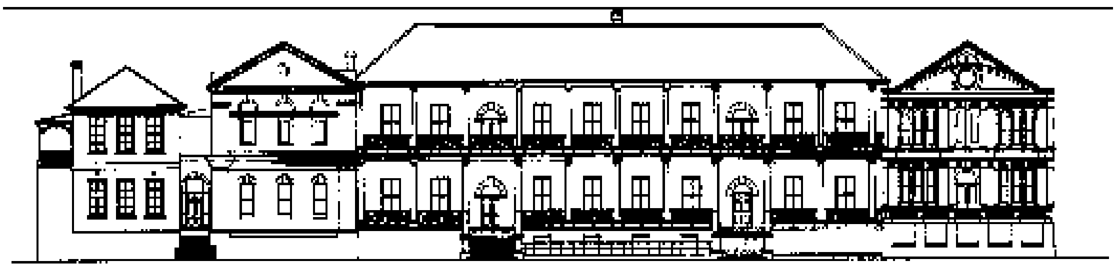
PUBLIC ACCOUNTS COMMITTEE

INDUSTRY ASSISTANCE



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Charter of the Committee

The Public Accounts Committee has responsibilities under the *Public Finance and Audit Act 1983* to inquire into and report on activities of government that are reported in the State's Public Accounts and the accounts of the State's authorities.[1] The Committee, which was established in 1902, scrutinises the actions of the Executive Branch of Government on behalf of the Legislative Assembly.

The Committee recommends improvements to the efficiency and effectiveness of government activities. The sources of inquiries are the Auditor-General's reports to Parliament, referrals from Ministers and references initiated by the Committee. Evidence is primarily gathered through public hearings and submissions. As the Committee is an extension of the Legislative Assembly its proceedings and reports are subject to Parliamentary privilege.

Members of the Committee

The Committee comprises members of the Legislative Assembly and assumes a bi-partisan approach in carrying out its duties.

Chairman:	Joseph Tripodi MP, Member for Fairfield
Vice-Chairman:	The Hon. Pam Allan MP, Member for Wentworthville
Members:	Ian Glachan MP, Member for Albury
	Katrina Hodgkinson MP, Member for Burrinjuck
	Richard Torbay MP, Member for Northern Tablelands
	Barry Collier MP, Member for Miranda

Committee Secretariat

Secretariat members involved in the Inquiry were:

Committee Manager:	David Monk
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[1] See Part 4 of the Act – The Public Accounts Committee.

Chairman's Foreword

The Public Accounts Committee is pleased to present its report on industry assistance following the Auditor General's report on the Department of State and Regional Development (DSRD) in 1998.

Although many New South Wales agencies run industry programs, the Committee has concentrated on the Department. It is the Government's main assistance agency and the Committee is of the view DSRD has a case to answer following the Auditor General's report. Comments made relating to the Department of State and Regional Development are applicable to other agencies that carry out similar programs.

The Committee accepted submissions from interested organisations, Ministers and Departments. The Committee held hearings in Albury, Armidale and Sydney.

The Committee thanks the representatives of agencies that provided assistance on these occasions, including the Department of State and Regional Development.

Generally, New South Wales has to date avoided much of the wastage and many of the excesses of other governments in Australia and overseas. On a per capita basis, the Department's budget is modest and this appears to have imposed some level of discipline. In addition, New South Wales enjoys many competitive advantages over its rival jurisdictions. For example, it has most of Australia's bank head offices, regional headquarters and international business arrivals. These advantages have also allowed the Department to attract investment cheaply.

The success of the NSW Government in restraining corporate welfare provided by the Department of State and Regional Development is to be commended. This result is largely attributable to the work of NSW Treasury.

Both the NSW Government and the Department have a policy perspective that essentially allows the market to allocate the State's resources. However, this raises the question of exactly why, and if so where, the Department should intervene in the State's economy. This broad policy framework seems to be lacking when the ad hoc nature of the Department's programs are considered.

The Committee used two main criteria as an initial test to examine whether the Department's programs were appropriate. Firstly, whether they improved economic efficiency, or secondly, whether they addressed social justice issues. If neither criterion applied, the Committee has recommended they be discontinued or changed.

A large number of the Department's programs passed this initial test. Many of the programs that do not improve economic efficiency are aimed at improving social outcomes in regional NSW. The Government has been explicit in this approach, releasing its policy *Rebuilding Country New South Wale*s in 1998.

One program where the Committee recommends change is in providing financial incentives to attract investment to Sydney. These programs do not have an efficiency or social rationale. Further, the Committee is concerned about the value of DRSD's work in progressing economic development within Sydney when its contribution and performance cannot be objectively measured.

The Committee is also concerned DRSD is claiming “victories” for economic activity that would have occurred without its intervention. One simple example is in the export of NSW Government services. The Government Services Export Unit presented ABS data verifying its success. However, DSRD made no connection between its work and the statistics; it simply claimed the result. When the data was subjected to elementary scrutiny, it proved to be misleading. A simple, objective measure of the Unit’s success, namely the proportion of total AusAID expenditure won by NSW vis-a-vis other jurisdictions, proved NSW to be a substantial under-performer, contrary to the Department’s claims.

Until the Department tackles the issue of an objective and transparent measurement of its contribution to economic development in NSW, the question will remain whether DSRD actually achieves what it claims.

Announcements for investments outside Sydney can be more directly and objectively attributed to the work of the Department. Also, such projects would be of greater social benefit through larger multiplier effects and less crowding out.

A number of other issues were pursued by the Committee. For example, it spent two and a half days in hearings talking to representatives of regional industry agencies from Albury, Armidale and Goulburn. It soon became clear there are too many organisations involved in regional development. The functions of Regional Development Boards, Business Enterprise Centres and independent development organisations can all be delivered by councils or regional organisations of councils. The Department has under-utilised this ready-made network of assistance.

The Committee is also concerned the Department does not publish the individual amounts of assistance it gives to firms. The Committee does not accept this practice is necessary, given there is a considerable amount of disclosure by other agencies around Australia. Further, disclosure would not reveal a firm’s business secrets, given the investments become physically apparent anyway. Agencies need to be accountable to taxpayers about how public funds are spent.

The Committee trusts its recommendations will prompt a thorough evaluation of the Department’s activities and deliver increased benefits for New South Wales.

Joe Tripodi

Joseph Tripodi MP
Chairman

Executive Summary

Introduction

Although the Department of State and Regional Development (DSRD) is divided into a number of Divisions, the best way of analysing the Department is to examine its actual activities. The Committee found DSRD is involved in the following eight activities:

- attracting and retaining economic activity;
- business advice;
- promoting NSW;
- regulation;
- funding research and development;
- providing information to business;
- networking; and
- community growth strategies.

On a per capita basis, the industry departments in other states have larger budgets than DSRD. The key components of the Department's $90 million to $100 million budget are:

- regional industry assistance (24%);
- general industry assistance to both Sydney and the regions (11%);
- assistance to small business in both Sydney and the regions (9%);
- staff (22%); and
- general expenses (21%).

There have been a number of common findings between recent reviews of industry assistance in Australia. The main ones are:

- Bidding between States to secure investment is wasteful. Some form of agreement could be reached to stop it.
- Treating industry assistance as commercial-in-confidence is not necessary.
- Standard government procedures (eg, eligibility criteria, monitoring and evaluation) should be used for all business programs.
- Selective business programs can distract governments from their unique function of improving the business conditions for all firms in their jurisdiction (eg taxes, infrastructure and regulations).
- The first priority of business programs should be on correcting market failure. Economic transition programs are also appropriate in special circumstances.

Findings and Recommendations

Finding: NSW's business programs should initially be judged on whether they improve the efficiency of the economy (pages 21-25)

The primary role of businesses in society is to improve the material wealth of the community. Accordingly, the first criterion in assessing industry programs must be whether they improve the efficiency of the economy. Of the Department's eight activities, the following four have the capacity to bring efficiency benefits:

- promotion of NSW and Sydney;
- regulation;
- information to businesses; and
- research and development.

The remaining four cannot be supported in-principle on efficiency grounds:

- attracting and retaining economic activity (bidding wars);
- advice to firms;
- networking; and
- community growth strategies.

Finding: Financial incentives are not the drivers of investment (pages 26-28)

The great bulk of investment in NSW is driven by the fundamentals of the economy, rather than attraction programs. Investment decisions are more likely to be based on access to markets, raw materials, a skilled workforce and good infrastructure.

Finding: Perverse incentives encourage governments to offer assistance to attract investment (pages 28-33)

The losers from investment attraction are competitors which do not receive assistance and taxpayers in general, which support the activity. These costs are hidden, but the benefits are high profile. Governments are able to promote the attraction as winning something for their community. At first glance, investment attraction programs appear to give a net benefit.

Despite the evidence these attraction programs have limited long term benefits, governments continue to provide them as they fear they will miss out on investments.

Finding: The second rationale for DSRD's programs is to improve social justice outcomes (pages 34-39)

The Government through its direction statement, *Rebuilding Country NSW*, has taken a policy decision to aim the Department's regional programs to address social concerns in regional NSW. These programs have a suitable rationale.

However, there are a number of programs which do not improve either economic efficiency or social justice outcomes. These should be discontinued or modified.

Recommendations

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

Finding: The Department's program description in the Budget Papers does not reflect its activities (page 40)

The Budget Papers list one program for DSRD, "Development of the NSW Economy." The Department in fact has two roles, improving the efficiency of the economy and addressing social concerns about regional NSW, eg adjusting to economic change.

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.

Finding: DSRD's performance indicators tend to be outputs (work done), rather than outcomes (results achieved)(pages 40-42)

For example, the main performance indicator for the Women in Business Program is 336 women participated. However, it would be more useful to determine what proportion of participants established businesses or changed a business decision as a result of the seminars.

With its small business advisory programs, the Department uses the assisted firms' growth as a performance indicator. However, DSRD selects the firms on the basis of their strong growth potential, so they would be expected to do well anyway.

Recommendations

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

Finding: DSRD over-estimates the success of its attraction programs (pages 42-44)

The Department used a benchmarking study to compare its performance against other industry departments in Australia and overseas. The measures used were expenditure per job facilitated and investment facilitated per unit of expenditure. DSRD performed well. However, the study probably only reflects the basic attractiveness of NSW compared with other locations.

The Department also claimed it had facilitated 19% of all of NSW's new business fixed investment and 20% of all jobs. However, this statistic fails to recognise much of this investment would have occurred anyway and there were probably alternative uses for the resources involved.

Recommendations

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.
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.

Finding: DSRD does not evaluate many of its programs adequately (pages 44-46)

The Committee received information on some of DSRD's programs, including how they had been reviewed. Five of the programs were sufficiently mature to be eligible for review. However, in some cases the extent of the review was a client survey. These surveys do not include comment from companies which did not receive assistance. Further, it would be unlikely for firms which had received money from the Government to give critical comments.

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.

Finding: There is no valid reason why DSRD's assistance should remain confidential (pages 47-53)

The generally accepted principle about public money is governments should be accountable for how it is spent. Contrary to this, the Department prefers to keep its assistance confidential. Its first argument is publication would expose a client's business plans and cash flow. However, all of a client's initiatives would be physically apparent by the time the investment was operating. Its competitors would be able to make a reasonable assessment of its operations from physical evidence.

The second argument is the information could be used by other firms to set a base for their own negotiations for funding with DSRD. However, a number of agencies are already releasing details of assistance. Tourism NSW, for example, has published its contribution to secure the Bledisloe Cup and the Greg Norman Holden International. Further, releasing details does not change the minimum figure a potential business is willing to accept.

Recommendations

11. DSRD should amend its assistance and funding contracts to state that in the Department's annual report for that financial year it 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.

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

Finding: There are too many organisations in regional development (pages 54-62)

There is a large number of organisations in regional development. The list includes councils, DSRD's regional offices, Regional Development Boards, Premier's Department Regional Coordinators, Small Business Service Centres (formerly BECs) and independent development bodies.

To a large extent the money spent on these organisations has only created additional bureaucracy, rather than delivering additional services. These bodies tend to develop as separate entities more interested in perpetuating themselves. The large number of organisations represents duplication, inefficiency, misuse of resources and requires a considerable degree of coordination. There is already a long-established network of councils which the Department has under-utilised.

Recommendations

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.
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.
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.
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.

Finding: There is a low level of awareness of DSRD's services in regional NSW (pages 62-64)

The Committee received considerable evidence to this effect. The Committee is of the view, as a general rule, government agencies should adequately promote their services and DSRD does not appear to have matched this standard. Council representatives stated they were often the first port of call for potential businesses in their areas. The Committee believes the council network can be used to publicise DSRD's programs.

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.

Finding: DSRD's regional offices do not need to be given more autonomy (pages 64-65)

Some witnesses suggested the Department's regional offices should be given a pre-approved budget so there would be a quicker turnaround on assistance decisions. However, DSRD's regional staff stated it could get a 24-hour turnaround on these matters. Further, local staff may become too close to prospective firms. The current arrangement also prevents bidding wars happening internally within NSW.

Finding: DSRD's secretive handling of investment leads has damaged its partnership with regional development groups (pages 65-67)

In hearings, the Department was criticised for distributing investment leads to groups, which the groups believed they had no chance of winning. The Committee accepts DSRD has to distribute some leads with a low chance of success. However, the secrecy attached to the leads denies any scrutiny of its partnership with local groups and allows the Department's clients to think the worst of it.

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.

Finding: Regional development groups are not sufficiently coordinated leading to missed opportunities (pages 67-70)

The large number of groups has meant resources must also be directed to their coordination. The development of turf wars between these groups appears to have made coordination more difficult. The Committee heard in evidence how inadequate communication between DSRD, Albury Council and the Albury-Wodonga Development Corporation meant NSW lost a possible investment.

Recommendations

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.
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.

Finding: The Country Industries (Payroll Tax Rebates) Act 1977 is out of date and no longer used (pages 70-72)

The Act directs assistance to manufacturing and food processing firms outside Sydney, Newcastle and Wollongong. However, the economy has developed and services can provide just as much wealth as manufacturing. Further, patterns of economic growth are more patchy and diverse than assuming all areas outside Sydney, Newcastle and Wollongong are doing poorly. The European Union takes a more sophisticated approach, using a needs index to allocate assistance.

The Act has been listed for a competition policy review since 1996/97.

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.

Finding: The arrangements for the Industry Assistance Fund do not encourage DSRD to get the best value for money (pages 73-77)

The Fund is currently divided into a small pooled fund ($3 million pa) for assistance packages up to $1 million. The remainder are approved by the Treasurer on a case by case basis after receiving Treasury advice. In 2000/01, these amounts will be increased to $5 million and $2 million respectively.

This arrangement provides little incentive for DSRD to prioritise assistance and encourages it to pursue larger projects and inflate the proposed level of assistance. Treasury's advice does not appear to have much impact on past decisions by the Treasurer.

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.

Finding: DSRD rarely uses competitive tendering, resulting in it getting less value for money (pages 78-80)

Competitive tendering helps governments generate competition when they enter into a commercial transaction. Tendering has public support and firms cannot demand an assistance package based on precedence. DSRD would not have to look for leads, as firms would come to it.

The Department's argument against using competitive tendering is prospective businesses only have a short timeframe before they make a decision. Therefore, at no stage are all possible projects "on the table" for consideration at the same time.

This argument only applies to attraction programs, therefore there are no obstacles to DSRD applying tendering to non-attraction programs. The Committee recognises

DSRD's argument for attraction programs, but wants DSRD to generate competition for its funds. Therefore, splitting the attraction programs is proposed.

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.

Finding: DSRD regularly breaches competitive neutrality, reducing the profitability of firms already located in NSW (pages 81-87)

Although the Department is required to consider competitive neutrality, this does not appear to have changed any of its decisions. An example is the assistance it provided to individual abattoirs. This assistance was inappropriate, given the sensitive restructuring process in the industry.

Recommendations

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

Finding: DSRD should establish a collaborative R&D program (pages 88-91)

R&D involves classic externalities. A DSRD R&D program would, in principle, improve the efficiency of the economy.

Although R&D programs should concentrate on assisting projects that would not have occurred without assistance, in practice it is almost impossible for government agencies to determine whether this is truly the case. Making commercialisation one of the eligibility criteria for assistance (as many programs do) diverts assistance to projects that probably would have proceeded anyway.

If DSRD decides to establish an R&D program, its focus should be on projects where the spillovers to other firms is greatest. This would occur where there are multiple commercial partners and the work is early in the R&D chain.

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.

Finding: DSRD's Government Services Export Unit is under-resourced and is not the appropriate structure for managing these exports (pages 92-97)

In its 1995 report, *Offshore and Off-target*, the Committee identified a government-owned corporation as the best structure for managing the export of government services. This model has been used with success in South Australia (SAGRIC) and Victoria (OPCV). However, DSRD manages these exports in NSW from within the bureaucracy with just one staff member. Its impact must be limited. In addition, the Department has used misleading statistics in promoting the work of the Unit.

The main improvement in NSW since 1995 has been the establishment by some agencies of their own corporations to manage these exports (eg Aus Health International). This at least means the projects are commercially focussed and the financial results are reported to the public.

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.