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# Inter-State bidding wars: calling a truce\*

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The Adelaide Grand Prix of 1994 is remembered mainly for the controversy that erupted on lap 35. Michael Schumacher, his car dying after clipping a wall, crashed into Damon Hill, taking both drivers out of the race and handing the German his first World Driver's Championship.

But cut-throat competition in that period was not confined to the track. Behind the scenes the Victorian Government had been working assiduously to secure the future rights to host Formula One in Australia, at the expense of its neighbour. Victoria's bid prevailed, and the rest is history. What is less clear, however, is precisely who won from this contest — apart from F1 Chief Bernie Ecclestone.

I start with this story to illustrate an important and growing phenomenon in Australia — competition between State and Territory Governments in the form of financial inducements to attract major events and investment projects and, as they see it, income and jobs to their State.

Actually, I will return to the car theme more than once because it seems that, whether it comes to making them or racing them, Australian governments find it hard to resist the allure of the automobile.

- Two years ago, for example, the Victorian Government, again in competition with South Australia, offered a special package to secure a Holden investment in a new engine plant in Melbourne. The Victorian Government has declined to release details of the grant (including its size), which was made on top of a \$12.5 million Commonwealth grant, citing commercial confidentiality.
- More recently, Mitsubishi in South Australia received a combined financial injection from the State and Commonwealth governments of \$85 million. In this

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case, the amount of funding is well known, but the specific criteria for providing it have proven harder to pin down.

- Going back a bit in history, there was a time when one Premier, in an attempt to retain a car plant in his State, even threatened to stop drivers of the particular make of vehicle from crossing the border if the company involved centralised its operations in a neighbouring State!

Of course, budgetary competition between the States and Territories to attract investment projects is not limited to the ‘horseless carriage’. Let me give some other examples:

- In 2001, the Queensland Government provided undisclosed incentives for Berri Fruit Juice to relocate its export production operations from NSW and South Australia to Queensland. Earlier, the South Australians had provided incentives to Berri to retain manufacturing operations in their State, after the company had been persuaded to shift its headquarters to Melbourne.
- Also in 2001, several States, particularly Victoria and Queensland, were bidding for federal funding to build a national synchrotron facility with potential for developing new pharmaceuticals, metals or machines. The Victorian Government subsequently bypassed federal funding and committed \$100 million to build the facility at Monash University.
- In 1999, Queensland outbid other States to have Virgin Blue locate its headquarters in Brisbane while, on a smaller scale, the ACT Government announced that it had successfully attracted Impulse Airlines to base its (ill-fated) operations in Canberra.
- And in 2000, the South Australian Government provided undisclosed incentives to attract Email (now Electrolux) to relocate from Victoria to South Australia. Some time earlier, that Government had provided incentives to entice Motorola to the State — the subject of public controversy just before the last State election.

State Governments generally announce such deals with fanfare, talking up the projected benefits in terms of investment dollars committed, jobs to be created, and multiplied effects throughout the local economy. Where they provide inducements in the form of tax-breaks or tax-holidays, governments may also reassure the community that all they are surrendering is money that they would not have collected anyway. Hence, it is claimed, these deals represent a ‘win’ not only for the recipient enterprise, but also for the Government, its taxpayers and the wider State economy.

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My message today may therefore not be entirely welcome. But the facts are that these sorts of deals are difficult to justify on economic grounds. Moreover, the processes for clinching them are even harder to justify against basic principles of good government.

In practice, it is difficult to assess the details of the claims made about particular assistance packages because governments generally keep the analysis and budgetary costs of the assistance to themselves. This raises its own problems in terms of transparency, accountability and due process. At the extreme, it opens the door to suspicions of nepotism or even corruption. More generally, when public scrutiny is hindered, there is more risk that an ethos of “*can do*” managerialism will swamp more cool-headed “*should we do?*” decision-making.

Indeed, on a number of occasions when the books have been opened up, it has turned out that the benefits had been significantly oversold, while the costs had been not only understated but often not understood.

For these and other reasons, the purported gains for the State are often illusory, and even when they are positive there will often be negative outcomes nationally.

These conclusions may seem somewhat radical. But they are well supported by detailed research conducted not only by my own organisation and its predecessors, but also by State and Territory Auditors-General and academic researchers in Australia and overseas. The problems are not without remedy. I will draw on the work of these bodies to make some suggestions for getting better outcomes.

But first, let me put this aspect of government industry policy into perspective.

## **State policies are important to industry development**

To begin with, it needs to be emphasised that State and Territory Governments have a critical role to play in the development of wealth-creating businesses and industries in Australia.

- The States and Territories plan most of the utilities, transport links and other physical infrastructure that underpin economic activity. Often they operate these essential services, or have responsibility for regulating those that do.
- They also have responsibility for many areas of social and environmental regulation.
- They levy land taxes, payroll taxes and the like that affect the viability of businesses.

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- And less directly from a business perspective, but just as importantly for economic development, State governments are primarily responsible for the provision of health care, family and community services, primary and secondary education, and vocational training institutions.

These are all arenas in which State governments' decisions have implications — some immediate, some longer-term — for the attractiveness of their State as a place for doing business. They are also arenas in which 'competitive federalism' can operate to good effect. For example, if some States maintain bloated bureaucracies, charge excessive prices for essential services, levy high business registration fees and payroll taxes and fritter away public finances on 'beer and circuses' rather than hospital beds and colleges, or let their transport networks fall into disrepair, more efficient jurisdictions are likely to find some businesses and workers migrating their way. This in turn provides an incentive for the Government in the inefficient State to put its house in order. So, competition between the States on such 'economic fundamentals' is an important benefit of a federal polity. Queensland has long sold itself as a low debt, low tax State.

We know that such 'fundamentals' are important determinants of investment decisions worldwide. Nonetheless, for many years, governments in Australia and overseas have commonly also provided assistance to encourage the creation or expansion of particular firms or industries.

Getting accurate estimates of the value of such industry assistance is not easy. The Industry Commission made a comprehensive attempt back in 1996, in a major public inquiry. The Productivity Commission is updating those estimates for release shortly, as part of its annual statutory reporting responsibilities. This work confirms that State and Territory budgetary assistance to industry is substantial — totalling now some \$3.3 billion annually — and it is growing steadily, being 20 percent greater in real terms than it was in the mid '90s. Queensland's expenditure on selective assistance has grown faster than any other State (though not as fast as the Territories) and is now broadly comparable to Victoria. These figures do not include most business payroll tax concessions, which amount to several billion dollars (only a part of which can properly be regarded as industry assistance).

Most of this assistance is provided on an industry basis and is delivered under a wide range of programs administered by several government departments. These industry policies target not only traditional industries, such as agriculture, mining and manufacturing, but also particular services industries, such as banking and financial services, tourism and the film industry. Increasingly, funding is also being directed towards selected 'high-tech' activities, such as biotechnology and information technology.

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As well as these general industry assistance programs, the States and Territories also have a number of schemes from which firm- or project-specific assistance is drawn. Examples include the NSW Industry Assistance Fund, the Queensland Investment Incentive Scheme, and the Northern Territory Export Marketing Assistance Scheme. Some States have also established specialist agencies, such as Invest SA and the Canberra Tourism and Events Corporation, to administer event-, project- and firm-specific assistance.

In their attempts to attract particular projects or investments, governments provide a combination of investment ‘facilitation’ and ‘promotion’ services, as well as the financial investment ‘attraction’ programs. Facilitation and promotion services involve publicity on the benefits that a State can offer companies. There is also the coordination of different government agencies so as to cut bureaucratic red-tape. In Victoria, for example, the Government’s facilitation service provides prospective investors with information and advice on regulatory requirements, identifies infrastructure needs and coordinates the development approval process. These activities are less problematic than selective budgetary support, and are generally beneficial.

## **Savvy spending or business welfare?**

Why, in view of the high public demands for State spending on hospitals, schools, police and community services and the like — not to mention transport and other economic infrastructure — are State Governments so involved in providing direct financial assistance to the business community? Governments obviously see a payoff in providing this assistance, even if only because other Governments are doing it. But does it really provide economic benefits to the community, or is it just ‘business welfare’, as some commentators would have it?

There are of course sound economic rationales for some forms of industry assistance. For example, it is well established that market forces alone will often not ensure that firms engage in enough socially beneficial R&D, because other firms can often ‘free ride’ on the results. Government assistance to encourage more R&D can improve the performance of the economy. Other possible ‘market failures’ potentially warranting government support include information failures, labour training and mobility (although the most effective interventions don’t necessarily involve financial assistance to firms). There can also be equity rationales for some funding of industry — adjustment assistance being one example. And some measures that have the effect of assisting particular industries might be intended to meet other objectives. Some funding of art and film production might fall into this category.

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A number of Commonwealth industry programs are directed at market failure or equity goals, as they typically arise across the national economy and are not best handled at a State level.

For much State assistance to industry, it is difficult to pin down a market failure, equity or specific social or cultural objective that could justify the funding. Certainly Governments themselves do not normally articulate the objectives of the programs in such terms. Rather, the thinking underpinning the provision of assistance often appears more rudimentary — at its simplest: “investment is beneficial, so *subsiding* investment must also be beneficial”!

### **Tying down footloose capital?**

A primary rationale given for corporate assistance is the perceived need to attract mobile capital, in competition with other jurisdictions. Proponents of such assistance assert that government inducements are necessary to ‘tip the balance’ — not just in relation to firms’ locational choices within Australia, but also for firms which could locate their operations overseas. For example, the Queensland and Commonwealth Governments, in offering a combined incentive package of \$300 million for Comalco’s alumina project at Gladstone, indicated that the company had been considering a rival site in Malaysia. Other countries typically offer financial inducements, it is observed, so why shouldn’t we?

Apart from the (domestic) costs of such support, to which I’ll come, a threshold issue is the extent to which financial assistance really *does* make a difference.

An extensive empirical literature indicates that the real drivers of firms’ investment location decisions lie elsewhere. For example, a firm considering building an alumina plant in Malaysia or Australia will weigh-up many social, economic and political factors. These include transport and energy costs, infrastructure quality and reliability, regulatory requirements, workforce skills, proximity to key markets and, not least right now, political and social stability. These factors generally overshadow even general policy settings such as company tax rates, let alone specific government inducements. In a recent Commission survey of Australia’s top 300 firms (PC 2002), a large majority of firms considered commercial or market-related factors to be more important overall than government policies in their locational decisions. Among government policies, the standout influence on decision-making was corporate taxation. This highlights the importance of all governments focussing on the economic fundamentals.

It also underlines the strong possibility that the provision of investment incentives might have little influence on a firms’ ultimate decision, wasting taxpayers money

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on firms who would have located in the jurisdiction without a subsidy. Government officials need detailed information to assess the merits of a project and to differentiate between the marginal investor and those who will invest anyway. Businesses have incentives to engage in strategic behaviour to secure the maximum incentives available — overstating both the benefits to the State and the level of assistance necessary to secure them. Government officials are generally at a disadvantage in such games.

As Australia's States and Territories could be said to be broadly comparable in terms of the economic fundamentals, investment incentives offered by Governments are more likely to 'tip the balance' for investment that is footloose *within* Australia. For example, while Richard Branson's decision to enter Australian skies was facilitated primarily by the Commonwealth Government's relaxation of foreign investment restrictions in 1999, the inducements offered by different State Governments may well have influenced his decision of where within Australia to headquarter Virgin Blue.

But this does not end the matter. A footloose firm need not stop being footloose simply because an initial inducement has been accepted. Once the inducement ends, the business again has the option of relocating, unless a further inducement is provided to remain. The trans-Australian travels of the Berri Fruit Juice company are testimony to this. Hence, the cost to the taxpayer can be ongoing, or the investment can be 'lost'. While some States may win, at least initially, such bidding wars can become negative-sum games, with Australia the poorer as a result.

### **Job creation?**

A 'winning' Government might well say that its responsibilities are to the residents of its own State or Territory, not other jurisdictions. Taking this viewpoint at face value, how real are the benefits to the 'winning' State?

'Jobs, jobs, jobs' is the mantra. It is true of course that if State inducements succeed there will be employment associated with the new activity. But again, this is only the start of the matter. In general, the subsidised project will draw capital and labour, particularly skilled labour, from other local firms. This will mean either that the wage rates of such employees increase, raising the costs of other firms within the local economy; or that some other potential projects will be stymied. At the extreme, there may be little or no change in employment in the local economy — that is, old jobs will be 'crowded out' by the new ones. Indeed, where the induced projects are more capital-intensive than those displaced, total employment in theory could fall.

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It is for this reason that the Commonwealth Department of Finance and, at the State level, bodies such as the NSW Treasury and the ACT Auditor-General, have indicated that those agencies preparing cost-benefit assessments should as a general rule not count employment gains among the benefits of particular projects.

Exceptions may of course arise in depressed regions with high unemployment, provided the required skill profile matches that of the unemployed, which in most cases means a need for relatively low skills.

But even here the answer is not straight-forward. This is because low-skilled labour is a complement for high-skilled labour in many industries — you can't have production workers without tradesmen and supervisors, for instance. So, once again, the induced project can draw the labour that is scarce away from other projects. This in turn can affect the viability of those other projects, and the employment prospects of the workers — skilled and unskilled — who depend on them.

Even in those cases where selective assistance *does* generate a net gain in employment, it needn't represent 'value for money' compared to alternative spending options to address employment. For example, the Comalco assistance package mentioned earlier reportedly equated to some \$750 000 per permanent job. The assistance per *net* job created would be much higher.

The bottom line is that governments expecting to reduce unemployment through selective assistance are likely to be disappointed. Aggregate employment is related principally to aggregate economic activity and regulation that affects the labour market directly, not industry assistance.

### **The magic of multipliers?**

A second trap into which proponents of selective industry support often fall is the superficial appeal of 'multipliers' — the seeming science by which investment ripples are transformed into tidal waves of economic activity. In reality the science of multipliers is the economics of the free lunch.

The common claim is that each extra dollar of output generated by the recipient firm generates several more dollars worth of activity — investment, sales and jobs — as the initial expenditure is spent in several subsequent rounds in the local economy. This is correct as far as it goes but, once again, it does not go nearly far enough. It fails to consider the 'opportunity costs' of the spending. Just as the spending created in and by the recipient firm has multiplier effects, so too does the spending that is displaced from other firms and industries. Looked at another way, while public funds devoted to a project will have multiplier effects, those public



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funds would also have had multiplier effects if spent on other purposes, or left in the hands of taxpayers to be spent on the things that they value.

Multipliers are just an illustration of the complex inter-linkages between different parts of the economy — the knee bone is connected to the thigh bone is connected to the hip bone. The economic benefits from new investment come not simply from such interconnections, but from improvements in efficiency and resource allocation that new investment can bring, which allow the production of more goods and services from available resources.

### **A magic tax pudding?**

There are also some fundamental misconceptions about the budgetary and other costs of providing investment incentives. Where incentives are provided in the form of tax-breaks or tax-holidays, it is often claimed that the States are simply surrendering revenue that they would not otherwise have collected. And where inducements are provided through budgetary subsidies, it is sometimes claimed these subsidies will be more than paid for by the taxes paid by the firm and its employees, as well as taxes generated from the flow-on effects on the economy.

The latter argument depends in part on the magic of multipliers — I have already pointed out the flaws in that approach.

Similarly, the notion that the tax revenue forgone would not have been collected anyway ignores the crowding out effects of induced investments on employment and investment elsewhere in the economy, and thus ignores the tax revenue that would have been paid on that other economic activity. For example, where labour is drawn away from existing firms to work in the induced project, payroll tax will be lost from those firms.

Another example of the tax merry-go-round occurred in the mid-1990s as States competed to attract the Australian Stock Exchange to locate in their jurisdiction. Thus Queensland cut its financial taxes, which resulted in New South Wales and Victoria responding in kind. But these tax-cuts were then followed by increases in other State taxes to make-up the shortfall. We should bear in mind that many of the taxes available to the States have undesirable efficiency and equity implications.

In the case of some ‘special events’, the total taxation receipts generated in the local economy and attributable to the event itself have been far less than the government outlay. For example, in relation to the V8 Super Car event staged in Canberra over the last few years (yes, cars again!), the ACT Audit Office found that, in 2001, net outlays on the event were over \$5 million, which was more than double the direct

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and indirect benefits attributable to the event — including from additional tourist spending. The tax receipts from this spending were smaller again. The shortfall has of course been borne by ACT taxpayers (ACT Auditor-General, 2002), amongst whom I must declare I am one.

But this is by no means the only sporting event to return less than hoped-for benefits to the host city. Detailed US research could not find a positive correlation between professional sport and the tax base. And even hosting a major event like the Super Bowl had no discernible *net* impact on spending in the region — merely diverting spending from other things.

The Victorian Auditor-General has reported that, while there have been some positive outcomes from investment attraction programs (abstracting from costs) they are ‘lower than initially anticipated’. Moreover, ‘the publicly announced estimates do not appear to be revised as time goes by’.

The provision of selective subsidies can also create other costs, although they are not always visible in the government budget, or acknowledged by proponents of such schemes.

- As the Commission documented in its 1996 inquiry, selective assistance can have high administrative and compliance costs — ranging from 20 to 80 per cent of the assistance provided for some programs.
- Obtaining the tax revenue required to fund subsidies can entail collection costs and disincentive effects. Commission staff have estimated that (pre-GST) these ‘deadweight losses’ ranged up to 71 cents for each additional State tax dollar collected. (Gabbitas and Eldridge, 1998)

In sum, we need to be wary of any presumption that a government will recoup the costs, properly defined, of selective assistance to new firms or projects.

### **Synergies, ‘head turning’ or other intangible benefits?**

This leaves some fairly difficult-to-substantiate and -operationalise claims about industry synergies and various intangibles associated, in particular, with the attraction of major events.

There is little doubt that there can be ‘knowledge spill-overs’, ‘agglomeration economies’ and other synergistic benefits associated with industry clusters. Silicon Valley is a prime example. This can happen spontaneously (as in Silicon Valley), but there is also the possibility that government support can be a catalyst.

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While many local governments use zoning laws and investment promotion programs to encourage small-scale cluster development, and while sympathetic infrastructure planning can also promote clusters, it is quite a challenge to devise selective industry assistance policies that would cost-effectively capture the benefits at the State level. Adelaide's experiment with the now defunct Multi Function Polis, although beset by an array of problems, bears testimony to some of the difficulties.

Another hard-to-verify rationale is the so-called 'lighthouse' effect, in which attracting a high-profile project or event is said to demonstrate the benefits from conducting business in the particular locality. The way Sydney executed its Olympics would seem a good example. On the other hand, the fallout from the Atlanta Games before it suggests that, depending on the competence with which the event is hosted, these effects could go either way. As the Victorian Auditor General's report notes, the success of such a strategy depends on attracting further investment without assistance (countering that aspect of the demonstration effect).

As the Sydney Olympics highlighted, there may also be a 'feel good' factor associated with attracting a major investment, which should not be dismissed just because it is hard to measure. However, as the Grand Prix saga illustrated, in some cases there may be 'feel bad' factor to consider for the losing State! And in the ACT, while the 'petrol heads' may have felt good about the V8 Super Car race, opinion polls showed them to be in a minority. The Audit view was that the net effect on 'civic pride' was 'likely to be very small'.

Finally, we should not discount the possibility that subsidising a high profile firm's entry will tend to damage incumbent rivals, and dampen their enthusiasm for doing business in that jurisdiction.

### **Bottom line on firm subsidies**

In sum, claims of economic benefit from selective assistance are often poorly founded. They generally arise from a restricted consideration of the linkages in an economy, and what those linkages and associated multipliers mean for policy. They focus on the direct impacts of an assisted project, often without considering the indirect economic effects or the opportunity costs of the assistance and resources expended on the project.

It is of course possible for a State to 'win' on some individual projects. The Commission's modelling in 1996 suggested that Victoria could indeed gain some net economic benefit from the relocation of the Grand Prix (depending on the size of the inducement paid, which had not been disclosed).

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But again it is necessary to consider the wider picture. In bidding wars, a State or Territory that wins today could lose tomorrow, so that over time no jurisdiction is better off than it would have been simply competing on its merits. The sense of ‘payback’ in some of these contests is palpable. In relation to the Grand Prix, the Commission’s modelling indicated that the South Australian economy lost not only the lion’s share of the national benefits associated with that event, but also saw its tax base reduce as some spending and business activity migrated to Victoria (although there were also some savings).

From a national perspective, inter-State competition for investment conducted via selective assistance is a negative-sum game. The analysis shows that States have an incentive to ‘overbid’ for projects and events, relative to the national benefits to be obtained. Even if the investment is genuinely ‘new’ to Australia, interstate bidding can cause any national benefits to be dissipated, with foreign shareholders the only sure winners. For such reasons, if Australia is to be in the bidding game internationally, it is preferable that the Commonwealth be the main player.

## **Opening up the books**

The scope for misunderstandings about the benefits and costs of selective assistance, and the risks in its provision, highlight the need for careful analysis and transparent evaluation of assistance packages. Public scrutiny is desirable to test the assumptions, methodologies and claims made for projects, and to allow those who might be adversely affected to have their concerns considered too. Without public disclosure, a ‘can do’ mentality within agencies ‘responsible’ for business is more likely to neglect a robust examination of the costs and benefits of assistance.

In its 1996 inquiry, the Commission found considerable variability in reporting procedures and the degree of transparency about selective assistance, both between States and between different government departments and programs. However, the lack of disclosure was greatest in all jurisdictions when it came to incentives for specific firms or activities. In many cases, neither the extent of the assistance provided, nor the analysis that underpinned the Governments decision, were made publicly available. That remains so today and is an issue at the Commonwealth level as well.

One argument made for non-disclosure is a need to protect information that the recipient considers commercially sensitive. However, it is not clear how disclosing the size of the assistance provided to a firm, or the reasons for providing it, could be used by competitors in the marketplace. Some aspects of the analysis of the firm’s commercial operations or prospects, which may have some value to its competitors

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or customers, may be of a potentially damaging nature if released. However, even this can be overstated. When private businesses are receiving tax-payers' money, the presumption should be that tax-payers are entitled to know the details. Otherwise, as the Victorian Auditor General has commented:

the [lack] of information on public expenditure undermines public confidence in the integrity of the process and creates suspicion of corruption and waste. Indeed, if there is widespread public support for the provision of assistance to industry, then this can only be enhanced by the provision of reliable information.

The more credible or logical argument mounted for non-disclosure is to strengthen the position of the Government in subsequent negotiations with other firms, by denying them knowledge of how much the Government is willing to pay for particular types of projects or investment commitments. Non-disclosure, it is argued, can also prevent or minimise the 'me-too' factor. The Victorian Auditor General, in agreeing to limits on disclosure in his recent report, accepted the Government's argument that disclosure would affect the State's negotiating position and could escalate the costs of investment attraction programs.

While there may be some logic in this position, in my view there are stronger reasons in favour of full public disclosure. These include the misconceptions about the merits of selective assistance that I have already mentioned, together with evidence of poor process and analysis, and ill-advised assistance packages being offered in some cases. It is, in any case, questionable whether secrecy does facilitate the minimisation of government outlays. Rent-seeking could arguably be *greater* when undefined pots of money appear to be up for grabs.

Non-disclosure allows poor analysis of the effects of incentives to go unchallenged. The experience in subsidising the V8 Super Car series in Canberra illustrates how problematic and costly an opaque evaluation of selective assistance can be. As you may be aware, Canberra in winter is no Surfers Paradise, and Holden and Ford V8s are not as alluring as Indy Racing Carts. Nevertheless, in 1999 the ACT Government decided to stage the V8 Super Car event in Canberra. Its decision was based on an 'economic evaluation' contained in a (confidential) Cabinet submission that the event would produce significant economic benefits for the Territory. However, as the ACT Auditor General has recently documented, the analysis of benefits from staging the race suffered from several deficiencies:

The economic benefit evaluation contained simple arithmetical errors, double counting, did not systematically allow for inflation, and did not discount future benefit and cost flows. The forecasts of interstate visitor impact, publicity value, jobs created and ticket sales are all overstated. The submission did not adequately deal with the financial risks associated with the race. The actual net financial cost of the race has been far above the predictions made in the submission, the indirect benefits much less.

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Indeed, contrary to public proclamations at the time, subsidising the race actually yielded a *net loss* to the ACT community of more than \$11 million over three years. It was only after this was exposed publicly that the event was abandoned. Why was the sort of analysis conducted so expertly by the Auditor-General not undertaken when it was most needed — *before* taxpayers' money was wasted? 'Inconvenience' or incompetence are perhaps the mildest explanations among those that come to mind. But lack of transparency was plainly the facilitator.

A recent Victorian Auditor-General report also provides evidence of some of the problems that non-disclosure can cause. For example, it documents the experience of Melton Shire in attracting a group of manufacturing companies to relocate from NSW. Between 1995 and 1999, the Council provided these companies with assistance valued at \$7.5 million. The assistance included the provision of land and interest-free loans. Although one of the companies subsequently defaulted on an employment target, it was not required to repay the assistance. In this case, non-disclosure reduced pressure on the Shire to monitor and evaluate the outcomes to ensure that the rate-payers of Melton were getting value for their assistance dollar.

And of course, the controversy surrounding the assistance package offered to Motorola in 1994 to establish a second software centre in Adelaide, and about the veracity of subsequent statements to the Cramond inquiry on this matter, reminds us that perceptions of shady deals are not confined to foreign governments.

Fortunately, in Australia, when governments keep their electorates in the dark, voters have the opportunity to 'repay the favour' (as recent history attests).

The general lack of transparency means that we cannot be sure how widespread the problems are in this country. Thus many independent agencies and parliamentary committees have called for greater transparency in industry assistance in several jurisdictions. They have also recommended sensible reforms to the administration, evaluation and monitoring of assistance programs. For example:

- The Tasmanian Auditor-General (2000) recommended that there be public disclosure of the details of government assistance, and that commercial confidentiality should not take precedence over governmental accountability.
- The NSW Auditor-General (1998) recommended that accountability and transparency for the provision of assistance be increased, and information not be classified as commercial-in-confidence unless it was demonstrably necessary.
- The NSW Public Accounts Committee (2001) similarly found no valid reason why government assistance should remain confidential and recommended several ways for greater disclosure of information on industry assistance.

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- The South Australian Economic and Finance Committee (2000) recommended that information on individual assistance packages be tabled and reported to the State Parliament annually.
  - The Victorian Auditor-General (2001) recommended annual reporting of details of assisted investment projects, their progress and the performance of sectors in which investment incentives were targeted.
  - And the ACT Auditor-General (2002) recommended that all agencies review their procedures for developing and verifying the veracity of input to Cabinet submissions and public announcements, as well as reviewing their record-keeping processes.

Clearly, there are many measures that could enhance the quality of analyses and bring greater transparency to selective industry assistance. Four measures would be particularly beneficial:

- Explicit selection criteria should be developed and published (as the Commonwealth has done for its Strategic Investment Incentive Program).
- Rigorous economic assessments should be institutionalised, and take into account the full economic costs and risks, as well as the benefits, of investment incentives. (If agencies lack the necessary analytical skills, they should make a prior investment in that area. And in all cases such analysis should be tested by officials outside the agency directly involved, ideally by an independent review unit within Treasury.)
- The nature and value of assistance to individual firms should be made public from the outset, including any conditions attached to it.
- There should be regular monitoring and review of the eventual outcomes by independent agencies (such as the Audit Offices).

## Calling a truce

While improved analysis, better processes and greater transparency would reduce a number of the problems in the provision of selective assistance, such reforms alone are unlikely to address the incentives individual States can face to compete financially for high-profile projects. In some ways the situation represents a classic prisoners' dilemma, because while all States would be better off by cooperating, in some cases individual States will see benefits in defecting.

The need to avoid mutually impoverishing 'beggar-thy-neighbour' policies was an important reason for the formation of Australia's Federation in the first place. Elimination of tariffs at State borders was critical in enabling a national economy to

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develop from early last century. Over time, regulatory and other impediments were also gradually removed or reduced, including through cooperative agreements on Mutual Recognition, National Competition Policy and Government procurement over the past decade or so. But selective assistance remains a growing threat to the realisation of this nationally beneficial goal.

State governments are conscious of the problems. The concerns of some jurisdictions led to the Industry Commission inquiry back in 1996. Drawing on precedents in Europe and North America, the Commission identified several options for an agreement between the States and Territories to limit or prevent bidding wars. States could agree to limits on the forms and levels of assistance available for individual projects and assistance packages, and/or global limits to the assistance they provide. An inter-government agreement could also entail a transparency and monitoring mechanism. The Commission also saw a potential role for the Commonwealth to encourage the States to limit the provision of selective industry assistance.

It is clear from submissions to that inquiry that, while some States were attracted to an explicit code of conduct, others were not. Smaller jurisdictions were ambivalent. They felt at a disadvantage bidding against larger States, but also felt that without a capacity to provide financial inducements themselves, the inherent advantages of larger States would prevail anyway. One State seemed to want to have it both ways — binding others but not itself — and some just didn't believe an accord in this area could work.

So is it a hopeless cause? While the difficulties are clear, I don't believe it is. Other countries, like Canada and the European Union, have made significant progress. And in the last couple of years there has been some movement in Australia. Indeed, the NSW and Victorian Governments have called for an inter-governmental agreement, sponsored by the Commonwealth. The three governments agreed to 'Operating Guidelines' in 2000 which, although limited in scope, require them to meet annually to review the efficiency and effectiveness of investment incentives. Then, in March last year, NSW and Victoria developed a joint working party on investment, and called for other governments to 'eliminate unnecessary bidding wars and... work to contain fiscal incentives'. South Australia has now indicated that it favours an initiative in this area.

So far the steps have been modest. But they are in the right direction. They can be taken further. As in international trade liberalisation, the key to achieving a meaningful agreement is for each government to accept that it would be beneficial to its own jurisdiction. Some Australian States and Territories remain to be convinced. I call on those governments to undertake hard-headed, independent reviews of their programs to determine what, in retrospect, they have *really*



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achieved. Once we dispel the magic of multipliers and other free-lunch thinking — and take a broader view of the interjurisdictional repercussions — the answer should become clear.

If governments can agree to a truce on inter-State bidding wars and other selective corporate support, they can then concentrate their forces on a much more worthy and productive battle: improving further their economic governance, tax regimes, infrastructure and other service delivery. These are the real mainstays of the contribution of State and Territory Governments to economic performance in the long term.

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