms.

#### **Recommendation 24**

DSRD should not provide financial assistance to firms in an industry that is restructuring, without the Government first considering whether a whole of government strategy is required. Any such whole of government strategy for restructuring industries should concentrate on assisting individuals cope with the changes, rather than firms.

The Committee is pleased much of the new meat industry program relates to market failure (eg OH&S regulation and accreditation of employee competencies) or helping individuals cope with the change caused by abattoir closures.

The Committee notes, for many components of the program, there are sufficient funds to allow all current abattoirs to access them. However, there are two components that involve some selectivity: the value adding investment proposals and the OH&S performance improvement projects. In the case of the latter, funding is awarded after competitive assessment by WorkCover.

For the value adding investment proposals, funding is awarded on a case by case basis by DSRD. As noted in chapter eleven, the Department's arguments against competitive tendering involve reacting to deadlines imposed by multinational firms that are choosing a range of sites. However, in the case of NSW abattoirs, these physical investments are already in place. It is unlikely DSRD will be reacting to tight deadlines imposed by an astute multinational. The Committee is of the view competitive tendering can be applied to the assistance for value adding investments.



**Recommendation 25**

DSRD to use competitive tendering in assessing applications for value-adding investment proposals under the NSW Meat Industry Restructuring Program.



## Chapter Thirteen

### A New South Wales Research and Development Program

It is well established firms may not undertake a R&D project that is profitable for society because sometimes the benefits of the project “spillover” to other firms or bodies, from which the firm itself cannot benefit. As far as the firm is concerned, it doesn’t make a profit, so it doesn’t do the research (see chapter four).

Although DSRD attempts to raise awareness of R&D to local firms (eg the Innovation Council and the Innovation Website), it does not appear to provide direct assistance to firms or other organisations to conduct R&D. Accordingly, the Committee gives in-principle support to DSRD developing its own R&D program.

#### *The Status of Australian Business Expenditure on R&D*

As the Industry Commission noted in 1995, Australian business invests less in R&D than its overseas counterparts. For example, the Industry Commission’s 1995 report on R&D noted Australian business expenditure on R&D (BERD) as proportion of GDP in 1992 was 0.69%. This was significantly less than the OECD average of 1.18%. The Commission stated this lower performance is largely due to previous high levels of protection, our smaller manufacturing sector (most R&D occurs in manufacturing) and the structure of that sector (Australia is active in areas with low and medium R&D intensity). Australian BERD over the last 24 years follows.

**Table 11: Business Spending on R&D, 1976/77 to 1998/99**

Year	BERD, Current Prices (\$m)	Ratio of BERD to GDP (%)
1976/77	225	0.26
1978/79	280	0.26
1981/82	397	0.25
1984/85	731	0.34
1986/87	1,289	0.48
1988/89	1,798	0.54
1990/91	2,082	0.54
1992/93	2,862	0.67
1994/95	3,508	0.74
1996/97	4,247	0.80
1998/99	3,992	0.67

Source: Industry Commission (1995) and ABS, Cat Nos 8112 and 5204.



Overall, BERD has been increasing, with the largest jumps occurring in the mid-80s (when the 150% tax concession was introduced) and in the early 90s. However, BERD dropped during the late 90s, probably because the Commonwealth reduced the concession to 125% in 1996. Some commentators have argued, despite the past 15 years of economic reform, the culture of Australian business is still centred on seeking concessions from government rather than generating profits through its own initiatives such as R&D.<sup>72</sup>

### ***Western Australia R&D Programs***

Some State Governments run R&D programs for business. One example is Western Australia. Two schemes, which mirror Commonwealth activities, are below.

#### Innovation Support Scheme

This scheme funds R&D activities by local firms and provided 12 grants of approximately \$50,000 each in 1998/99. Grants are available on a dollar for dollar basis, from \$20,000 to \$50,000. Applicants are expected to have an annual turnover of less than \$20 million and less than 100 staff. The projects would be expected to cost less than \$200,000. The eligibility criteria include:

- Applicants must demonstrate they cannot benefit from the 125% tax concession.
- The project must show net economic benefits for WA (eg jobs or investment).
- Applicants must demonstrate a real need for funding. That is, there are no alternative funding sources or the project will not proceed in a timely way to maximise its benefits.
- The project must be aimed at commercial outcomes. Applicants must be able to demonstrate they can finance the commercialisation of the project outcome.

#### Centres of Excellence in Industry Focussed R&D

The main component of this program is funding to science and technology research centres for the purchase of research infrastructure. The Government paid \$938,000 in 1998/99 for this purpose, out of total approved grants of \$3.7 million (grants are spread over three years). The funding minimum is \$250,000. Recipients are Cooperative Research Centres (CRCs) and other research bodies (eg the Australian Centre for Geomechanics and the Centre for Water Research).

The eligibility criteria include:

- The centre, or proposed centre, must conduct research that will be of commercial benefit to Western Australia.

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<sup>72</sup> Gittins "Lobbying for Innovation" *Sydney Morning Herald* 9 October 2000, p 35





- The centre must be a publicly accountable entity or comprise publicly accountable entities such as universities, private sector entities and government agencies.
- It must demonstrate significant industry support.
- It has a strategic plan that indicates an agreed direction between participants.

### ***Industry Commission's views on R&D Programs***

In its 1995 report, the Commission recognised governments had a role in correcting market failure by subsidising R&D. Even the Uruguay Round of trade negotiations permitted subsidies for R&D. The Commission's main point was the focus should be on supporting R&D that would not have otherwise occurred because the firm in question did not get enough of the benefits of the work to make it profitable, although society overall (including its competitors) got substantial benefits. There are some implications from this basic position:

- Subsidies should go to research with generic benefits to a range of firms, rather than to technologies with benefits to specific firms.
- Commercialisation by the assisted firm should not be a requirement for funding. This approach concentrates on benefits to the assisted firm, whereas the reason for government to encourage R&D is the general benefits to other businesses.
- A key concern of government should be not to assist projects that would have gone ahead anyway, even if they would not have gone ahead satisfactorily. An initial indicator would be failure to get funding through other channels (eg venture capital or banks).
- Projects with multiple commercial partners should be preferred over those with single commercial partners.
- Dissemination of results should be a priority. On the other hand, requiring intellectual property agreements to be in place before a grant is awarded reduces the flow-on benefits to the rest of society.

However, the Commission found that it was virtually impossible for government agencies to accurately determine whether a project would go ahead without assistance. It is also very difficult for governments to assess what projects have the highest spillover benefits for the rest of society. It recommended against grants to individual firms to undertake R&D.

One area where the Commission accepted a role for competitive grants is collaborative research between public bodies and businesses. These grants typically involve work earlier in the R&D chain where the chances are greater for the benefits of the work to spillover to other firms and bodies. Further, the ownership of the intellectual property is typically vested in the research partner, allowing dissemination of the results.



### *Discussion*

The Committee is of the view DSRD should develop its own R&D program to support collaborative research between public bodies and businesses. This gives the Department the best chance of using its funds to promote R&D that would not have otherwise occurred, but is still of substantial benefit to society. The Committee has already identified some savings (eg the cancellation of the High Growth and Small Business Expansion programs) that could be used to fund such a program.

Although the Commonwealth already funds Cooperative Research Centres, which have a similar role, the Committee is not concerned about duplication in this case as:

- State agencies already provide support and direction to CRCs.
- The Industry Commission supported diversity in all aspects of R&D programs, including the involvement of all levels of government.
- DSRD can give priority to firms and bodies that have not yet participated in collaborative research.

#### **Recommendation 26**

DSRD develop its own collaborative R&D program that promotes links between industry and research organisations. Features of the program should include:

- A grant maximum of 50% of project costs.
- Grants be allocated by competitive tendering.
- Projects should either have more than one commercial partner, together with the research institution, or if there is only one commercial partner, it should not have exclusive rights to the technology.
- Projects should not be limited to a particular industry sector.
- Diffusion of results should be emphasised, rather than commercialisation.
- Priority should be given to firms and groups that have not previously participated in collaborative research.



## Chapter Fourteen

### The Export of Government Services

#### *Introduction*

Australia is a developed country and its public service agencies operate at a standard comparable with international best practice. Other countries, including developing nations, often make use of this expertise, especially through aid programs. The Industry Commission estimated the size of the Australian share of this market to be \$2.1 billion in 1995/96, or 2% of total Australian exports.<sup>73</sup>

In its 1995 report, *Offshore and Off-Target*, the Committee listed many reasons why NSW agencies should be involved in this area. They include:

- revenues, jobs and profits;
- earning a return on taxpayers' investment in public sector skills;
- sharpening skills in NSW in competition with world's best practice;
- benefits to the private sector;
- prestige and goodwill; and
- internationalising the world's economy.<sup>74</sup>

The NSW Government issued guidelines to manage these exports in 1993.<sup>75</sup> However, despite the guidelines, these projects have not always been well managed. As the Industry Commission commented on the export of government services generally:

The financial profitability of government service exports is highly variable. GBEs and many of the education institutions face strong commercial pressures to ensure that their exports are profitable. In contrast, it is doubtful if exports by many budget sector agencies fully cover costs, let alone make a profit. In some cases, this may be appropriate given the wider benefits that can accompany these exports. However, in others, it reflects poor commercial judgement or accounting systems that do not properly identify the costs entailed in exporting.<sup>76</sup>

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<sup>73</sup> Industry Commission, *Export of Government Services* (1997), p ix

<sup>74</sup> See p 6 of the report

<sup>75</sup> Premier's Memorandum 93-31, *Guidelines for the Export of the Skills and Expertise of NSW Public Sector Agencies*

<sup>76</sup> Industry Commission, *Export of Government Services* (1997), p x



In *Offshore and Off-Target*, the Committee surveyed a number of NSW agencies from 1992/93 to 1994/95. The total profit/loss figure for this period across all agencies was a loss of \$8 million.

In contrast, South Australia and Victoria had created special corporations to manage these projects (SAGRIC and OPCV). Over the same period, these bodies had delivered profits for their States of approximately \$1 million and \$3 million respectively. These corporations' success has resulted in them being major players in the market. For example, they are in the top 10 recipients of AusAID funding.

**Table 12: Top 10 Organisations, Current AusAID Country/Regional Projects**

Organisation	Number of Contracts	Total Value (\$m)
ACIL Australia	25	216.0
SAGRIC International	16	156.3
GRM International	10	125.8
Boulderstone Hornibrook	1	83.0
OPCV	16	82.8
IDP Education Australia	12	81.7
Hassall & Associates	14	67.8
SMEC International	2	56.1
Barclay Mowlem Construction	9	52.4
Support Services	2	45.0

Source is AusAID, *Business Participation*, 1999/2000. IDP is the commercial arm of a consortium of universities. SMEC is descended from the Snowy Mountains Electricity Corporation.

The Committee found several reasons for NSW's losses:

- lateness in entering the market;
- little bottom line pressure;
- virtually no economies of scale; and
- a supply-driven rather than market-driven approach.

### ***The Preferred Model***

In *Offshore and Off-Target*, the Committee identified three options:

- through the public service;
- through a licensed private sector corporation; and
- through a government corporation.



The Committee rejected the first option because it did not introduce commercial pressures on agencies to perform. It rejected the second option because government bodies carry more prestige and have privileged access to markets. The Committee recommended the creation of a government-owned International Projects Corporation with a staff of 11. This was similar to the Victorian and South Australian models at the time. It would have also meant the profitability of the projects would be properly reported.<sup>77</sup>

The Industry Commission accepted the need for commercial practices, competitive neutrality and public reporting, but took a different view on how these goals might be achieved. It stated:

Nonetheless, the case for other jurisdictions to replicate the OPCV or SAGRIC models is not compelling. The marketing of government services is now much better developed than when these organisations were established. Over the years, private project managers and some agencies have acquired considerable marketing experience in this field. Thus, it is not clear that new public sector managers would add much value in an already competitive market. Centralising responsibility can also mean that, for individual agencies, the direct link between exporting and their domestic activities is weakened.<sup>78</sup>

The Industry Commission instead recommended explicit export guidelines for non-corporatised agencies in jurisdictions that did not have them. However, the Committee proved in its 1995 report that the NSW guidelines, which meet the Industry Commission's criteria, have not been effective in protecting the interests of NSW taxpayers. Accordingly, the Committee reaffirms its support for a government-owned corporation to manage the export of government services.

### ***The NSW Approach***

NSW has taken the option of managing these exports through the public service. At the end of 1998, a Government Services Export Unit was established in DSRD. In 1999/2000, the Unit had one staff member and a budget of \$140,000.<sup>79</sup> This low level of resources means the Unit is generally limited to being a referrals and reception service.

Given this lack of central authority within the Government, some agencies have followed the same path as the universities and created their own commercial corporation to manage the export of their services.<sup>80</sup> For example, Aus Health International Pty Ltd was incorporated in 1997 to export health services. It is managed by a board of up to seven directors and its shares are equally owned by the

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<sup>77</sup> The SA Government has since sold SAGRIC to Coffey MPW Pty Ltd. It now runs a Government Services Export Unit within the bureaucracy.

<sup>78</sup> Industry Commission, *Export of Government Services* (1997), p xiii

<sup>79</sup> Department's submission, Appendix 5

<sup>80</sup> For example, UNSW has set up New South Global Pty Ltd.

Treasurer and the Minister for Health. Its operations are reported in the Auditor General's reports to Parliament. It made a profit in 1999/2000 of \$329,000, compared with a loss of \$429,000 in 1998/99.<sup>81</sup>

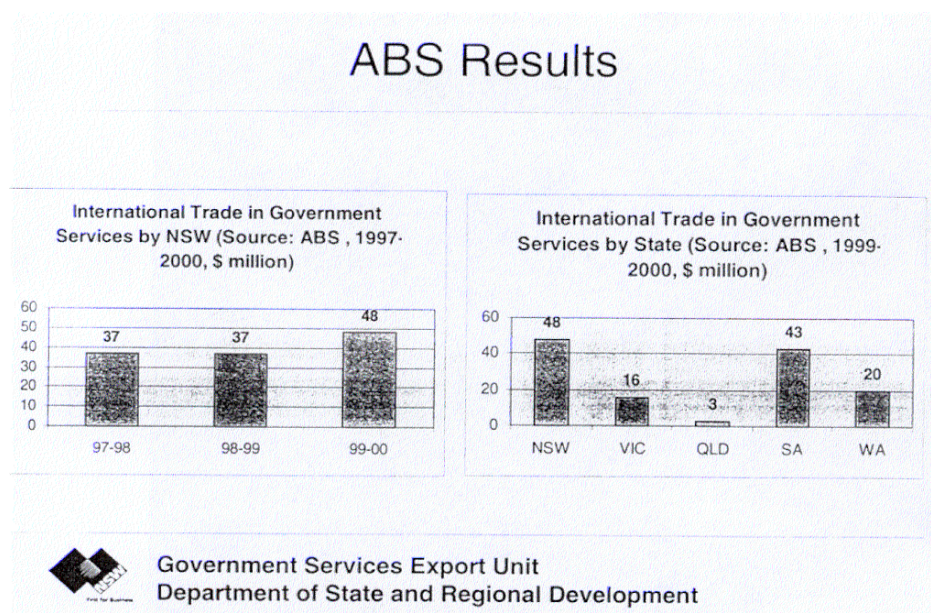
In contrast, some agencies still run projects as part of their departmental operations. This does not comply with the NSW guidelines. Firstly, it reduces the pressure to operate commercially. Losses can be met from the agency's general revenue. Secondly, the profit or loss of the venture is usually not separately reported. For example, in 1999/2000 Premier's Department was managing three AusAID contracts in Fiji, with a total value of approximately \$1.2 million. However, they were not mentioned in the Department's Annual Report for that year.

### Performance Measurement

As discussed in chapter seven, it is more useful for performance indicators to measure the results of a program, rather than the work done. However, DSRD's Annual Report takes the latter approach in reporting the work of the Government Services Export Unit. It lists the number of agencies assisted, the number of meetings it arranged, and the number of records on its database. Whether this work resulted in any contracts, and whether they were profitable, has not been discussed.

DSRD has quoted data from the Australian Bureau of Statistics (ABS) to present its work in a favourable light. The figure below has been given at some of DSRD's presentations.

**Figure 3: Excerpt of DSRD Presentation**



Source is DSRD

<sup>81</sup> Auditor General's Report to Parliament 2000, Volume 5, p 283



The charts use data from table F2 in the ABS publication, *Balance of Payments & International Investment Position*, Cat No. 5363. There is an entry in the table for government services n.i.e, which matches the Department’s figures. However, n.i.e. stands for “not included elsewhere” and largely covers military items, embassies and consulates. A government export relating to education would be listed under the entry “education related” on the table. DSRD has misinterpreted the data and presented a misleading picture of its success.

Although a definitive measure of NSW’s performance in this area is not currently available, some proxies do exist. One possible approach is to examine the share of the AusAID budget NSW has secured. Many of these projects require specialist skills only found in government. The table below shows the States’ relative performance.

**Table 13: AusAID Budget by State, Current Contracts, 1999/2000**

State	Value of Contracts (\$m)	Share of Contracts (%)	Share, Excluding “Other” (%)	Population (%)
NSW	306.3	19.7	25.3	33.8
Victoria	480	30.9	40	24.8
Queensland	218.5	14	18	18.5
SA	201	12.9	16.6	7.9
WA	3	0.2	0.2	9.8
Tasmania	0.2	0.0	0.0	2.5
Other	346.3	22.3	--	2.7
Total	1,555.3	100	100	100

Table calculated using AusAID, *Business Participation*, 1999/2000. “Other” includes the ACT, NT and overseas contractors. Population shares calculated from document on ABS website, *Population Size and Growth*.

The table compares the share of the budget each State receives with the share it might expect to receive, based on its population. The ACT receives a disproportionately large share of the budget due to its proximity to federal agencies and has been placed in the “other” category so as not to distort the results. International providers of work for AusAID have also been put in this group. Therefore, the share of the budget a State could properly be considered to have received is in the “Share Excluding Other” column. The population column gives the benchmark.

The table shows Queensland and Tasmania have performed adequately, as they have a share of the budget similar to their population size. Victoria and South Australia have above-average performance. This may be due to them establishing their government-owned corporations to manage this work (OPCV and SAGRIC). OPCV has 17% of Victorian AusAID contracts and SAGRIC has 78% of the contracts in South Australia.



NSW and Western Australia have below-average performance. WA could explain this by its geographical isolation from Canberra, but no such interpretation applies to NSW. The AusAID budget is probably only one component of a proper performance indicator, but it does suggest NSW has ground to make up in the export of government services.

### Discussion

Despite *Offshore and Off-Target* in 1995 and a follow-up report by the Committee in 1998, the Government has not acted on the Committee's recommendations for a single corporation to manage these exports across government.

The Committee is concerned the management of the export of government services in NSW has not greatly improved since 1995. The Government Export Services Unit is under-resourced and does not provide the central expertise and focus which the OPCV and SAGRIC have given their States. The Committee remains of the view a similar state-owned corporation should be established in NSW.

The Public Accounts Committee recommends this reform for the third time.

Anticipating the Government will continue with the status quo, the Committee makes an alternative recommendation in recognition that the main area of improvement in NSW since 1995 has been the establishment by some agencies of their own corporations to manage these exports.

This alternative is inferior as it creates substantial duplication. However, it would at least result in projects being commercially focussed, having their financial results reported to the public and making their accounting and budget arrangements discrete and transparent.

### **Recommendation 27**

The Government establish a state-owned corporation to manage the export of government services and implement the Committee's other recommendations from its 1995 report, *Offshore and Off-target*.

Alternatively, the Government require all relevant agencies to establish their own corporations to manage the export of their services.