

VICTORIA

Auditor General
Victoria

Investment attraction and facilitation in Victoria

*Ordered to be printed by Authority.
Government Printer for the State of Victoria*

ISSN 1443 4911
ISBN 0 7311 5986 1



AUDITOR GENERAL
VICTORIA

The Hon. B.A. Chamberlain MLC
President
Legislative Council
Parliament House
MELBOURNE

The Hon. A. Andrianopoulos MLA
Speaker
Legislative Assembly
Parliament House
MELBOURNE

Sir

Under the provisions of section 16 of the *Audit Act* 1994, I transmit my performance audit report on *Investment attraction and facilitation in Victoria*.

Yours faithfully

J.W. CAMERON
Auditor-General

30 May 2002

Contents

	Foreword	vii
Part 1	Executive summary _____	1
	<i>Introduction</i> 3	
	<i>Audit objectives and scope</i> 3	
	<i>Audit conclusion</i> 4	
	<i>Audit findings</i> 6	
	<i>Recommendations</i> 11	
Part 2	Background _____	15
	<i>Government industry assistance</i> 17	
	<i>Victorian industry assistance</i> 20	
	<i>Conduct of the audit</i> 23	
Part 3	The case for and against investment attraction _____	25
	<i>Investment attraction</i> 27	
Part 4	Extent of, and criteria for, government investment assistance in Victoria _____	33
	<i>Department of Innovation, Industry and Regional Development</i> 35	
	<i>Other government agencies</i> 49	
Part 5	Effectiveness of government investment assistance in Victoria _____	69
	<i>Benefit to Victoria</i> 71	
	<i>Selected financially assisted projects</i> 85	
Part 6	Public reporting of government investment assistance in Victoria _____	101
	<i>Reporting on investment assistance</i> 103	
Part 7	Follow-up of the 1995 audit _____	107
	<i>Progress since the 1995 report</i> 109	

Foreword

The public is sceptical of the assistance provided by Governments to attract new investment. This is because the assistance appears to be discretionary and selective and, where it includes incentives of direct financial assistance, is often seen to be secretive.

The Victorian Government reports annually on the aggregate financial assistance provided to attract investment during that year and also lists the names of the companies who received that assistance. However, the Government does not disclose the details of the financial assistance provided to each company to support investment projects. Local governments provide details of industry investment assistance in varying degrees, some with full disclosure, others withholding information regarded as commercially sensitive. Where there is non-disclosure of information, it is done on the basis that the information is commercial in confidence.

The issues surrounding commercial-in-confidence matters for private organisations doing business with government are complex and the subject of various reports, the most pertinent of which in Victoria is the Public Accounts and Estimates Committee Report to the Parliament in March 2000, *Commercial in Confidence Material and the Public Interest*.

The report notes "... there is potential for conflict of interest between mechanisms that ensure accountability and claims of 'commercial in confidence' that seek to justify the withholding of information. The notion of 'public interest' is generally used to describe that which benefits the public as a whole. Such a claim inevitably involves some balancing of competing claims and criteria."¹

In the conduct of this audit, the question of whether to publicly disclose the amounts provided to companies under investment attraction programs was considered. There are some who believe that total disclosure of all information is the only way to achieve the necessary accountability by government for use of public funds. There are circumstances where disclosure is not in the public interest. These circumstances include situations where innocent individuals may be harmed, where disclosure may result in misinterpretation and public alarm, or where disclosure increases the cost or reduces the viability of programs without improving the efficiency and effectiveness of their administration. The assistance provided through the investment attraction programs frequently falls into the last category.

¹ Public Accounts and Estimates Committee Thirty Fifth Report to the Victorian Parliament. *Commercial in Confidence Material and the Public Interest*. Government Printer for the State of Victoria. March 2000. pp 23-24.

I have decided not to release, as a matter of course, specific details of financial assistance provided to companies. I consider that, in this case, disclosure of such details may result in increased costs for investment attraction through encouraging “bidding wars” for the investments and discouraging companies from choosing Victoria as an investment location. The focus of my examination has been on how well the program is administered. The disclosure of each amount of financial assistance given runs the risk of the public debate focussing on “who got what”, rather than “how carefully are such programs managed” and “did they lead to greater benefits to the Victorian economy as a whole”.

Nor have I disclosed the names of companies in the six case studies detailing the contractual obligations between the Victorian government and the companies. The purpose of these case studies is to highlight the public administration processes involved and to provide a short narrative about the outcomes from such assistance. The specific companies involved are not relevant to the purpose. However, where an organisation, or party, does not meet the agreed performance, or funds in question have not achieved value for money, I will disclose the amount of assistance provided and the name of the government organisation or recipient body.

Both the Victorian and local governments’ management of investment attraction services have been steadily improving. The total expenditure on such services is relatively small, the payback in terms of increased government revenues appears reasonable and payments are usually not made until project milestones are met. However, reporting of the performance of the program needs to be more comprehensive and timely.

Where public funds are involved, Parliament requires assurance that investment attraction programs are properly administered and provide value for money. My examinations and this report have therefore focussed on these issues, making recommendations for greater disclosure of the criteria underlying the provision of investment attraction and facilitation services and of the outcomes from such assistance.

With such information, Parliament and the public will be in a better position to assess the value for money of investment attraction and facilitation services.



J.W. CAMERON
Auditor-General

30 May 2002

Part 1

Executive summary

INTRODUCTION

1.1 In Australia, as in most other countries, governments maintain a range of industry assistance policies as a means of enhancing economic performance, particularly to encourage employment growth and business investment.

1.2 Current Victorian Government industry assistance reflects the Government's priorities of promoting growth across the whole State and achieving global competitiveness. Part of this industry assistance includes Victoria competing internationally as a location for foreign direct investment and flow on economic activity. As a consequence, like other governments around the world, Victoria offers direct financial incentives and facilitation services in order to attract new international or interstate investment and to encourage new investment by companies already operating in Victoria. Most governments seeking to attract investment provide financial incentives in one form or another. The annual Victorian Government expenditure on such financial incentives is small compared with many other jurisdictions. This audit explores assistance to individual companies in attracting and facilitating new investment.

1.3 Industry assistance is the subject of energetic economic debate and, in Australia at least, investigation by independent government agents such as the Productivity Commission and Auditors-General in Victoria, NSW, South Australia and Tasmania, as well as the NSW Parliament Public Accounts Committee and the Victorian Public Accounts and Estimates Committee. The debate centres largely on doubt about the net benefit from industry assistance, particularly when it involves the payment to companies of financial incentives, and the lack of publicly available information on the extent of investment assistance.

AUDIT OBJECTIVES AND SCOPE

1.4 The objectives of the audit were to investigate the extent of State provided and co-ordinated industry assistance to attract new investment, and evaluate:

- the effectiveness of investment attraction and facilitation programs in achieving their stated objectives, including the net benefits to Victoria;
- whether objective and comprehensive criteria have been established and consistently used to support industry attraction decisions;
- the transparency of such arrangements; and
- the adequacy of measures of whether recipients of public assistance are generating the expected economic, social, and environmental benefits for the community.

1.5 The audit also assessed whether appropriate follow-up action had been taken on key recommendations contained in the Auditor-General's October 1995 performance audit report *Promoting industry development: Assistance by government*.

1.6 The audit focused on initiatives designed to attract and retain new investment, that is, facilitation services such as labour market information, planning advice, access to industry networks and site location, “in-kind” assistance such as rate relief, land or other infrastructure development, and direct cash payments.

AUDIT CONCLUSION

1.7 Local economies can gain from encouraging direct investment. However, there is debate about whether governments should financially underpin such investment. Choices must be informed by a good understanding of the benefits that accrue from such assistance. The total amount of investment assistance given to industry by governments in Victoria is estimated to have been \$143.1 million over the 6 years since 1995-96, made up of \$77.6 million in direct financial assistance by state government, \$13.5 million in direct assistance by local government, \$10.5 million in in-direct assistance by local government, \$5.5 million from other public sector agencies and \$36 million in administration and facilitation services by the Department of Innovation, Industry and Regional Development.

1.8 Investment attraction and facilitation has been associated with positive outcomes for the state. However, these outcomes are lower than initially anticipated. Reporting of the outcomes of the investment attraction program have been focused on claims made by recipients about proposed increases in investment (\$8.3 billion), jobs (30 812 full time) and exports (\$5.8 billion) at the time assistance was provided rather than on the actual investment, jobs and exports achieved. While this is not unreasonable, as it is the only information available at the time, it gives an inflated impression of the likely effectiveness of investment attraction. The publicly announced estimates do not appear to be revised as time goes by.

1.9 Our analysis suggests that either the targeting of the programs was successful in selecting the firms with the best growth potential or that the programs were successful in raising employment and sales. Neither conclusion supports the view that the program is operating poorly.

1.10 We acknowledge the government’s position that the publication of details of funds paid to individual companies may, in some way, reduce the effectiveness and increase the costs of investment facilitation. However, we do not believe that the government or the Parliament is being provided with sufficient information about the outcomes, as opposed to the claimed benefits, of investment facilitation to make an informed judgement about the effectiveness, or otherwise, of the program. The Parliament requires information on the expected outcomes and the milestones against which the assistance is to be monitored and the actual outcomes in future years.

1.11 Facilitation is an effective expenditure of government funds. We recognise that the Department commences all investment cases with a range of offerings and works to construct a ‘least cost’ package in order to attract potential investors. These offerings can include both facilitation and the possibility of direct financial assistance. Therefore some measure of facilitation is present in all cases of investment assistance.

1.12 Decisions regarding an appropriate balance between facilitation only and financial assistance need more information on the actual investment outcomes and net benefits to Victoria from this assistance. Where financial assistance is provided, the Department should undertake more extensive checks of the reasonableness of expected investment and employment claims, since these should be a factor in determining the level of a grant to a company.

1.13 The Department’s processes for the provision of investment attraction and facilitation services are generally good, with sound criteria for provision of facilitation, both financial and non-financial.

1.14 While the Department carefully targets, facilitates and provides direct financial assistance to companies and investment projects assessed to be of benefit to the Victorian economy, and applies a set of appropriate criteria to underpin these decisions, there is insufficient public disclosure and availability of these criteria. Further, the formal documentation of assessment processes against these criteria, the education and training of staff in their application and the transfer of this knowledge from very experienced senior staff is limited through the absence of explicit documentation of criteria.

1.15 Where a decision to provide financial assistance is made, an appropriate contractual agreement is made with the company, which outlines investment and employment milestones that must be met before payments are made. We saw no payments being made prior to achievement of milestones, which is evidenced by audit certificates provided by the companies. However, there was no analysis of overall progress and outcomes from the assistance. Such analysis was also not used to inform future decision making or program development.

1.16 The involvement in investment attraction of public sector agencies, other than the Department of Innovation, Industry and Regional Development, is complex and frequently tied to policies in areas such as sustainable development, arts or tourism, where it may be combined with other services or regulation designed to achieve particular policy outcomes.

1.17 Local government involvement in investment attraction frequently includes a complex array of accompanying arrangements and associations with other government agencies. For example, negotiations around an offer of assistance from a council to a firm may include agreements with those firms to contribute significantly to local infrastructure, such as car parks and recreational areas, as well as the usual requirements to invest locally and create local jobs, and other possible agreements with State and/or Commonwealth Governments.

AUDIT FINDINGS

Investment attraction

1.18 More than 2 500 government and private agencies worldwide are said to compete for foreign direct investment. The stock of foreign direct investment in Australia is \$212 billion as at 30 June 2001 and the annual inwards flow for 2000-01 was \$12.9 billion.¹ (*para. 3.1*)

1.19 Much of this foreign direct investment, as well as new investment projects of many local Australian-based companies, is considered to be *footloose*. This means that a company's activities do not need to be located close to its markets and can potentially be encouraged to locate elsewhere. This is particularly the case for those companies that are new investors, need limited capital infrastructure and have low transportation costs. (*para. 3.2*)

Department of Innovation, Industry and Regional Development

1.20 The Department's investment attraction and facilitation activity is conducted through the Business Output Group. The administrative cost for this activity is approximately \$36 million over the 6 years, which includes that part of the administrative costs of Victoria's 9 overseas business offices allocated to investment attraction. The cost of investment attraction and facilitation, therefore, is approximately \$30 000 per project facilitated and \$75 500 per project that was successfully located in Victoria. The average grant amount paid for each directly financially assisted project, during the period 1995-96 to 2000-01, was \$630 000. (*para. 4.3*)

1.21 The Department's investment attraction activity is targeted to industries and companies which may provide new investment in Victoria, particularly those operating in strategic industry sectors. Key markets for attraction of new projects are the traditional locations of the United States, Europe and Japan, as well as footloose companies already operating in Victoria. Industries and companies are targeted through avenues such as local and international trade fairs, word-of-mouth, or direct contact between the companies and government representatives. (*para. 4.5*)

Investment facilitation

1.22 A range of financial and non-financial facilitation services are provided to new investment projects, both as part of the initial process of investment attraction and also as ongoing services provided once a company has made a decision to locate its new investment in the State. (*para. 4.11*)

¹ ABS Balance of Payments & International Investment Position, Series 5302.0 Dec. Qtr. 2001.

1.23 Facilitation services include information on legislative and regulatory requirements, assistance with site location and purchase, identification of infrastructure and utility needs, co-ordination and brokering of development approvals processes, assistance with business development programs, training and introductions to industry networks. *(para. 4.12)*

1.24 From 1995-96 to 2000-01, over 1 200 projects and 966 companies were given facilitation services. Of these, 477 investment projects went ahead in Victoria in 374 companies and can be classified as successfully facilitated. Forty-five companies have generated more than one investment project in that time, with 2 companies receiving investment facilitation for 9 and 10 projects, respectively. *(para. 4.14)*

1.25 At the time of the facilitation, it was expected that these projects would create investment value to Victoria of more than \$8.3 billion, 30 800 permanent full-time jobs and exports of \$5.8 billion. *(para. 4.15)*

Direct financial assistance

1.26 Direct financial assistance has been provided to just over one-quarter of the successfully facilitated projects that met certain investment criteria. Of these, 107 companies accepted the payment during 1995–96 to 2000–2001, to a total commitment by the Victorian Government of \$196 million in 123 projects. Thirteen companies, or 12 per cent of all companies accepting direct financial assistance, accepted it for more than one project. *(para. 4.17)*

1.27 Thirty-four of these financially-assisted projects are yet to receive any payments; 16 have received \$1 million or more over the 6 years; 21 have received between \$300 000 and \$1 million; and 50 projects have received \$300 000 or less. *(para. 4.19)*

Criteria for investment facilitation

1.28 The Department has a policy that it will facilitate, in some way, any new investment project that seeks support, including redirecting the company to seek advice and assistance in feasibility or business development before proceeding further. *(para. 4.25)*

1.29 Beyond these broad criteria of strategic industry priorities and equitable access to assistance, the Department uses specific criteria for assistance, applied in conjunction with robust decision-making processes that take into account factors such as:

- the economic benefits to Victoria;
- the financial strength and long-term sustainability of the investment;
- appropriate levels of cost-benefit analyses that also include considerations of broader socio-economic criteria; and
- consideration of the State's national and international obligations, including the non-competitive understanding with NSW and the World Trade Agreements. *(para. 4.26)*

1.30 Criteria for direct financial assistance include financial risk assessments consisting of Australian Securities and Investments Commission searches, Dunn and Bradstreet inquiries and bona fides checks, together with economic impact and socio-economic assessments, based on business plans, project documentation and potential benefits likely to accrue to the State as a result of the proposed investment. For projects where government assistance is likely to exceed \$2 million, an independent cost-benefit analysis must be undertaken. *(para. 4.33)*

Contractual arrangements

1.31 The contractual arrangements for these grants meet the criteria established in the Australian National Audit Office's *Better Practice Guide for the Administration of Grants*. In particular, the requirement that payment is linked to achievement of agreed performance outcomes, such as investment and jobs, has resulted in grant amounts generally being paid only against audited statements of achievement. *(para. 4.44)*

Monitoring of progress

1.32 The agreements incorporate provisions for the company to provide information for monitoring its continued viability and operations. Such information includes annual reports and financial statements, project progress reports, business plans and other information relevant to corporate performance and operations. The provision of this information is also linked to a defined timeframe. This information is not independently verified. *(para. 4.50)*

Extent of investment assistance by public sector agencies other than the DIIRD

1.33 A survey of 161 Victorian local government and other public sector agencies was undertaken as part of this audit to ascertain the extent of new investment assistance, either direct or in-direct, provided across Victoria by public agencies other than the Department of Innovation, Industry and Regional Development. *(para. 4.58)*

1.34 When combined with the assistance given by the Department, the investment assistance given to industry by governments in Victoria is estimated to have been \$107.1 million since 1995-96. When the Departments administrative costs of \$36 million, over the 6 year period are added, the total investment assistance is \$143.1 million. *(para. 4.62)*

Investment assistance from local government

1.35 The majority of Victorian Government investment assistance, outside that provided by the Department, is from local government, with survey responses indicating that 26, or one-third, of all Victorian councils seek to bring new investment and companies into their local areas and adopt a range of activities to do so. *(para. 4.73)*

1.36 In those cases where councils are actively pursuing investment attraction, assistance is frequently to large, strategic investments that also have been facilitated by the Department. In more recent years, this assistance is more likely to be in-direct than in the form of cash or land. *(para. 4.121)*

1.37 The councils' relationships with the Department remain informal, with evidence of overlapping of assistance between the Department and local government. Several councils are seeking more structured relationships, greater availability and transparency of information and guidance in successful investment assistance. *(para. 4.122)*

Effectiveness of government investment assistance in Victoria

1.38 We acknowledge the difficulties in accurately measuring the benefits of investment attraction and facilitation. However, such measurement is fundamental to the Department's own effectiveness and its accountability to Parliament, and should be undertaken. *(para. 5.9)*

1.39 Estimates of the effect of facilitation on company outcomes suggest that companies that received facilitation had annual employment levels that were, on average, 558 higher than the control group, and annual sales that were on average \$147 million higher than the control group. These estimates were significant at the 10 and 5 per cent levels, respectively. *(para. 5.16)*

1.40 A survey was undertaken of 82 businesses that had received investment facilitation assistance from the Department and that had located their project in Victoria. *(para. 5.30)*. When rating the value of this assistance, "location and site selection" and "planning approvals" were given the highest rating. Most other services were also rated satisfactorily. *(para. 5.32)*

1.41 Assistance to industry is a generally accepted role of governments, especially the provision of an appropriate economic environment to support business and the provision of information and facilitation for all firms establishing businesses and investment projects. However, it is difficult to estimate whether the benefits to the economy generally, and directly to the State budget from increased payroll and other tax revenues as a result of increased business activity, do or do not outweigh the costs of the assistance. *(para. 5.36)*

1.42 The 6 case studies examined in detail indicated that around two-thirds of the amount of financial assistance provided was returned in payroll tax over 5-6 years. *(paras 5.43 – 5.46)*

Reporting of government investment assistance in Victoria

Reporting on investment assistance

1.43 The Department's nondisclosure of details of direct financial assistance has been the policy of successive Governments, on the basis that it is necessary to maintain the confidentiality of commercial relations with the firm receiving the assistance. The publication of the level of assistance provided to a recipient of investment assistance could cause harm to a company's competitive position and undermine the Department's future bargaining position in relation to other jurisdictions, thus damaging the capacity of the Government to compete for investment in the future. According to the Department, such disclosure would also raise expectations among existing companies and potential investors and encourage rent seeking behaviour. (*para. 6.3*)

1.44 While we agree that disclosure may raise the costs of investment assistance, 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 further enhanced by the provision of reliable information. (*para. 6.4*)

Progress since the 1995 report

1.45 Our follow-up of recommendations from our 1995 report indicates that the Department continues to refine the activities of investment attraction and facilitation. However, further attention to monitoring, verifying, measuring and reporting of these services is required, especially of the economic benefit and other outcomes for Victorians. (*para. 7.2*)

RECOMMENDATIONS

Report reference	Paragraph number	Recommendation
Extent of, and criteria for, government investment assistance in Victoria	4.41	<p>We recommend that:</p> <ul style="list-style-type: none"> • explicit criteria for investment facilitation and direct financial assistance be developed and published. • these criteria specify the requirements, including relative weights, for: <ul style="list-style-type: none"> • footlooseness; • Victoria's strategic industry sectors; • net economic benefits, and the measures for these; • impact on investment and/or production in other industry sectors, or on companies in the investor's industry sector; either competitors, users or suppliers; • any other benefits, such as research and development capability, flow-on effects, socio-economic and community benefits, environmental considerations, etc.; • sustainability of the investment without government support; • other strategic capabilities; • international obligations, including World Trade Agreements. • departmental methods of assessment against program criteria be formalised and documented: <ul style="list-style-type: none"> • as part of the process of program co-ordination, information management and knowledge transfer within public sector agencies working in the area of investment attraction and facilitation; • as a means of systematically collecting data that will inform progressive analysis, evaluation and reporting – for management purposes and for public disclosure – of facilitated investments.
	4.54	<p>We recommend that:</p> <ul style="list-style-type: none"> • the Department selectively undertake its own assessment of the achievement of milestones under contractual arrangements with companies to improve the timeliness and accuracy of audit returns. • a standard clause be inserted into contracts requiring grant recipients to inform the Department prior to corporate restructuring or project changes that affect the relationships, legal rights or obligations of the contracting parties. • guidelines be provided to staff defining the circumstances under which penalty interest is to be recovered and those circumstances under which such interest is to be forgone. • the Department establish, in a similar manner to that which already exists for executive officers, a register of interests for non-executive staff members within the business groups that manage investment assistance, including clear guidelines on what constitutes a conflict of interest and a requirement that staff complete an annual return declaring any interest.

RECOMMENDATIONS - *continued*

<i>Report reference</i>	<i>Paragraph number</i>	<i>Recommendation</i>
Extent of, and criteria for, government investment assistance in Victoria - <i>continued</i>	4.122	<p>We recommend that:</p> <ul style="list-style-type: none"> when determining the degree of their involvement in industry assistance, we recommend that all Councils be mindful of the experience of Melton Shire Council and ensure that: <ul style="list-style-type: none"> the benefits to be generated by any proposed industry assistance are identified for the community and the council and that the achievement of the agreed milestones are publicly reported; a risk assessment is undertaken that includes identification of risks to the industry and the council and how they might be managed and reduced; mechanisms are identified and responsibilities allocated to provide the council with the means of monitoring the success or otherwise of the venture and protecting the interests of the community. the Department continue working closely with other public sector agencies and other levels of government, particularly local government, to ensure the co-ordination of investment attraction and facilitation, and subsequent monitoring, measurement and public reporting. the Department provide regular briefings to local councils, and other relevant public sector agencies, on strategic directions in economic development, as: <ul style="list-style-type: none"> part of the process of increasing transparency of government investment attraction and facilitation; a means of providing supporting mechanisms for the transfer of knowledge between the Department and local councils.
Effectiveness of government investment assistance in Victoria	5.42	<p>We recommend that:</p> <ul style="list-style-type: none"> an ongoing program monitoring system be established to assess program effectiveness, in particular: <ul style="list-style-type: none"> measuring the net benefits and effects of the program for Victoria; the actual results for all companies that have been offered facilitation services or direct financial assistance. the information derived from this monitoring be used to: <ul style="list-style-type: none"> inform the government's decision-making regarding the program, including the appropriate balance between facilitation and financial assistance; adjust the criteria against which investment attraction decisions are made to maximise the effectiveness of the assistance provided; revise the design of investment attraction programs to maximise their efficiency, and effectiveness; actively promote facilitation services, including the provision of information to industry, as a more effective means for the Government to overcome market imperfections and stimulate investment.

RECOMMENDATIONS - continued

Report reference	Paragraph number	Recommendation
Public reporting of government investment assistance in Victoria	6.13	<p>We recommend that the Department:</p> <ul style="list-style-type: none"> report annually the details of new investment projects that have been provided with assistance. The report should include the expected performance outcomes and milestones against which these projects are to be monitored and identify the sectors of the economy in which Victoria has strategic competitive advantage to which the projects are related. report annually the progress of committed projects, for the duration of the contract, detailing the initial claims and the subsequent outcomes, including any performance outcomes and milestones against which the project has been monitored and the contribution to sectors of the economy in which Victoria has strategic competitive advantage to which the projects are related. report annually the aggregate performance of sectors of the economy in which Victoria has strategic competitive advantage and which are targeted for investment assistance.

RESPONSE by Department of Innovation, Industry and Regional Development

There are some elements of this program that are quite unlike other public sector programs and these demand a different approach to considering effectiveness. Most specifically, a key purpose of this program is to address international competition for mobile projects. Many national governments and most regional governments compete aggressively for these projects with a variety of inducements and often with “deep pockets”. The State is in direct competition for “mobile” projects with a number of these governments. Establishing and maintaining a competitive position in this (national and) international marketplace is critical to the effectiveness of the program.

Your audit has been conducted as though the funds committed to the program are a cost to the budget and can be considered to have alternative uses such as for schools, roads and hospitals. This is incorrect. The attraction of mobile projects through financial incentives rarely results in a net cost to the budget. In this sense, “buying” a project with tax revenue that would not otherwise accrue, is revenue neutral to the State. Recognition of both the revenue neutral nature of attracting mobile projects and the need to compete effectively, changes the way that the usual principles of accountability and transparency might be applied.

FURTHER audit comments

The Department’s claims that the projects are revenue neutral cannot be verified because of the lack of data on outcomes. In our 6 case studies around two-thirds of the financial assistance was returned in payroll tax over 5-6 years. This is not revenue neutral and the timeframe for return of the assistance in the form of state taxes may be very long for some projects.

RESPONSE by Melton Shire Council

Council consider the audit as an opportunity to review and enhance their own economic development strategy, policies, procedures and performance and risk indicators for the municipality.

The report relates the facts of and processes associated with establishing and administering an agreement between Melton Shire Council and a company commencing in 1996. Council does not disagree with the facts presented in the Review undertaken by the Office of the Auditor General.

The current Council recognises the incentive assistance package offered to the company at the time was Melton Shire Council's first and this business as well as subsequent businesses pursued under economic development processes have had a major role in the reduction of Melton's unemployment rate from 15% in 1994 to 7% today. The audit will provide a further incentive to continue the evaluation and improvement process that Council has embarked upon to address the complex and competing requirements facing local government.

Council is committed to balancing the needs of the community with openness of government to achieve the community's required results.

Council measures the community's priorities through an extensive and independent community consultation process associated with the development or review of its corporate plan annually. The community's expectation for Council to provide, encourage and promote opportunities for industry development is reflected consistently as an area of high importance. Council is also advised of the priorities of the community through a Department of Infrastructure initiated survey known as the 'Annual Constituent Survey'.

The pressure on Council to continue to focus on economic development is anticipated to remain for some time. The current population growth rate of 9.5% will require careful attention by Council in terms of development so that a balance between local industry, commercial development and retail opportunities can provide for the municipality in the future. The Office of the Auditor General's report is seen as a catalyst for Council to strive for continual improvement and review of our processes in the area of economic development.

As indicated in the report, between 1996 and 2001 Council entered into 9 incentive arrangements. The one tabled as a case study, although not typical of later incentive arrangements, was Melton Shire Council's first and provides a opportunity to assess some of the difficulties faced by local government in attracting and facilitating investment, measuring performance and providing openness to the community in relation to business incentives.

Part 2

Background

GOVERNMENT INDUSTRY ASSISTANCE

Forms of industry assistance

2.1 In Australia, as in most other countries, governments maintain a range of industry assistance policies as a means of enhancing economic performance, particularly to encourage growth in employment and business investment. Assistance can be defined as:

“... any act that, directly or indirectly, assists a person to carry on a business or activity, or confers a pecuniary benefit on, or results in a pecuniary benefit accruing to, a person in respect of carrying on a business or activity.”¹

2.2 While there is general acceptance of the role of governments in supporting economic development, debate surrounds industry assistance in regard to:

- the extent of resources which should be allocated, since these resources are then not available for other purposes. This is essentially a resource allocation decision for the government. However, it is critical that such assistance be transparent, both in terms of the dollars expended and the outcomes achieved, so that the public can assess the appropriateness of that decision; and
- the best form of providing industry assistance. There are a range of measures available to governments, including:
 - Providing an economic environment which supports and reduces costs for industry. This includes providing infrastructure, such as utilities and transport, business regulation, industrial relations, ensuring a skilled workforce etc. Some of these measures might be targeted to selected industry sectors, such as changing legislation to enable certain medical research to occur and/or providing financial incentives for research and development in sustainable development. Decisions regarding the economic environment are dependent on many factors, not just the impact on industry;
 - Providing and subsidising information and universally available services to assist companies in making business decisions. These services include producing information and analysis about local labour market skills, access to markets, regulatory environments, strategic industry sectors and competitive strengths, wage structures and industrial relations etc. Companies are likely to under-consume these services because they find it hard to assess the value of the information before they have absorbed it. We expect that companies will be hesitant to pay for services of uncertain value. The challenge for governments is to ensure such services are appropriately priced and well targeted, and are provided as part of normal government business. For example, it is better to remove red tape than assist a company to negotiate the red tape;

¹ Productivity Commission Act 1998 (s10).

- Providing selective assistance to individual companies. This form of industry assistance, which includes investment attraction, facilitation and direct financial assistance, has many risks for government, since it requires seeking and selecting individual companies, and not others, to receive a benefit. Companies have an incentive to try to maximise any assistance received by overstating both the importance of the government assistance to making the investment decision and the likely benefits flowing from it in terms of growth, employment and exports. There is also potential for waste and corruption. In these circumstances, governments need to have in place programs for assistance which maximise the effectiveness while minimising the potential for rent-seeking², waste, and corruption. It also requires rigorous, transparent criteria for the selection of projects and companies for assistance, and effective monitoring and evaluation of outcomes.

2.3 This audit explores, in particular, the last of these measures: selective assistance to individual companies in attracting and facilitating new investment, and public accountability for such assistance.

Independent assessments on industry assistance

2.4 The practice of industry assistance continues to be the subject of energetic economic debate and, in Australia at least, investigation by independent government agents such as the Productivity Commission and Auditors-General in Victoria, New South Wales, South Australia and Tasmania, as well as the New South Wales Parliament Public Accounts Committee and the Victorian Public Accounts and Estimates Committee. The debate centres largely on the net benefit from industry assistance, particularly the payment to companies of financial incentives, and the lack of publicly available information on the extent of investment assistance.

2.5 The Victorian Auditor-General reported on Victoria's industry assistance programs in 1989, exposing serious deficiencies in the administrative arrangements. A subsequent report in 1995 found that these deficiencies had been addressed, and recommended added attention to the strategic examination of projected economic benefits, as well as improved monitoring of the costs of the programs.

² In the context of investment attraction, the term "rent-seeking" refers to seeking subsidies and assistance from Government to remain in a particular location.

2.6 The Audit Office of New South Wales and the New South Wales Parliament Public Accounts Committee, for example, have offered several reasons why such incentives might be of limited benefit to the local economy. First, most investment projects attracted by incentives from outside New South Wales are complementary to other company operations. Second, if a firm can be induced to locate in New South Wales, it may be just as easily lured by other governments to relocate once the contract has expired. That is, if they can move in that easily, they can move out just as easily.

2.7 Such assistance schemes raise the question of why some companies can obtain support and others cannot, especially if it puts existing producers at a cost disadvantage and breaches competitive neutrality. Both the Audit Office of New South Wales and the Productivity Commission (then Industry Commission) note that this is a particularly important issue if such assistance is provided to a firm that eventually folds because it is not financially viable. The Productivity Commission observed that the provision of these grants also relies on the ability of the particular government to correctly identify market failures and winning firms, and then target their policies appropriately.

2.8 Two other important reports on assistance to industry were published in 1996. The Productivity Commission report³ examined the provision of assistance to industry by State, Territory and local governments and their instrumentalities in Australia and found that significant assistance is provided in Australia by State and Territory Governments, and, to a much lesser degree, by local governments. The expressed purpose for such industry assistance was to promote growth and employment.

2.9 The study reported widespread agreement that governments have a vital role to play in economic development and reaffirmed that there was considerable debate about the extent to which industry assistance, particularly firm or project-specific assistance, should be used. In addition, the report noted that assistance packages provided by State Governments to individual firms or organisations are often subject to competing offers from other States, with large firms actively soliciting assistance and encouraging competition between jurisdictions for the location of major new investments.

2.10 The Bureau of Industry Economics' review of the Federal Investment Facilitation Program⁴ recommended that governments should adopt a market enhancement role to attract industry rather than an entrepreneurial role of pro-active investment assistance. The report found that by getting the basics right, governments could provide an environment where the costs of establishing and operating a business are reduced, and the ability of businesses to compete on their merits is enhanced. This market enhancement role, rather than an entrepreneurial role, was regarded as a less risky method of attracting industry than offering firm specific incentives. The costs of incentives offered by governments to attract firms were held, in many cases, not to be matched by the benefits accruing to the jurisdiction.

³ Industry Commission (1996) *State, Territory and Local Government Assistance to Industry*, Report No. 55, October, AGPS.

⁴ Bureau of Industry Economics (1996) *Evaluation of the Investment Promotion and Facilitation Program*, Report 96/4 March, AGPS.

VICTORIAN INDUSTRY ASSISTANCE

Victorian Government policy

2.11 Successive Victorian State and many local governments have operated a range of industry assistance programs in accordance with the objective of economic growth. Current Victorian Government industry policies, summarised below, reflect the Government's priorities of promoting growth across the whole State and delivering improved services.

2.12 These policies also draw upon strategies and programs undertaken by the previous State Government and dating back to 1993, including *Doing Business in Victoria - Victorian Industry Statement* and *Investing in Country Victoria: A nine-point plan for investment and employment growth in provincial and rural Victoria*. Viewed collectively, these policies constitute the overall framework for industry support in Victoria, including investment attraction and facilitation.

Growing Victoria Together

2.13 The Government's strategic direction for the Victorian economy is to achieve global competitiveness through the creation of an economy based on innovation and knowledge. *Growing Victoria Together*, released in late 2001, identifies areas of strategic importance to the Victorian economy, namely:

- the creation and use of new ideas and technologies to attract investment and employment in new and existing industries;
- growth in the following industry sectors: information and communications, biotechnology, professional services, design, advanced manufacturing and environmental management; and
- an improved business environment through competitive business costs, certainty and security of energy supply, high performing, co-operative workplaces and a highly skilled workforce.

Victorian Industry Participation Policy

2.14 Also introduced in 2001, the *Victorian Industry Participation Policy* (VIPPP) highlights the Government's purchasing power, including financial assistance to attract major events and investments. It encourages contractors and purchasers to use local suppliers for major government-funded projects where they offer the best value for money in procurement across the whole of government.

2.15 The policy is intended to aid the creation of new jobs, and the transfer of skills and technology, by projects managed by leading Australian or international companies. Each contract over \$3 million in metropolitan areas, and \$1 million in non-metropolitan areas, is subject to bidders submitting a VIPP statement. All investment grants are subject also to VIPP. The policy is structured to be consistent with World Trade Organisation rules, and does not operate as a subsidy or give preference to local suppliers, as value for money remains the primary consideration in contractual arrangements.

Strategic Audit of Victorian Industry

2.16 The *Strategic Audit of Victoria Industry Overview* was released by the Victorian Government in February 2002 aimed at identifying opportunities for growth in the economy and strategies to capitalise on these and remove impediments to industry development, including that of small business. Individual industry audits have also been undertaken to examine specific issues relevant to a range of manufacturing and service sectors.

2.17 The *Agenda for New Manufacturing*, released by the Victorian Government in May 2001, establishes the basis for the development of a manufacturing industry policy to target growth. Other industry sectors with strategic audits include:

- automotive;
- environmental management and renewable energy;
- financial services;
- metal fabrication;
- precision engineering;
- professional and technical services;
- textiles, clothing, and footwear and leather;
- transport distribution and logistics; and
- sport and recreation.

Investment attraction and facilitation

2.18 These policies, particularly the Victorian Industry Participation Policy and the Strategic Audit of Victorian Industry, include pro-active support for investment assistance.

2.19 The principal objectives in investment assistance, including attraction of foreign direct investment projects, are to build the business base in Victoria and to assist Victorian businesses to grow and export, through enhanced capabilities in global competitiveness, and to create wealth and jobs. In addition to the Department of Innovation, Industry and Regional Development⁵, a small number of other public agencies are involved in investment attraction and facilitation, provided both independent of, and in conjunction with, Victorian Government investment assistance.

⁵ Prior to March 2002, named the Department of State and Regional Development.

Commonwealth Government

2.20 The Commonwealth Government's investment assistance activity is carried out through *Invest Australia* which, from time-to-time, works in conjunction with State investment agencies. Operating in Australia and 15 locations around the world, *Invest Australia* provides information on establishing businesses in Australia together with a range of facilitative services such as information and advice, contacts, introductions to industry networks and so forth, as well as feasibility study grants, information on financial incentives and particular facilitation for major projects.

Local governments

2.21 Many local government councils actively pursue economic development through a range of industry assistance and business development services. A limited number of these councils are directly involved in investment attraction and facilitation, particularly through infrastructure development, facilitation of planning and other regulatory permits and fee waivers on council services.

Major competitors

2.22 Major competitors to Victoria in attracting and retaining investment are other Australian States and New Zealand, and those countries developing as global centres in particular industry sectors. For example, the USA, South East Asia and Europe in the automotive industry, or the USA, Singapore, France and Italy in biotechnology. Governments in any of these locations may provide a combined set of business development services, facilitation and financial incentives in order to secure the investment.

2.23 In March 2001, a joint meeting of Cabinets of the Victorian and New South Wales Governments agreed to contain unnecessary bidding wars for investment projects and major events and to minimise the use of financial incentives where there is no national benefit. Since then, several projects have been discussed by Victoria with Queensland, Tasmania, South Australia and Western Australia and all States and Territories have been invited to agree to a set of principles for working arrangements to contain competitive practices.

2.24 In late April 2002, the Victorian Government announced a further \$100 million in new spending in industry assistance, with the intention to compete with other States so as to position Victoria as an Asia-Pacific centre for growth through emerging export industries such as advanced manufacturing.

CONDUCT OF THE AUDIT

Audit objectives and scope

2.25 The objectives of the audit were to investigate the extent of State-provided and co-ordinated industry assistance to attract new investment and evaluate:

- the effectiveness of investment attraction and facilitation programs in achieving their stated objectives, including the net benefits to Victoria;
- whether objective and comprehensive criteria have been established and consistently used to support industry attraction decisions;
- the transparency of such arrangements; and
- the adequacy of measures of whether recipients of public assistance are generating the expected economic, social, and environmental benefits for the community.

2.26 The audit also assessed whether appropriate follow-up action had been taken on key recommendations contained in the Auditor-General's October 1995 performance audit report *Promoting industry development: Assistance by government*.

2.27 This audit focused on initiatives designed to attract and retain new investment, that is, facilitation services such as labour market information, planning advice, access to industry networks and site location, "in-kind" assistance such as rate relief, land or other infrastructure development, and direct cash payments.

2.28 The audit methodology comprised:

- surveys of public sector agencies and local councils concerning the extent of their investment attraction activities;
- review of the records maintained by the Department of Innovation, Industry and Regional Development;
- verification of the accuracy of those records through an examination of initiatives comprising the major financial commitments by the State and local governments;
- selective examination of files in State and local governments to determine whether criteria for assistance were in place and consistently applied;
- review of the framework established by the Department to govern the provision of assistance, including the criteria for provision of assistance;
- review of the net benefits to Victoria derived from assisted investments;
- examination of 6 projects, to determine whether they generated the expected economic and other benefits to the State; and
- survey of a sample of companies that had been provided with facilitation services over the 6 year period.

2.29 The report includes discussion on a number of projects that received facilitation and financial assistance. In the light of the ongoing discussion on the level of disclosure of financial assistance, which is detailed in Part 6, information in respect of the level of financial assistance provided has only been included in the report where an organisation or party does not meet agreed performance requirements or it was considered that public monies were at risk. The audit was confined to industry assistance and did not include examination of assistance associated with education, sport, recreation and cultural pursuits.

Compliance with auditing standards

2.30 This audit was performed in accordance with Australian Auditing Standards applicable to performance audits and, accordingly, included such tests and other procedures considered necessary in the circumstances.

Period covered by the audit

2.31 The audit covered the period from July 1995 to June 2001, and any significant events since that time.

Assistance to the audit team

2.32 Specialist assistance was provided to the audit team by:

- Dr Elizabeth Webster, Senior Research Fellow and Joanne Loundes, Research Fellow, The Melbourne Institute of Applied Economic and Social Research (at The University of Melbourne), who provided specialist advice on net benefits to Victoria derived from assisted investments; and
- Wallis Consulting to undertake a telephone survey of a sample of organisations that have received facilitation services from the Department of Innovation, Industry and Regional Development to determine their perceptions of the facilitation services provided by the Department.

2.33 We are grateful for the assistance provided to the audit team by the management and staff of the Department of Innovation, Industry and Regional Development.

Part 3

The case for and against investment attraction

INVESTMENT ATTRACTION

Footloose and foreign direct investment

3.1 More than 2 500 government and private agencies worldwide are said to compete for foreign direct investment. The stock of foreign direct investment in Australia is \$212 billion as at 30 June 2001 and the annual inwards flow for 2000-01 was \$12.9 billion.¹

3.2 Much of this foreign direct investment, as well as new investment projects of many local Australian-based companies, is considered to be *footloose*. This means that a company's activities do not need to be located close to its markets and can potentially be encouraged to locate elsewhere. This is particularly the case for those companies that are new investors, need limited capital infrastructure and have low transportation costs.

3.3 Various studies indicate that a company's choice of location is becoming less dependent on access to suppliers and consumers and more dependent on other factors. A 1994 review² of 3 large-scale international studies found 6 significant factors influencing locational choice:

- the quest to take up a stake in regional markets so as to preserve and/or expand global market share;
- access to raw materials;
- access to a low-cost skilled workforce;
- a well-developed local infrastructure;
- an efficient and honest public sector; and
- political stability.

3.4 While direct financial assistance does not appear in the above list, it may make the marginal difference that determines the final location decision, particularly with respect to the establishment costs for new companies. Rolfe *et al*³ suggest that the value or effectiveness of financial incentives may depend on the specific situation of the investor. For example:

- export-oriented companies will prefer tax holidays and tariff concessions, whereas those companies interested in the local market will prefer incentives that protect that market, such as tariff and quota protection;
- start-up companies will prefer incentives that lower their initial investment (for example, cash grants and feasibility studies), whereas established companies looking to expand may prefer tax-related incentives; and

¹ ABS Balance of Payments & International Investment Position, Series 5302.0 Dec. Qtr. 2001.

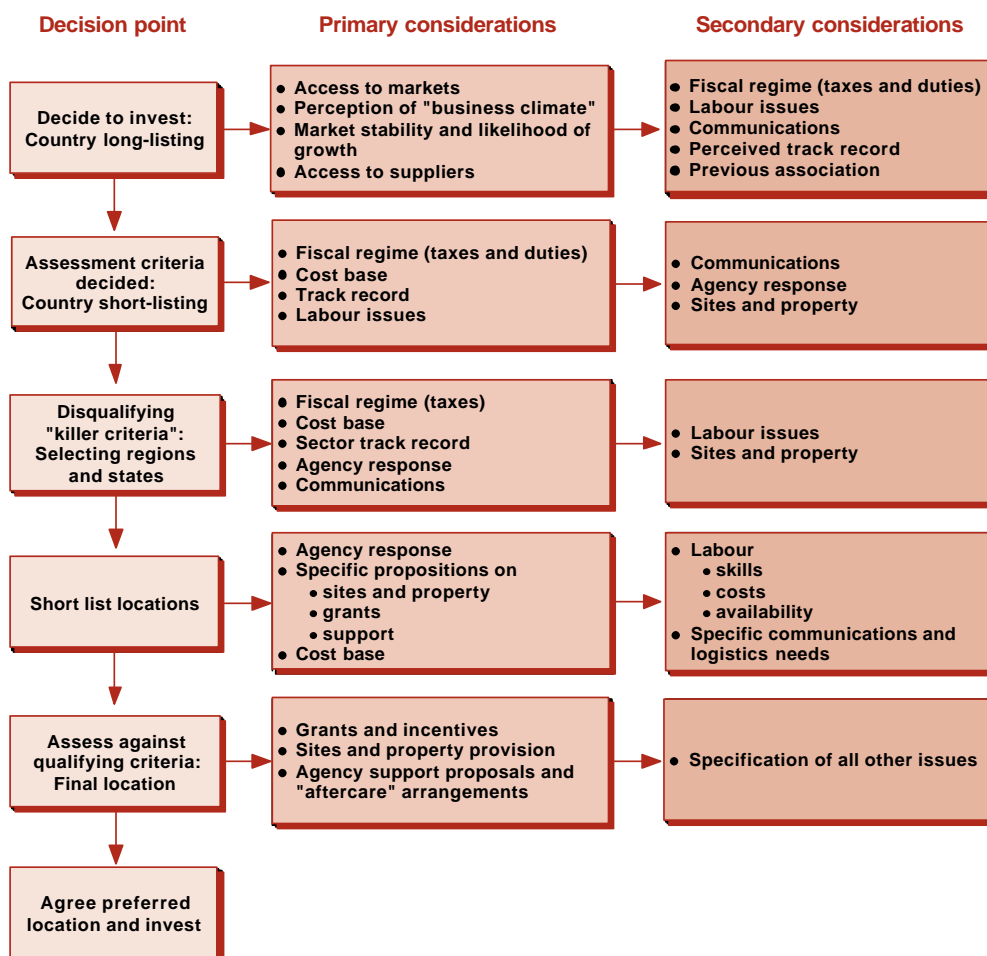
² Preston, A. (1994) "Taxation Policy and Australia's Competitiveness", *Economic Roundup*, pp. 23-34.

³ Rolfe, R. J., Ricks, D. A., Pointer, M. M. and McCarthy, M. (1993) "Determinants of FDI Incentive Preferences of MNEs", *Journal of International Business Studies*, 24(2), pp. 335-55.

- depreciation cash grants will probably be of less interest to service companies than manufacturing companies.

3.5 More recently, PriceWaterhouseCoopers, in a report commissioned in 2000 by the (then) Department of State and Regional Development, charted changes in importance of certain factors as an investor moved through a decision process regarding location of investment. In this study, the availability of grants and other financial incentives become important if there are more than 2 possible locations that have equivalent advantages with respect to the main considerations. In these cases small incentives at the margin become influential.

**CHART 3A
THE INVESTMENT DECISION-MAKING PROCESS**



Source: DIIRD: *The Role of Incentives in Attracting Investment*, PriceWaterhouseCoopers, November 2000.

Arguments for and against investment assistance

3.6 There is little argument that local economies can gain from encouraging direct investment. The main debate is about whether governments should financially underpin investment and, if so, what is the best method for providing these financial incentives, for example, subsidies, grants, in-kind facilitation services, tax concessions, and so on.

3.7 Nevertheless, the provision of investment incentives can be viewed also as encouraging non-productive rent-seeking⁴ behaviour. If incentives to footloose companies actually have no impact on locational decisions, then these represent a transfer of resources from the government to specific companies, some of which pays for the cost of lobbying the government for funds. The real cost is the loss of government funds for spending on other services. Once such rent-seeking behaviour is entrenched, both the government and the investing companies have a vested interest in ensuring that the program continues, as both sides have usually devoted considerable resources in developing and maintaining the infrastructure required to dispense and accept the funds.⁵

3.8 Most financial incentives will induce some rent-seeking behaviour and some real impact on the client's behaviour. The difficulty for policy makers is determining how much of either effect is present, and to the extent that a firm's Victorian investment levels are raised, what effects the selective investment assistance has on the rest of the Victorian economy.

3.9 Table 3B presents a summary of common arguments advanced for and against investment assistance.

⁴ In the context of investment attraction, the term "rent seeking" refers to seeking subsidies and assistance from government to remain in a particular location.

⁵ Krueger, A. O. (1993) "Political Economy of Policy Reform in Developing Countries", Cambridge, MA, The MIT Press.

TABLE 3B
THE CASE FOR AND AGAINST INVESTMENT ASSISTANCE

<i>Reasons for assistance</i>	<i>For</i>	<i>Against</i>
Increased globalisation of the economy and the mobility of companies (or footlooseness) has made investment more sensitive to expected regional rates of return.	<p>Selective incentives may add the increment to the expected rate of return necessary for company to invest in Victoria.</p> <p>This issue has become more prominent as Australia has sought to open up the economy to competition and integrate it better into the international economy (especially in the Asian region) by, among other things, becoming a base for regional headquarters of multinational companies.</p> <p>A recent Australian example is the location of the Australian headquarters of Virgin Blue in Queensland, where the incentives included relaxation of State taxes and charges, training support for Virgin staff, a contribution to relocation and set-up costs and marketing support.⁶</p>	<p>The decision to invest is determined largely by the rate of return on investment in Australia, which is in turn determined predominantly by general economic factors. The incentive packages offered by State governments are unlikely to alter this rate of return significantly.</p> <p>It will always be difficult for governments to determine whether the project would have located in a particular State or country anyway, and the firms have little incentive to reveal the true situation to government. Even if the incentive was sufficient to change the location decision of firms, it would be very difficult to ensure that the government does not pay more than that required to effect the change.</p>
A response to failure in the private market for information.	<p>Because it is hard to value information before you have bought it, information will be under-consumed by risk-averse firms.</p>	<p>The market failures or imperfections need to be identified clearly, and government action targeted to addressing the imperfections.</p> <p>Governments often lack the information and expertise necessary to identify and then correct the specific market failure in a manner that ensures that the positive effects outweigh the negative, including the costs of financing the intervention.</p> <p>There is a substantial risk that the cost of government action will outweigh any benefit from addressing market failure. For example, there is no easy way to determine how much subsidy is required in order to achieve optimal consumption of information and networking. Hence, it is easy to over-subsidise information provision.</p>

⁶ Baragwanath, C. and Howe, J. (2000) "Corporate Welfare: Public Accountability for Industry Assistance", *The Australia Institute Discussion Paper No. 34*, October.

TABLE 3B
THE CASE FOR AND AGAINST INVESTMENT ASSISTANCE - continued

Reasons for assistance	For	Against
The belief that investment generates additional employment and economic activity via multipliers within the local economy.	An investment project, as well as employing a certain number of people itself, will generate additional employment in other industries. A typical statement is that "one job in X will 'generate' Y additional jobs elsewhere in the economy". Typical output multipliers quoted are in the range 1.1 to 2.5, implying that one dollar of investment will generate an increase of between 1.1 and 2.5 dollars in Gross State Product.	Multipliers represent a net gain to the economy only to the extent that their demand on resources for associated activities can be met from resources which otherwise would not be used or if it involves a more efficient use of those resources. If an expansion of one industry can occur only by bidding resources away from another industry, then there is no net multiplier effect. The alternative uses of government funds used to assist investment are usually ignored. These funds may have greater value used in other ways or if left in the hands of taxpayers. The magic of multipliers in providing leverage from an initial investment can turn out to be a myth when account is taken of alternative uses of the resources allocated to the investment.
The "prisoners' dilemma" which arises when other governments are providing unknown levels of assistance.	States are caught in a "prisoners' dilemma". Despite costs for all involved, it is difficult for a State to withdraw from the bidding process because of the potential losses that it would incur if other continued to bid. As predicted by game theory, the decision of any State to offer investment incentives is the best outcome for it, given other governments also offer these incentives, even though the best solution may be for neither government to offer incentives.	States individually are acting rationally to engage in competitive assistance provision, but collectively they would be better off by not doing so. Economic wellbeing in Australia as a whole will be improved by an agreement to cease State assistance to industry and to use other mechanisms to equalise economic outcomes between States.
Political pressures on governments to be seen to be doing something to stimulate economic development.	In times of high unemployment or in the face of the successes by rival States, governments are under pressure to be seen to be acting, even if that action has minimal real effect. Additionally, if an incentive scheme is successful in attracting an investment which would not have otherwise occurred, it is argued that the money paid will be more than recouped by the extra taxes and income that will be generated for the State.	There may be a temptation to increase State assistance to maintain a loss-making investment, in order to avoid the appearance of failure, particularly if the project has been the recipient of highly publicised government assistance. Governments may become hostage to the success of the firm or industry, making it difficult to withdraw assistance, even if initially provided as a short-term measure.

⁷ Industry Commission, op. cit.

Mudambi, R. (1999) "Multinational Investment Attraction: Principal-Agent Considerations", *International Journal of the Economics of Business*, 6(1), pp. 65-79.

⁸ Parliament NSW Public Accounts Committee (2001) "Industry Assistance", Sydney, Parliament NSW Public Accounts Committee: 112. Preston, op. cit.

TABLE 3B
THE CASE FOR AND AGAINST INVESTMENT ASSISTANCE - continued

Reasons for assistance	For	Against
<p>A critical mass is necessary before significant development becomes self-sustaining, and that governments can create this critical mass.</p>	<p>Grouping of related businesses can reduce the costs to each other through reduced transport costs, reduced reaction times, and general gains from easier working relationships, and intangibles such as the cross-fertilisation of ideas.</p> <p>There can be a market failure to the extent that early entry firms may not take into account the future gains to themselves and other firms which will benefit from the clustering. As a consequence, there will be under-investment until such time as a critical mass is reached for the development to attract investment in its own right.</p> <p>Investors have imperfect knowledge and the presence of some successful projects can help to correct for misinformation or lack of information in the market place on the true benefits of a particular location.</p>	<p>The reasons why some clusters are successful and others are not, and the reasons for their initial location in a particular area, are little understood. It is difficult for governments to make sound judgements of the appropriate amount of assistance that should be provided, or to know if any success was the result of their efforts or would have occurred naturally.</p> <p>The existence of under-utilised technology parks established by both State and local governments and by universities, indicates the risks inherent in government intervention.</p> <p>The success of such a strategy depends on attracting further investment without assistance. However, once governments become involved in providing selective assistance, there seems to be difficulty in ceasing such a policy even after a series of 'lighthouses' has been assisted often over many decades.</p> <p>Moreover, there may be more efficient means of dealing with perceived information problems, and 'lighthouse' assistance may be less effective in fostering investment than more general measures to create an efficient business environment.</p> <p>In these cases, the costs to the citizens can seem small, and the gains considerable. In this situation, public information on the full costs and benefits of government intervention is essential to enable citizens to make such an informed judgement.</p>
<p>The belief that large, high-profile projects can act as a "beacon" or "lighthouse" advertising and demonstrating the benefits of the State.</p>	<p>There is a "psychic income" or a "feel good" effect flowing to State populations from attracting a major investment.</p> <p>Surveys confirm that the citizens of a State are often in favour of their government bidding for a specific firm or event (particularly when it is successful) as it leads to the citizens themselves feeling that they live in a successful State capable of attracting major events and firms.</p>	<p>Intangible benefits largely in the form of improved State "morale", particularly relating to the staging of major events.</p>

Source: Industry Commission (1996) State, Territory and Local Government Assistance to Industry, Report No. 55, October.

Part 4

Extent of, and criteria for, government investment assistance in Victoria

DEPARTMENT OF INNOVATION, INDUSTRY AND REGIONAL DEVELOPMENT

Investment attraction and facilitation services

4.1 The Department of Innovation, Industry and Regional Development is Victoria's lead economic development agency, and is responsible for investment attraction and facilitation. The budget for the Department for 2001–02 reflects the Government's emphasis on strengthening business support, and developing an innovative and creative economy.

TABLE 4A
DIIRD EXPENDITURE IN 2000-01 AND ESTIMATES FOR 2001-02
(\$million)

<i>Output Group</i>	<i>2000-01 expenditure^(a)</i>	<i>2001-02 estimates^(b)</i>
Innovation and Policy	26.5	94.7
Business	113.2	190.5
Industrial Relations	8.1	12.1
Sport, Recreation and Racing	56.8	70.6
Tourism	47.6	39.7
Major Projects	9.6	6.0
Total	261.8	413.6

(a) Department of State and Regional Development 2000-01 Annual Report.

(b) Department of Treasury and Finance 2001-02 Budget Papers, Budgets Paper No. 3.

4.2 The Department delivers a range of services to attract and facilitate new foreign and Australian investment into the State and to encourage new investment by companies already operating in Victoria. In a limited number of circumstances, direct financial assistance is paid to companies with facilitated projects, where they meet particular investment criteria.

4.3 The Department's investment attraction and facilitation activity is conducted through the Business Output Group. The administrative cost for this activity is approximately \$36 million over the period 1995-96 to 2000-01, which includes that part of the administrative costs of Victoria's 9 overseas business offices allocated to investment attraction. The cost of investment attraction and facilitation, therefore, is approximately \$30 000 per project facilitated and \$75 500 per project that was successfully located in Victoria. The average grant amount paid for each directly financially assisted project, during the 6 years, was \$630 000.

4.4 In the last financial year, the Department committed 77 per cent of its industry assistance grants to investment attraction and facilitation, which is about 10 per cent of total expenditure by the Department. The remaining industry assistance grants were applied to business improvement, innovation and export development as well as selected sponsorships of activity carried out by some industry bodies.

Investment attraction

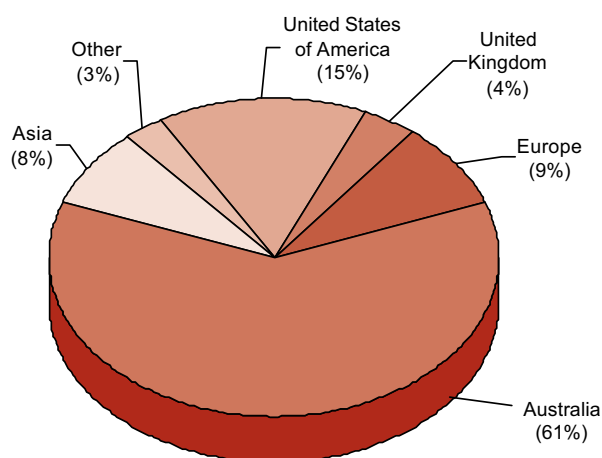
4.5 The Department's investment attraction activity is targeted to industries and companies which may provide new investment in Victoria, particularly those operating in strategic industry sectors. Key markets for attraction of new projects are the traditional locations of the United States, Europe and Japan, as well as footloose companies already operating in Victoria. Industries and companies are targeted through avenues such as local and international trade fairs, word of mouth, or direct contact between the companies and government representatives.

4.6 This promotion of Victoria is generally done through established networks, such as Chambers of Commerce, industry groups, the Commonwealth Government's investment agency, Invest Australia, AusTrade, Victoria's 9 overseas business offices – located in Chicago, Dubai, Frankfurt, Hong Kong, Jakarta, London, Seoul, Tokyo and San Francisco – and linkages with other government agencies.

4.7 Information is provided to companies on local investment opportunities, labour market demographics, infrastructure, industrial, political and economic conditions, taxation and business permit rules and so on, as a means of promoting the advantages of Victoria as a business location. Such companies may seek a range of services and incentives from government before making a commitment to invest in a particular city or region of the State.

4.8 The chart shows investment projects successfully attracted to Victoria by the Department since July 1995, broken down by foreign or Australian ownership.

CHART 4B
NUMBER OF SUCCESSFULLY ATTRACTED PROJECTS BY COUNTRY OF COMPANY OWNERSHIP, 1995-96 TO 2000-01

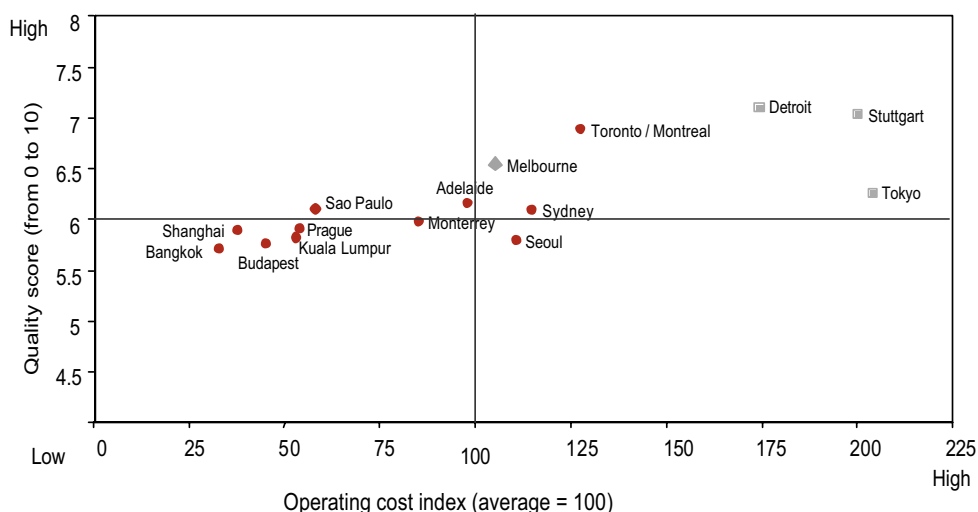


Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

4.9 More comprehensive targeting has been achieved in the last year through the establishment of value propositions (business rationales) in 15 sectors arising from the benchmarking of Victoria against competitive investment locations elsewhere in the world. These value propositions provide key information on Victoria relevant to certain investment criteria and are intended to be available through the internet and supplemented by searchable content providing specific details on Victoria's capabilities.¹

4.10 One example of this is the benchmarking of Melbourne's quality and cost rating in vehicle component manufacturing relative to a range of major centres, as shown in the following chart.

CHART 4C
RESULTS OF BENCHMARKING AGAINST COMPETITIVE LOCATIONS IN VEHICLE COMPONENTS MANUFACTURING



Source: Department of Industry, Innovation and Regional Development, from a study by PriceWaterhouseCoopers, Brussels office.

Investment facilitation

4.11 A range of financial and non-financial facilitation services are provided to new investment projects, both as part of the initial process of investment attraction and also as ongoing services provided once a company has made a decision to locate its new investment in the State.

¹ See website: www.invest.vic.gov.au

4.12 Facilitation services include information on legislative and regulatory requirements, assistance with site location and purchase, identification of infrastructure and utility needs, co-ordination and brokering of development approvals processes, assistance with business development programs, training and introductions to industry networks.

4.13 Facilitation of investment projects, from attraction through to project monitoring, is generally co-ordinated through departmental teams that provide contacts, specialist knowledge and linkages with a range of services, and are led by industry sector client managers with responsibility for ongoing maintenance of the company relationship.

4.14 From 1995-96 and 2000-01, over 1 200 projects and 966 companies were given facilitation services. Of these, 477 investment projects went ahead in Victoria in 374 companies and can be classified as successfully facilitated. Forty-five companies have generated more than one investment project in that time, with 2 companies receiving investment facilitation for 9 and 10 projects, respectively.

4.15 At the time of the facilitation, it was expected that these projects would create investment value to Victoria of \$8.3 billion, 30 812 permanent full-time jobs and exports of \$5.8 billion. Annual breakdowns of this expected activity are shown in Table 4D.

TABLE 4D
INVESTMENT FACILITATION BY DIIRD AND EXPECTED RESULTS,
1995-96 TO 2000-01

<i>Year</i>	<i>Successfully facilitated projects (no.)</i>	<i>Estimated investment (\$m)</i>	<i>Estimated number of full-time jobs (no.)</i>	<i>Estimated exports (\$m)</i>
1995-96	47	1 302.7	4 263	602.0
1996-97	57	1 138.8	3 791	1 792.9
1997-98	73	1 408.9	4 250	462.9
1998-99	79	1 300.1	5 775	1 792.2
1999-00	97	1 451.1	7 277	432.4
2000-01	124	1 689.1	5 456	717.9
Total	477	8 290.7	30 812	5 800.3

Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

4.16 Of these 477 projects, 61 per cent were in the metropolitan area and 39 per cent in regional Victoria; 78 per cent were in the manufacturing sector and 22 per cent in the service sector. Annual breakdowns of these distributions are shown in Table 4E.

TABLE 4E
NUMBER OF FACILITATED PROJECTS BY REGION AND SECTOR,
1995-96 TO 2000-01

Year	Metropolitan projects	Non-metropolitan projects	Manufacturing sector	Services sector
1995-96	26	21	33	14
1996-97	26	31	46	11
1997-98	54	19	44	29
1998-99	51	28	49	30
1999-00	60	37	64	33
2000-01	75	49	85	39
Total	292	185	321	156

Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

Direct financial assistance

4.17 Direct financial assistance has been provided to just over one-quarter of the successfully facilitated projects that met certain investment criteria. Of these, 107 companies accepted the payment during 1995–96 to 2000–2001, to a total commitment by the Victorian Government of \$196 million in 123 projects. Thirteen companies, or 12 per cent of all companies accepting direct financial assistance, accepted it for more than one project.

4.18 Payment of this direct financial assistance is tied to achievement of investment and employment targets. As all targets have not been achieved, or have been achieved in financial years later than the year of government commitment, only \$77.6 million had been paid to June 2001. This amounts to \$630 000 per financially assisted project during the 6 years. Table 4F sets out annual payments and commitments towards direct financial assistance of selected successfully facilitated projects.

TABLE 4F
EXTENT OF INVESTMENT FACILITATION INVOLVING DIRECT FINANCIAL ASSISTANCE,
1995-96 TO 2000-01

Year	Facilitated projects ^(a) (no.)	Financially-assisted projects (no.)	Amount committed (\$m)	Amount paid ^(b) (\$m)
1995-96	47	23	9.7	12.3
1996-97	57	17	10.7	9.5
1997-98	73	16	26.9	9.6
1998-99	79	16	20.0	10.0
1999-00	97	22	21.4	11.8
2000-01	124	29	107.7	24.4
Total	477	123	196.4	77.6

(a) Includes those that also receive direct financial assistance.

(b) The achievement of milestones prior to grant payments can delay payments to some projects for up to two years, or result in non-payment, hence the differing amounts committed and paid in any one financial year.

Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

4.19 Thirty-four of these financially-assisted projects are yet to receive any payments; 16 have received \$1 million or more over the 6 years; 21 have received between \$300 000 and \$1 million; and 50 projects have received \$300 000 or less.

Criteria

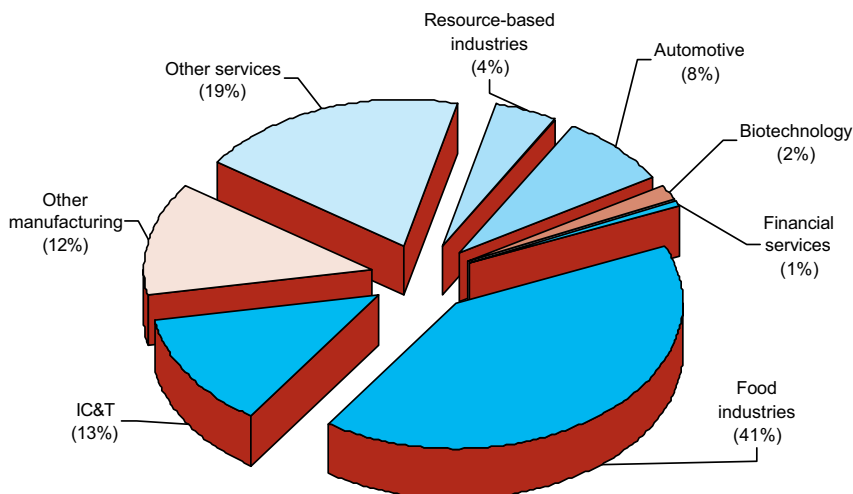
Purpose and type of assistance

4.20 Investing companies receiving facilitation need to demonstrate a commitment to improving performance and achieving international competitiveness, and the investment needs to add to Australia's productive capacity. Companies that are identified as being high growth firms within their sector may be targeted for intensive facilitation.

4.21 Priority for both attraction and facilitation, including direct financial assistance, is given to companies operating in the industry sectors identified by the Government as having strategic significance for Victoria. The 5 major sectors are IC&T, food, financial and shared services, automotive, and biotechnology industries,² supported by a range of trade exposed manufacturing, service and resource based industries.

4.22 Breakdowns by industry sector, of the numbers of successfully facilitated projects and of the estimated investment, are given below. About one fifth of the numbers of projects, and also of the estimated investment, are identified as being in other industry sectors other than those of strategic priority, mainly engineering, plastics, forestry and transport.

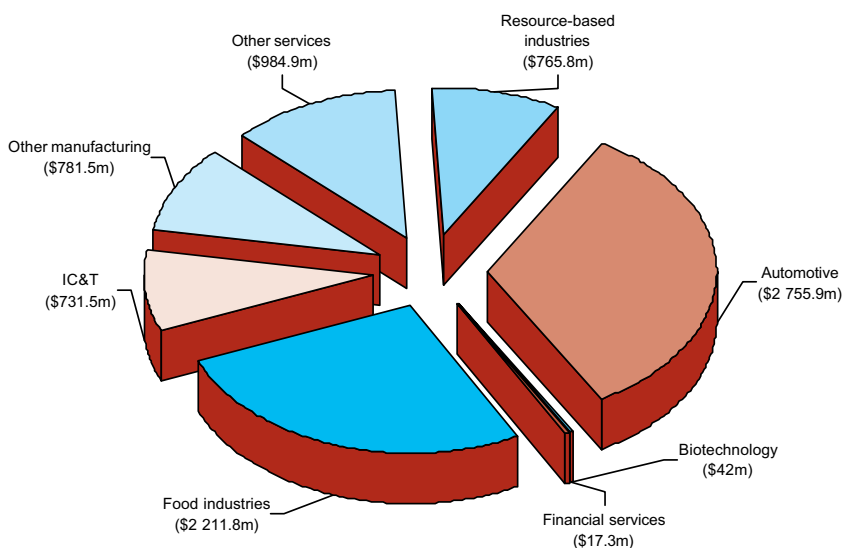
CHART 4G
NUMBER OF SUCCESSFULLY FACILITATED PROJECTS BY INDUSTRY SECTOR,
1995-96 TO 2000-01



Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

² State of Victoria, *Strategic Audit of Victorian Industry*, February 2002, pp. 9-10.

CHART 4H
ESTIMATED INVESTMENT VALUE OF ALL SUCCESSFULLY FACILITATED PROJECTS BY
INDUSTRY SECTOR, 1995-96 TO 2000-01



Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

4.23 Where investment facilitation extends to direct financial assistance, this assistance is made through investment grants requiring either Ministerial or Investment Support Committee of Cabinet approval. The nature and level of assistance is determined on a case-by-case basis with the view of securing the investment at least cost to the State, having regard to the strategic importance to Victoria, the impact upon the industry sector and any downstream economic benefits to the Victorian economy. Significantly, financial incentives are usually structured to be less than the projected gain to the State from payroll tax and land tax as a result of the incremental jobs and/or capital investment.

Criteria for investment facilitation

4.24 The Government's industry policy priorities form the basis for the Department's broad criteria for investment attraction and facilitation, and these are reflected in the Department's internal structures and resource allocations. Client managers with responsibility for the priority industry sectors both respond to, and actively seek out, new investment projects, particularly in companies demonstrating growth potential.

4.25 The Department has a policy that it will facilitate, in some way, any new investment project that seeks support, including redirecting the company to seek advice and assistance in feasibility or business development before proceeding further.

4.26 Beyond these broad criteria of strategic industry priorities and equitable access to assistance, the department uses specific criteria for assistance, applied in conjunction with robust decision-making processes that take into account factors such as:

- the economic benefits to Victoria;
- the financial strength and long-term sustainability of the investment;
- appropriate levels of cost-benefit analyses that also include considerations of broader socio-economic criteria; and
- consideration of the State's national and international obligations, including the non-competitive understanding with NSW and the World Trade Agreements.

Eligibility criteria and method of assessing recommended assistance packages are set out in Cabinet guidelines which include a detailed proforma.

4.27 We found that, while departmental officers take into account the factors listed above, the criteria for investment assistance are not explicitly stated in the Department's publications, annual reports or website. Information is available to potential investors on a range of matters, but the criteria for, and process of, gaining and maintaining assistance, including financial incentives, is not explicit.

4.28 Departmental officers also apply a number of inherent criteria to investment attraction and facilitation, developed over time and through the knowledge and experience of senior staff, that bolster their decision-making processes and reinforce other requirements, such as those that need to be met to receive direct financial assistance. For example, guiding principles such as those known as *The 4Cs* are applied in assessing the capacity of companies to generate successful investment projects:

- Capability – evidenced by a proven track record, or an innovative, global player;
- Credibility – evidenced by due diligence and reputation;
- Commitment – evidenced by long-term commitment to Victoria; and
- Competitive advantage – innovative, high value, sustainable without government assistance.

Combined with other professional assessments of the strength, or otherwise, of the investment proposal, decisions are made by staff regarding the degree of facilitation other than direct financial assistance that is provided.

4.29 This capacity of departmental staff to apply judgements based on inherent criteria and experience is both a strength and a weakness. On the one hand, the combined skill, knowledge and years of experience of certain officers, and the teams that they lead, points to the careful analysis of a complex set of inter-relating factors in evaluating whether a new investment project is worth supporting. On the other hand, there is an absence of explicit and structured documents and no clear way of passing on this process and knowledge to new staff, particularly from senior staff close to retirement and in areas of high turnover, such as client managers.

4.30 The Department's Investment Committee is one forum where knowledge and experience is shared between the case officers and more experienced executives, and where criteria are explicitly discussed and applied to particular projects. Other opportunities to convey knowledge are taken by building project teams that aim to include more experienced staff and to ensure that staff remain with projects for their life cycle.

4.31 Some officers also attend a twice yearly, 4 day course, *Winning Investment to Australia*, run by the Australian National University in conjunction with *Invest Australia*.

Criteria for direct financial assistance

4.32 Financial assistance to investment projects is provided under the programs set out in Table 4I below.

TABLE 4I
PROGRAMS FOR DIRECT FINANCIAL ASSISTANCE TO INVESTMENT PROJECTS

Type of Assistance	Purpose of assistance	Eligibility conditions
Program: Investment and industry		
Financial incentives	To provide financial incentives to attract new industry investment that may not otherwise be located in Victoria.	<i>Investment Support Program</i> Investment proposals are assessed on a case by case basis by a Cabinet Committee chaired by the Premier. Projects that involve new investment and/or employment creation and export growth may be eligible for assistance.
	To target key industry sectors that have the potential for rapid growth through export development.	<i>Business Assistance Program (Investment-related)</i> Projects identified for assistance must offer significant economic benefits to Victoria in terms of exports or import substitution, employment or the development acquisition and diffusion of new technology. Projects should be in key industry sectors, with priority being accorded to export or import competing companies.
		<i>Regional Investment Attraction</i> Grant assistance is provided to rural firms for projects that are footloose or involve the expansion of existing rural firms.

Source: Department of Innovation, Industry and Regional Development.

4.33 Criteria for direct financial assistance include financial risk assessments consisting of Australian Securities and Investments Commission searches, Dunn and Bradstreet inquiries and bona fides checks, together with economic impact and socio-economic assessments, based on business plans, project documentation and potential benefits likely to accrue to the State as a result of the proposed investment. For projects where government assistance is likely to exceed \$2 million, an independent cost-benefit analysis must be undertaken.

4.34 All of the 38 proposals examined as part of the audit had appropriate financial, risk and other assessments, with the more recent project proposals reflecting more comprehensive understanding and economic modelling of the operations and financial details of the applicants and providing sound assessments.

4.35 These assessments are included in detailed proposals for financial assistance which also contain information on:

- the strategic industry sector;
- a minimum capital investment value to metropolitan or country Victoria;
- a minimum number of expected full-time jobs;
- whether the project is footloose and seeking direct financial assistance from this and other governments; and
- how the investment will:
 - add to Victoria's competitive strengths and the company's longer term sustainability in an international environment;
 - add to Australia's productive capacity; and
 - contribute to the company's improved performance and international competitiveness.

4.36 Few proposals included considerations of broader socio-economic criteria; nor are these set out against the criteria for financial assistance.

4.37 The Department's Investment Committee assesses proposals before they are forwarded to either a Minister or the Investment Support Committee of Cabinet for approval. Funding is provided under the Investment Support Program, the Business Assistance Program or the Regional Investment Attraction Program. The latter 2 programs require Ministerial approval; the former program requires Cabinet Committee approval. The Cabinet Committee approves most proposals for direct financial assistance.

4.38 The company's acceptance of an offer is required within 2 months and the project is required to commence within a year from that time. It is interesting to note that not all offers for financial assistance are taken up. For example, between 1993 and February 2002, 178 offers of direct financial assistance were made through the Cabinet Committee and the Investment Support Program. Of these, 86 have been converted to a legal agreement, 71 have not been taken up and 21 are still being negotiated. Reasons for not taking up the offer may include company decisions to either change the nature of the investment or to locate it outside Victoria.

Conclusions

4.39 While the Department carefully targets, facilitates and provides direct financial assistance to companies and investment projects assessed to be of benefit to the Victorian economy, and applies a set of appropriate criteria to underpin these decisions, there is insufficient public disclosure and availability of these criteria. Further, the formal documentation of assessment processes against these criteria, the education and training of staff in their application and the transfer of this knowledge from very experienced senior staff is limited through the absence of explicit documentation of criteria.

4.40 Establishment of such explicit statements and processes would also provide a source of information for the development of comprehensive baseline data and subsequent evaluations of the effectiveness of investment attraction and facilitation activity.

Recommendations

4.41 We recommend that:

- explicit criteria for investment facilitation and direct financial assistance be developed and published.
- these criteria specify the requirements, including relative weights, for:
 - footlooseness;
 - Victoria's strategic industry sectors;
 - net economic benefits, and the measures for these;
 - impact on investment and/or production in other industry sectors, or on companies in the investor's industry sector; either competitors, users or suppliers;
 - any other benefits, such as research and development capability, flow-on effects, socio-economic and community benefits, environmental considerations, etc.;
 - sustainability of the investment without government support;
 - other strategic capabilities;
 - international obligations, including World Trade Agreements.
- departmental methods of assessment against program criteria be formalised and documented:
 - as part of the process of program co-ordination, information management and knowledge transfer within public sector agencies working in the area of investment attraction and facilitation;
 - as a means of systematically collecting data that will inform progressive analysis, evaluation and reporting – for management purposes and for public disclosure – of facilitated investments.

RESPONSE by Department of Innovation, Industry and Regional Development

The Department's present criteria focus primarily on the direct economic benefits to the State. The Department is presently exploring more broad-based assessment methods and will share these methods with stakeholders – including your office if you wish – as they are developed.

Contractual arrangements

Monitoring of financial payments

4.42 Where a decision to provide financial assistance is made, an appropriate contractual agreement is made with the company, which outlines investment and employment milestones that must be met before payments are made.³ This agreement outlines investment and employment milestones that are directly related to payments. Schedules for monitoring milestone achievement and program effectiveness are prepared for each financial assistance package and are designed to assist the relevant sector's client manager to monitor and evaluate the project.

4.43 If the investment does not eventuate, or proceeds on a lesser scale or is delayed, the amount of assistance is reduced accordingly. We saw no payments being made prior to achievement of milestones, which is evidenced by audit certificates provided by the companies. However, there was no analysis of overall progress and outcomes from the assistance. Such analysis was also not used to inform future decision making or program development.

4.44 The contractual arrangements for these grants meet the criteria established in the Australian National Audit Office's Better Practice Guide for the Administration of Grants. In particular, ever increasing attention over the period, to the requirement that payment is linked to achievement of agreed performance outcomes such as investment and jobs, has resulted in grant amounts generally being paid only against audited statements of achievement.

4.45 The agreement also requires that the Government be notified of any changes in company ownership, but does not specify notification of instances where corporate restructuring or project changes have taken place, which can subsequently affect the relationships, legal rights and obligations of the contracting parties.

³ Projects funded under the Business Assistance or Regional Investment Attraction Programs, and which are less than \$50 000, have a standard departmental letter of offer and company acceptance which together form the agreement.

Recovery of grant following non-performance

4.46 The legal agreements entered into between the Minister and the companies contain standard clauses that cover company failure to comply with the terms of the agreement. If this occurs, the Minister may require repayment of an amount of money not exceeding the amount of the grant moneys already paid to the company. The agreements also provide for the levying of interest at the rate fixed by the *Penalty Interest Rates Act* 1983 from the date of the grant to the date of repayment.

4.47 The Minister may also withhold, suspend, cancel or terminate any payments under the grant. This discretion under the agreement occurs when the Minister is of the reasonable opinion that there has been deterioration in the financial circumstances of the company or that the company has failed to comply with some or all of its obligations under the agreement.

4.48 We examined 3 companies that failed to meet the terms of the agreement and where the Department had instigated recovery action. Grant recovery from 2 companies was achieved within a short time frame. Negotiations are still continuing with the third company. In each case, penalty interest has not been levied. The total interest forgone in the 3 cases is approximately \$1.16 million.

4.49 We found that the waiver of penalty interest, on each occasion, approved by the Minister, was being used as a lever to negotiate a prompt recovery of the grant. Ministerial decisions have consistently reflected the position that penalty interest should not apply in circumstances where the company has acted in good faith, but due to a change in commercial circumstances has not been able to deliver on the project.

Monitoring of progress

4.50 The agreements incorporate provisions requiring the company to provide information for monitoring its continued viability and operations. Such information includes annual reports and financial statements, project progress reports, business plans and other information relevant to corporate performance and operations. The provision of this information is also linked to a defined time frame. This information is not independently verified.

4.51 Our examination of 38 financially-assisted projects demonstrated a lack of priority given to systematic monitoring other than that required for grant payments. There was no evidence that analysis of progress had been undertaken, nor that any such analysis had been incorporated into evaluation or other briefings.

4.52 Without such timely evaluation and reporting, the client manager is unable to assess properly whether companies are meeting their project targets or whether the combined, overall benefit to Victoria is being sustained. While it is pleasing to note that, during the course of the audit, the Department has introduced quarterly reporting on investment projects to the Investment Committee, it is the quality of the variables collected that are the key to ongoing program monitoring, rather than the frequency of reporting.

4.53 The role of the client manager is pivotal in pro-actively attracting new investments from companies already operating in Victoria, in developing proposals in support of facilitation and financial incentives and in monitoring performance. While we found no evidence of any potential, actual or perceived conflicts of interest, a register of interest should be maintained by the Department to protect non-executive staff working in investment attraction. This issue was raised during my report on *Grants to non-government organisations: Improving Accountability* in November 2000.

Recommendations

4.54 We recommend that:

- the Department selectively undertake its own assessment of the achievement of milestones under contractual arrangements with companies to improve the timeliness and accuracy of audit returns.

RESPONSE by Department of Innovation, Industry and Regional Development

The achievement of milestones is attested to by audit certificates from the recipient's external auditors. The department will strengthen this process by incorporating a standard clause in the legal agreement to request the background papers to the issuance of any audit certificate to be retained for a reasonable period and made

- a standard clause be inserted into contracts requiring grant recipients to inform the Department prior to corporate restructuring or project changes that affect the relationships, legal rights or obligations of the contracting parties.

RESPONSE by Department of Innovation, Industry and Regional Development

There is already a standard clause in the grant agreement requiring the recipient to advise of any change of corporate ownership and prospective transfer of rights and to seek Ministerial approval for this action. However, the department will examine how this clause might be strengthened by a requirement to advise of any significant organisational or market changes which might impact on the recipient's ability to deliver contracted outcomes.

- guidelines be provided to staff defining the circumstances under which penalty interest is to be recovered and those circumstances under which such interest is to be forgone.

RESPONSE by Department of Innovation, Industry and Regional Development

In relation to guidelines the Department will formalise existing practice through incorporation in the Investment Guidelines manual.

- the Department establish, in a similar manner to that which already exists for executive officers, a register of interests for non-executive staff members within the business groups that manage investment assistance, including clear guidelines on what constitutes a conflict of interest and a requirement that staff complete an annual return declaring any interest.

RESPONSE by Department of Innovation, Industry and Regional Development

The Department will implement the recommendation regarding the establishment of a register.

OTHER GOVERNMENT AGENCIES

Context

4.55 The Department's facilitation and financial assistance of particular projects is often undertaken in association with, or is supplemented by, facilitation and financial assistance by Commonwealth and other State or local government agencies.

4.56 *Invest Australia* is the national investment promotion and facilitation body and, from time to time, works with State bodies, to attract large investment projects into Australia. The relationship between *Invest Australia* and Victoria, in respect of the 477 facilitated projects, has not been examined as part of this audit.

4.57 Other agencies within the State may also assist new investment. For example, in Victoria there are a small number of public sector agencies that provide assistance towards regional development, sustainable development, tourism and other specific investment activity.

4.58 A survey of 161 Victorian local government and other public sector agencies was undertaken as part of this audit to ascertain the extent of new investment assistance, either direct or in-direct, provided across Victoria by public agencies other than the Department of Innovation, Industry and Regional Development.⁴ The information was verified for some selected local councils only, and no attempt was made to measure the net benefit of this assistance to the State.

4.59 The involvement in investment attraction of public sector agencies, other than the Department of Innovation, Industry and Regional Development, is complex and frequently tied to policies in areas such as sustainable development, arts or tourism, where it may be combined with other services or regulations designed to achieve particular policy outcomes. For example, the Environment Protection Authority provides matched seed funding to promote investment in new and efficient production processes. Since 1996, the amount granted through these Cleaner Production Grants is \$1.8 million and the total value of new works is \$3.6 billion. Other, similar programs by the Environment Protection Authority, that do not provide direct financial support, also may have a significant effect on Victoria's investment climate. In instances such as these, where the activity is principally directed towards a separate and different policy outcome to investment attraction and facilitation, we have excluded consideration of the agency from this audit.

⁴ See 2.28 of this report: Audit objectives and scope.

Extent of investment assistance by agencies other than DIIRD

4.60 The results from our survey indicate that \$29.5 million of additional investment assistance, both financial and in-kind, has been provided towards new investment in Victoria over the period 1995 to 2001, as shown in Table 4J. The majority of assistance is from local government.

4.61 Local government involvement in investment attraction frequently includes a complex array of accompanying arrangements and associations with other government agencies. For example, negotiations around an offer of assistance from a council to a firm may include agreements with those firms to contribute significantly to local infrastructure, such as car parks and recreational areas, as well as the usual requirements to invest locally and create local jobs, and other possible agreements with State and/or Commonwealth Governments.



Manufacturing is a large part of Victoria's economy.

TABLE 4J
TOTAL ASSISTANCE TO INDUSTRY BY VICTORIAN AGENCIES
1995–96 TO 2000–01
(\$MILLION)

<i>Non-DIIRD assistance</i>					
<i>Year</i>	<i>Other agencies</i>	<i>Local government</i>	<i>Total non-DIIRD assistance</i>	<i>DIIRD assistance</i>	<i>Total for Victoria</i>
1995-96	0.6	0.7	1.3	12.3	13.6
1996-97	1.0	9.4	10.4	9.5	19.9
1997-98	0.6	3.5	4.1	9.6	13.7
1998-99	0.8	2.0	2.8	10.0	12.8
1999-00	1.2	6.3	7.5	11.8	19.3
2000-01	1.3	2.1	3.4	24.4	27.8
Total	5.5	24.0	29.5	77.6	107.1

Note: Government Departments other than DIIRD did not provide financial assistance.

Source: Victorian Auditor-General's Office, based on data provided by DIIRD, local government, other State departments, and public sector institutions and agencies

4.62 When combined with the assistance given by the Department, the investment assistance given to industry by government agencies in Victoria is estimated to have been \$107.1 million since 1995-96. When the Departments administrative costs of \$36 million, over the 6 year period are added, the total investment assistance is \$143.1 million.

Investment assistance from public sector agencies

4.63 Investment assistance from other public sector agencies is estimated at \$5.5 million over the 6-year period, and is provided largely through programs and grants administered by Tourism Victoria, Cinemedia and some water authorities.

Tourism Victoria

4.64 Tourism Victoria's Infrastructure and Aviation Division was formed in 1994 to address strategic issues facing the State's tourism industry. The Division facilitates infrastructure investment and international air services, with most resources dedicated to expanding and attracting investment in quality infrastructure.

4.65 Funds for this direct assistance are sourced from the Community Support Fund, the Department of Treasury and Finance, the Department of Innovation, Industry and Regional Development, and directed through the Tourism Victoria's Global Marketing Division, appearing in Tourism Victoria's accounts as "airline cooperative" marketing assistance. Tourism Victoria has reported that the total amount of these transactions is \$820,000 for the 6-year period. The Division also leverages funds from other State and Commonwealth funding programs.

4.66 The Division's annual performance target is \$250 million in private sector infrastructure investment per annum, \$10 million in public sector infrastructure investment facilitation, 5 000 additional weekly airline seats and improved connections to strategic markets. This is achieved at a cost, between 1996 and 2001, of \$4 million for all recurrent staffing and operating costs and cooperative marketing assistance of \$820 000 to targeted airlines.

4.67 In relation to project facilitation, the Division has facilitated several new investment projects and introduced a number of new offshore investors to the State. Concerning airline negotiations, using a number of criteria, Victoria has outperformed other states in terms of year-on-year inbound passenger growth and attraction of new carriers. Since 1994, Tourism Victoria report that international air services have increased from 270 to 390 per week with annual growth of 6.3%, and net growth of 44%.

4.68 The Infrastructure and Aviation Division reports publicly on its activities in Tourism Victoria's annual report, which summarises investment facilitation activity and reports on Divisional outcomes against performance targets.

Cinemia

4.69 Cinemia, through the business unit, Melbourne Film Office, has administered Victoria's Production Investment Attraction Fund since its inception in June 1999, and the Regional Victoria Film Location Assistance Fund since its inception in February 2000, to attract footloose production to Victoria, including regional Victoria, and to increase the level of production, post production and employment in film and television.

4.70 From June 1999 to July 2001, 31 grants have been offered, with 9 productions paid a total of \$615 000 to date⁵, to secure audited expenditure by overseas production houses of \$32 million in Victoria and \$610 000 outside Melbourne. Offers and payments are expected to increase in the future.

4.71 The criteria for assistance are set out in the guidelines and application process.⁶ The list of companies receiving assistance and the aggregated total is reported in Cinemia's annual report and quarterly in the Melbourne Film Office's published update. Individual grant amounts are not reported to reduce the potential for bidding wars and are argued to be "commercial-in-confidence".

Water authorities

4.72 Four Victorian water authorities have assisted new investment, during the 6 years, to a total of \$400 000, most of which is revenue forgone. Three of the companies assisted were also being facilitated by DIIRD:

- revenue forgone from 1990 to 2000 by South West Water Authority and, from July 1997, by Central Gippsland Water Authority;

⁵ Similar to DIIRD investment grants, there can be up to 2 years between an offer of assistance and an audit certificate to release payments.

⁶ Information available on the Cinemia website at www.film.vic.gov.au/mfo

- small grants in 1995-96 by Goulburn Valley Water Authority; and
- in-direct assistance in 2000-01, by Western Water Authority.

Investment assistance from local government

4.73 The majority of Victorian Government investment assistance, outside that provided by the Department, is from local government, with survey responses indicating that 26, or one-third, of all Victorian councils seek to bring new investment and companies into their local areas and adopt a range of activities to do so.

4.74 Writing of the complexity in determining the extent of local government assistance to industry, the Industry Commission noted in its 1996 report that:

- almost all local governments provide assistance to firms in the form of information, advice and help with the regulations they administer;
- there appears to be a wide variation in the attitude of councils to the appropriateness of other involvement in industry assistance, although there seems to be a trend towards greater involvement in industry development by local government;
- other assistance provided by local governments is varied, but typically relates to the functions of local government in the provision of infrastructure zoning or concessional access to council land;
- rate holidays or rebates are sometimes used to provide assistance (subject to the varied constraints of Local Government Acts among the States), but direct grants are rare; and
- local councils may assist business also through the establishment of industrial parks and business incubators.⁷

4.75 The Industry Commission observed,

“It is very difficult to determine an aggregate measure of local government assistance to industry. In many cases, this is because the definition of what constitutes assistance becomes more blurred as the activities become closer to the areas of normal government service provision, such as infrastructure provision and advice on planning procedures”.⁸

In keeping with this observation, the data from our survey included projects that are not strictly new investment attraction. For example, Warrnambool City council reported a substantial loan over 3 years to a local processing company to expand their facility for export purposes and to avoid job losses in the town. The company subsequently repaid the loan, continued to recruit staff and successfully sought bank finance for a further expansion. The council has provided no further assistance to industry since that time.

⁷ Industry Commission, op. cit., p. 15.

⁸ Industry Commission, op. cit., p. 16.

4.76 Some councils reported that their business development activity was formalised after the amalgamation of councils in 1994 and the subsequent formation of Economic Development Boards with linked funding by the Department (then Business Victoria). Successive elected councils continued this business development activity, sought to wind it back or changed the focus, with others deciding to abandon pro-active investment attraction.

4.77 The 26 councils now active in the area reported an estimated \$24 million of assistance: 56 per cent in the form of direct financial assistance, such as grants or loans; and 44 per cent in in-direct assistance, for example, through revenue forgone, land, buildings or other infrastructure support, or training, as set out in Table 4K.

TABLE 4K
TOTAL ESTIMATED LOCAL GOVERNMENT ASSISTANCE,
DIRECT AND IN-DIRECT, 1995-96 TO 2000-01
(\$million)

<i>Year</i>	<i>Direct</i>	<i>In-direct</i>	<i>Total</i>
1995-96	0.7	-	0.7
1996-97	6.8	2.6	9.4
1997-98	2.7	0.8	3.5
1998-99	1.1	0.9	2.0
1999-00	1.2	5.1	6.3
2000-01	1.0	1.1	2.1
Total	13.5	10.5	24.0

Source: Victorian Auditor-General's Office, based on data provided by local government.

Co-ordination with DIIRD

4.78 One-third of the councils reported assistance of \$9.7 million, or over 40 per cent of the total, to 13 companies with projects also facilitated by DIIRD. This assistance was \$2.7 million in grants or subsidies, \$3.4 million in loans, \$2.8 million in land and \$800 000 in revenue forgone. In some cases grants have been directed to councils from the Department and then passed to the company.

4.79 The Department's support of council activity in local business development, from at least the time of council amalgamations, has meant that there has been active, if informal, liaison between councils and the Melbourne and regional offices of DIIRD when attracting investment.

4.80 Some support from councils for investment projects facilitated by the Department involves bringing forward planned new infrastructure works and advice and brokerage regarding various regulatory requirements. As mentioned above, this assistance was not necessarily reported in the survey if councils considered this service part of their normal business.

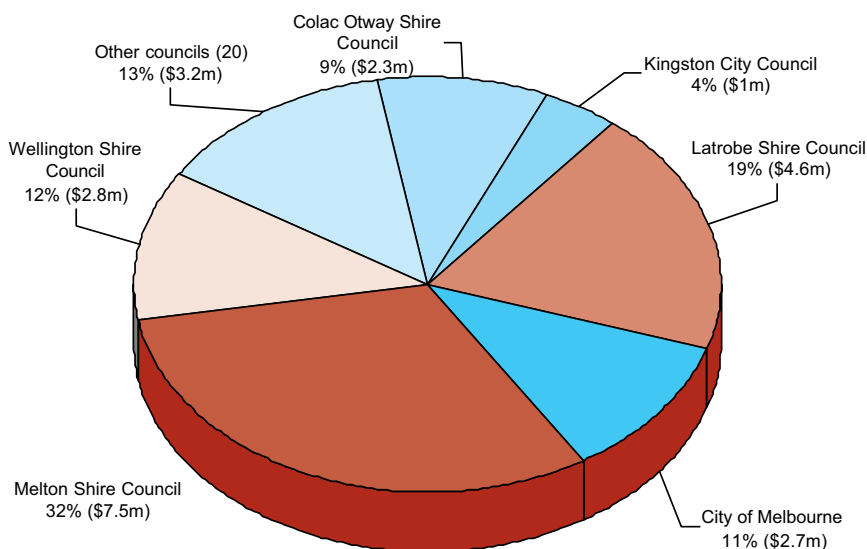
4.81 The Department also may seek competitive proposals from selected councils regarding what they can offer, in terms of location, infrastructure and other assistance, to new footloose projects being attracted to Victoria. Several councils reported finding this process secretive and lacking sufficient information such as detailed requirements of prospects. Requests are often made within a time frame considered inadequate to provide a comprehensive response. Further, there appears to be no formal process for providing feedback from DIIRD on unsuccessful bids. These issues make it difficult for councils to maximise the opportunities in attracting the investment.

4.82 Further, councils expressed a need for the Department to offer their executive staff and councillors both technical and strategic skills in the business of public sector assistance in investment attraction and facilitation. This need supports our other observations that the Department, as the lead Victorian agency in investment attraction and facilitation, gives insufficient attention to the formal skills transfer, and development of enhanced capacity, in public sector investment attraction and facilitation.

Major council contributors to investment assistance

4.83 Of the \$24 million of investment assistance to industry by councils, \$20 million comes from 6 councils, as shown in Chart 4L. The majority of this assistance is provided to a small number of companies as large grants between \$1.5 million and \$4.2 million.

**CHART 4L
TOTAL LOCAL GOVERNMENT ASSISTANCE BY LARGEST CONTRIBUTING COUNCILS**



Source: Victorian Auditor-General's Office, based on data provided by local government.

4.84 The remaining \$4 million is distributed by the other 20 councils, predominately as grants of \$25 000 or less.

4.85 The audit examined issues of Council policy, legal agreements, transparency of reporting and monitoring of assistance given to industry to facilitate investment.

Kingston City Council

4.86 The City of Kingston adopted a *Strategic Development Policy* in 1996 to encourage strategic and major development within Kingston where it can be demonstrated:

- that such developments provide significant benefit to the community;
- have total committed investment of at least \$10 million within 5 years and/or a permanent net local employment gain of at least 100 positions; or
- be a strategic investment which will be a catalyst for further significant investment.

4.87 The policy allows for incentives, such as rebates or concessions in relation to rates or other charges or rescheduling council works and services, in order to assist development or offset the cost of works and services provided for municipal benefit. Rate rebates for major and strategic developments are limited to a maximum 3 year equivalent. Council facilitation may include site identification, provision of information, strategic and technical advice and “fast tracking” approvals within statutory limits.

4.88 The Council, subsequently, has provided assistance, totalling \$1 million, to 3 companies investing locally, one of which contributed a reported \$1.5 million in local works and services. The Council has agreements with each company, outlining the rate rebates for each year and the conditions attached to these rebates. This assistance was provided in 1997 and the Council has not given any assistance since.

4.89 The Council’s decision-making processes are transparent through outlining the nature and extent of the assistance in council minutes and budget papers.

Colac Otway Shire Council

4.90 Colac Otway Shire Council’s 1998 acquisition of a local export meat processing facility that was in voluntary liquidation was the subject of the May 1999 and June 2000 Victorian Auditor General’s *Report on Ministerial Portfolios*. The acquisition of land, buildings and plant assets for \$627 000 was aimed at retaining the 86 full-time jobs in the district while an investor was sought to purchase the company.

4.91 The Council operated the company for 27 months as a council business, at an accumulated trading loss of \$200 000, simultaneously seeking to attract a developer. In June 1999, the Council entered into an agreement with a consortium of local investors and a developer to:

- build a new abattoir for an investment of \$7.8 million;
- meet export licensing standards and operate as an export facility;
- employ 135 staff, 50 of which were additional; and

- operate for at least 10 years.

4.92 The Council provided additional assistance to the consortium of a grant, land, rate waiver and certain asset transfers associated with the former abattoir to a total of \$1.5 million. The consortium assumed all the business risks of building and operating the facility; the Council's potential contribution of up to \$2.4 million was secured against progressive asset transfer and general revenue, tied to employment targets. The Department subsequently provided business development assistance to the company. The company now has 280 employees, exports to 13 countries and supplies lamb to a major Australian supermarket chain.

4.93 The decision to support this company occurred within the council's municipal strategy designed to facilitate economic development within the region and to diversify its employment base. The Council's decision-making processes were transparent and undertaken with the necessary Ministerial approval under section 193 of the Local Government Act. The Council reported publicly, through annual financial reports and press releases, and acted with the knowledge of the community.

4.94 The Council's participation in investment attraction is now limited to facilitating direct financial assistance from the Department and developing infrastructure, such as road access, for new investments. The Council reports the recent successful attraction of metropolitan-based companies to Colac as a preferred location with access to supplies, industrial infrastructure and distribution to local, national and international markets.

Wellington Shire Council

4.95 Wellington Shire Council has actively assisted 25 companies over the past 6 years, with significant investment assistance of over \$1 million in infrastructure development.

4.96 The Council formally began this activity following amalgamation with the establishment of the Wellington Economic Development Board and the subsequent refining of policy, administrative and management arrangements on the basis of past experience.

4.97 Assistance is given on a case-by-case assessment against a range of criteria that are set out on the Council's website alongside the policy, types of direct and in-direct assistance, conditions for incentives etc. Accountability for decision-making is tied to the Council's financial delegations and approved and minuted by the Council.

4.98 The Council's policy is to promote facilitation as the primary form of assistance and to prefer incentives that have no direct cash cost to the Council. In-kind services and infrastructure development are preferred over direct cash contributions or grants. This policy allows the Council to retain ownership of improved land and buildings following default of any building lease-back contract.

4.99 The Council works actively with the Department's State and regional offices, and has expressed a need for more structured and co-ordinated advice and information from the Department in order to improve its investment attraction activity and to support the Council's conscious effort not to be working competitively as a region.

City of Melbourne

4.100 Melbourne City Council assists several companies to invest in the City through a grants program, established in 1996-97, known as the Small Business Development Fund which provided \$1.5 million per annum, to stimulate economic growth in the City of Melbourne. In 1998, the Council restructured the (now) Business Development Fund to include strategic business attraction and industry promotion as well as the small business component.

4.101 In 1999, following an independent review of the Fund, the Council introduced consistent guidelines, performance measures and reporting mechanisms. Key indicators relate to the level of investment, number of new jobs created and the ability to attract new business in key growth areas.

4.102 From 1996 to 1999, the value of grants from the program was \$1.5 million and included grants to small business, strategic attraction of businesses, and industry promotion. Since then, the business attraction expenditure is distinguishable from the other parts of the Fund and totals \$1.2 million, granted to about 40 companies and organisations with most grants under \$25 000.

4.103 The assessment of these grants to small businesses are reviewed by a committee of small business experts external to Council who provide recommendations. Strategic investment grants are assessed by Council and an internal committee made up of two Council Committee Chairs, the Lord Mayor and senior staff. A report to Council on the Business Development Fund is made annually.

Latrobe City Council

4.104 The Latrobe City Council also provides business support and investment attraction and facilitation services to several companies as part of a broader economic development strategy for the Latrobe Valley. The Council's activity in this area has continued since its amalgamation with neighbouring councils, amending its Economic Development Policy under successive councils while also continuously refining its administrative and management arrangements on the basis of past experience.

4.105 Criteria for assistance include assessment of the value of new investment in the local economy, the number of new jobs, risk and sustainability of the project and the industry sector. The assessment also includes export opportunity of goods and or services as a major criterion. Since the closure of the State Electricity Commission of Victoria, the council has actively sought to introduce new industry sectors to the region. Its pro-active attraction and facilitation of National Foods is an example and one that the Council now uses to market the region's capability in dairy food production.

4.106 The Council works actively with the Department's State and regional offices, providing a range of services including infrastructure, business planning, labour market analysis. Increasingly, and similar to Wellington Shire Council, the Council is providing location incentives through developing the land infrastructure, building the facility and entering into lease-back arrangements. The grantee also has to provide in-kind or financial up-front capital as a part of the support request.

4.107 The Council's decision-making processes are minuted, with some discussion in camera. Economic development activity and related expenditure is reported through annual reports, website and regular newspaper features.

Melton Shire Council

4.108 Melton Shire Council began economic development activity under administration by commissioners following amalgamation of local governments in 1994. Major concerns at that time within the Shire Council were high levels of unemployment and the need to develop the local economy.

4.109 In 1996, Council received \$100 000 from the Commonwealth Government to conduct detailed research to develop the concept of an "Employment Node". The concept sought to attract new types of industries and activities to the western suburbs. The plan for the Toolern Employment Node was completed during 1996-97 and the Council approved the concept plan early in 1997.

4.110 The Municipal Strategic Statement (MSS) summarises the directions set by the Council's strategic planning policies, including the Melton Shire Council 1997-2000 Corporate Plan, the Melton Township Strategy and the Melton East Strategy.

4.111 The MSS sets the Council's strategic planning framework and direction of future growth and development for the next 20 years. The MSS provides the context for the Council's Employment Policy contained in the Melton Planning Scheme that outlines the Council's objectives for industry assistance. This context is designed to create an environment conducive to economic growth and wealth generation.

4.112 The policy objectives of the Melton Planning Scheme employment policy include:

- to attract a range of new industry and employment generating uses to the municipality;
- to direct the majority of new employment growth to either the Melton township or the Melton East Growth Area; and
- to encourage the provision of a range of employment opportunities for a variety of skill levels and qualifications.

4.113 The employment policy also notes that it is local policy to:

- pursue the development of the Toolern Employment Node and promote it as the area's prime employment generating opportunity;
- ensure that a range of industrial lots are available for development; and

- develop a local economic development strategy to co-ordinate marketing, tourism and industry assistance programs.

4.114 In pursuit of these policies in the period covered by the audit, 1995 to 2001, Melton Shire Council assisted 9 companies with total assistance valued at \$7.5 million. The majority of this activity occurred during the period 1996 to 2000. The assistance included the provision of land to 7 of the companies. In addition, the Shire made a substantial interest-free loan of \$3.3 million to one of these companies for the construction of a factory building.

4.115 While the pursuit of investment in Melton has been public, the Council's decision-making processes have been not so public, with investment assistance discussions of Council held in camera. Accountability for negotiating industry assistance packages has been directly through the CEO.

4.116 The level of investment assistance is not reported publicly, and there has been significant concern expressed within the community regarding both the processes for, and the amount of assistance provided to, selected companies.

4.117 Investigation of the Melton Shire Council's involvement in investment assistance has revealed that ongoing monitoring and risk assessment should accompany research, analysis and planning in developing programs of industry attraction.

4.118 The assistance to one company is described in the case study below. The case illustrates some of the risks involved in investment assistance and the costs of investment assistance when desired public outcomes are not fully achieved. The case also illustrates the lack of coordination between the Department and the Council in each agency's efforts to provide investment assistance. This uncoordinated approach resulted in higher than usual financial assistance being provided to this group of companies.

Case Study – Investment Attraction to Melton Shire

In 1995, the Melton Shire Council approached a large manufacturing group to relocate one of its manufacturing facilities to Melton from NSW. To attract the plant to Melton, business incentive arrangements were negotiated with the Council and approved at a Special Council Meeting in April 1996.

Under the terms of the Principal Agreement, dated 17 April, 1996, the Council agreed to:

- transfer council owned land, comprising 5.66 hectares, to one company in the group for a financial consideration of \$1;
- waiver the usual statutory and building permit fees which would otherwise be payable in establishing a factory on the land;
- pay all stamp duties on the Principal Agreement and any document executed under it, subsequently amounting to \$48 070;
- provide council services (including, but not limited, to waste removal) equal in value to the rates payable on the land, for a period of 5 years after the settlement date at an estimated cost of \$91 024; and
- provide an interest-free loan of \$3 million to another company in the group.

Under the Principal Agreement, the company establishing the factory acknowledged its intention to generate 200 jobs, plus or minus 10 per cent (i.e. a target of 180 to 220 jobs) in the period after the effective date, defined as the date of the commissioning of the plant.

In an agreement dated 17 May 1996 and made under section 173 of the Planning and Environment Act, where the Council transferred its land to the company and converted it to rateable land, the company provided a covenant that it would:

- construct a factory and office within 9 months of the date of the agreement; and
- not use the land for any purpose other than for the establishment and operation of a manufacturing facility.

Land transfer

The parties to the Principal Agreement acknowledged the valuation of the land at \$850 000 following a valuer's assessment obtained in March 1996.

The Local Government Act (s.189) requires that a Council place an advertisement in the newspaper advising ratepayers of its intention to transfer or sell council owned land and to advise that a person has the right to make a submission (under s. 223) on the proposed sale or exchange.

In the Council advertisement, the location of the land was identified, and its value of \$850 000, but not the sale price of \$1, nor the 200 jobs that the Council expected to be created as part of the transfer. It would appear there was insufficient information for the readers of the advertisement to decide whether or not to make a submission on the transfer.

Council retained a mortgage over the land in order to secure the repayment of the interest-free loan. However, the Council agreed to discharge the mortgage at the expiration of 3 years from the settlement date, that is 17 May 1999.

These provisions, contained in the Principal Agreement, were designed to protect the Council's interest in the land in the 3-year period after the settlement. This land transfer was held in escrow by the Council during the prescribed 3-year period. In the event that the company was placed in liquidation or receivership, or discontinued the business on the land, the Council would have been entitled to seal and execute the land transfer and re-transfer the land to the Council.

In May 1999 the ACCC successfully argued in the Federal Court that particular goods manufactured within the group did not comply with Australian Standards. The court ordered that the company recall those goods sold after 1 July 1996 and issue a full refund to all purchasers.

Due to the financial impact of the Federal Court Orders, that company was placed in voluntary administration on 2 August 1999.

On 24 June 1999, the Council discharged the mortgage on the land, in accordance with the terms of the covenant.

Interest Free Loan

Under the terms of the Principal Agreement, an interest-free loan of \$3 million, provided by the Council to another company in the group in return for the company's covenant on jobs, was to be used in:

- the construction of the manufacturing plant;
- relocation and training of staff to work at the manufacturing plant; and
- other related expenses incurred in the relocation.

In December 1996, Council approved an additional \$308 185 contribution to the cost of construction as a variation for additional works. The company progressively drew-down the loan as construction of the plant progressed and progress claims were submitted to the Council as proof that the building works had been completed.

The 99 year term of the loan required principal repayments of \$100 every 5 years, with the first repayment due on 17 March 2002, 5 years after the agreed "effective date".

The nature of the loan repayments is of concern as only \$2 000 will have been repaid after 99 years and there are no provisions in the Agreement for repayments at the end of the period. It would seem that it is not the intention of the Council to recover the loan and that it will be forgiven in 99 years.

The Agreement does, however, provide for additional repayments of principal determined by a formula calculated under a default clause, and related to jobs creation.

Consequences of default on job creation

Under the Principal Agreement the company was required to make additional specified payments of the loan principal to the Council if they fell short of the target of 180-220 jobs by 17 March 2000 and did not maintain them in the corresponding periods in 2001 and 2002.

In the event of the target not being achieved, the Council was to be repaid an amount comprising:

- a cash payment calculated by an agreed formula; and
- the amount of a bank guarantee equal to the amount calculated by the formula at the specified date (17 March 2000).

Correspondence to the council, dated 29 November 2000 'certifies' the company had generated 175 jobs as at 30 June 1998. In response to a specific request by consultants employed by the council to report on business incentive arrangements, an e-mail dated 2 July 2001 indicated that the company employed 116 staff as at 1 June 2001.

Based on the provision of 175 jobs at 17 March 2000, the amount of the bank guarantee calculated by the formula is \$45 000. Assuming the provision of 116 jobs at 17 March 2001 the Council was owed \$192 000. If the company maintained 116 jobs at 17 March 2002, Council was owed an additional \$192 000 .

Based on these estimates the total amount owed to the Council was \$429 000, due on and payable on 17 March 2002. This sum would be reduced if the company could substantiate that it employed a higher number of staff on any of the compliance dates.

The company requested the Council to accept generation of 175 jobs at 30 June 1998 as a fulfilment of all the company's obligations under the agreement.

On 24 August 2001, the Council wrote to the company confirming their release by the Council from the requirements specified in the Principal Agreement as a fair course of action. The Council's decision was based on an appreciation of the company's financial difficulties as a result of the legal dispute with the ACCC. It is hoped, as a result, that the company will continue to operate and provide ongoing investment and employment for Melton.

The extent to which legal proceedings instigated by the ACCC have contributed to the reduction in the number of jobs since 1998 shortfall cannot be ascertained. In August 2000, the company establishing the manufacturing facility successfully appealed the decision of the Federal Court and the orders of the primary judge were set aside.

Council decision making and action to enforce the Principal Agreement

In view of the failure of the company to meet ongoing employment targets, the application of the formula for calculation of penalties would indicate that the Council should have received additional repayments. However, since the Council agreed to consider the employment of 175 staff, at 30 June 1998, to represent full compliance with the Agreement, the bank guarantee and other payments were not pursued by the Council.

Monitoring by the Council of employment levels was clearly inadequate. Current staff have concluded that this may have been because it was Council's first investment assistance package and systems were not in place to ensure adequate and timely monitoring, resulting in corrective action not been taken and penalty payments being forgone.

The information provided to commissioners during the establishment process for the Agreement was adequate. The company made presentation to all 3 commissioners and the CEO on their proposal. The CEO, on behalf of the Council, negotiated much of the assistance package and signed most of the documentation. Agreements were appropriately signed and sealed, and Council was regularly briefed on the progress of negotiations.

The Council prepared a cost-benefit analysis on the establishment of the manufacturing plant in December 1996, based on a projected cost to the Council of \$4.09 million and the provision of 200 jobs. The analysis showed a financial net benefit to the Melton community of \$2.99 million based on net present values calculated over a 20 year period.

The cost-benefit analysis was prepared in December 1996, after the Principal Agreement was signed in April 1996. Costs which do not appear to have been taken into account in the analysis, include legal costs, and services of council staff. Regular updates of the analysis as actual costs became known was not undertaken. The audit trail between the analysis figures and the financial records was inadequate for verification purposes. The Council did not perform a risk assessment to gauge the financial viability of the venture to supplement its cost-benefit model.

Economic benefits to Melton Shire Council

A further cost-benefit analysis was prepared by consultants to the Council, based on the creation of 116 new jobs and using 1 June 2001 data. This analysis indicates that the plant still generates a net positive return to the Melton community of \$502 111, based on net present values calculated over 20 years.

TABLE 4M
COST-BENEFIT ANALYSIS

<i>Cost Benefit Analysis</i>	
Number of jobs created as at 1 June 2001	116
Average wage of employees	\$31 000 per annum
Capital investment by company in buildings and plant	\$7.5 million
Incentives provided to company:	
• Value of land transferred at nil consideration	\$850 000
• Loans	\$3 308 815
• Costs of land transfer	\$48 050
• Rate concession	\$91 024
Total cost of incentives provided	\$4 297 899
Economic benefits flowing to the community:	
• Local expenditure arising from building construction	\$750 000
• Local expenditure from new jobs	\$3 680 000
• Purchases by company of local goods and services	\$61 000
• Purchase of new houses by new residents employed by company	\$309 000
Total benefits flowing to local community	\$4 800 000
Net benefit to the local community arising from Company operations	\$502 111

Source: Melton Shire Council, Report on Business incentive Arrangements.

However, given the financial value of the incentives provided by the Council, it will take 9.5 years before the economic return to the community reaches break even point. Before this time, the economic cost to the community is greater than the economic benefit. An earlier return to break-even and positive returns to the community could be achieved if there is an increase in the number of staff employed in the Melton manufacturing plant, or if the company made repayments of the loan principal as described in the Principal Agreement.

Assistance provided by the State Government

In November 1996, six months after the signing of the Principal Agreement with the Melton Shire Council, the Government also agreed to provide a company in the group with financial assistance of \$902 500 on condition that it establish a plant in Melton and meet the grant conditions set out in Table 4N.

TABLE 4N
GRANT CONDITIONS

<i>Grant agreement conditions</i>	<i>Commitment</i>	<i>Progress</i>
Evidence that the foundations for the facility have been laid	\$275 000	Audit certificates confirming expenditure of \$1 million was provided in November 1996.
Audit certificate confirming investment in Victoria on the project of at least \$1 million.		\$275 000 paid.
Evidence that the company has completed construction of the facility.	\$275 000	Audit certificates confirming expenditure of \$5 million was provided in November 1996.
Audit certificate confirming investment in Victoria on the project of at least \$5 million.		\$275 000 paid.
Evidence that the company has completed and commissioned the facility.	\$275 000	Audit certificates confirming expenditure of \$10 million was provided in August 1997.
Audit certificate confirming investment in Victoria on the project of at least \$10 million.		\$275 000 paid.
Evidence that the plant is operating satisfactorily.	\$775 000	Evidence that the plant is operating satisfactorily was provided in August 1997.
		\$775 000 paid.
Employment requirements		
• 170 employees for 1997		Audit certificate provided October 1997 showing 134 full-time employees.
• 180 employees for 1998		Certificate not provided.
• 190 employees for 1999		Certificate not provided.
Written reports		
Annual company and project progress reports by 30 September 1997 to 1999		In May 2001, the Department wrote seeking company annual reports due in September 1999 and project reports due September 1998 and 1999.

Source: DIIRD, Legal agreement and audit certificates of actual expenditure and employment.

The Government paid the full \$902 500 based on achievement of capital investment, not employment targets. An audit certificate confirming investment of at least \$10 million was received, and \$0.275 million was paid. The Shire of Melton records show the company invested only \$7.5 million. The \$10 million audit certificate provided to the Government included the \$3 million loan from Melton.

There were a number of site visits by departmental staff. Audit certificates in relation to investment targets were provided to confirm that the company had met its targeted investments of \$1 million, \$5 million and \$10 million. However, 2 audit certificates in regard to employment, as well as annual financial reports and progress reports, were not provided.

Despite meeting the investment targets in the agreement, the Department could seek repayment of the grant given that employment targets were not achieved. This was considered, but when advised that the company manufacturing the goods was undertaking voluntary administration it was deemed unlikely that the Department could recover the money. As recovery action by the Department, a letter dated 18 May 2001 made requests for documentation not yet provided. The group responded advising them of what had occurred. At the date of our audit, the files were not clear as to what action the Department intended to take.

Consideration of council and departmental files indicated that liaison between those involved was neither adequate nor regular. The greatest level of activity occurred in regard to the legal action brought by the ACCC in the Federal Court. It is acknowledged that, since the agreement 1996, the Department has strengthened its approach towards the structuring and ongoing management of financial assistance.

RESPONSE by Melton Shire Council

Council would have intended that jobs creation and the development of capital infrastructure on the property would have, in addition to the financial value of \$1, formed part of the legal consideration of the contract of sale and section 173 agreement. In essence the land was not transferred for \$1, but for \$1 plus 200 jobs plus the construction of an \$8 million dollar factory complex.

Although Council agree that there may not have been an intention to recover the amount of the loan, it is believed the report could have further acknowledged the fact that the purpose of the loan was to provide assistance for the establishment of a local enterprise for the purpose of engaging local employment opportunities in the community. It may not have been Council's intention to recover money but to in fact recover employment and develop opportunities. The common usage of the term 'loan', may have been confused in relation to Council's intention in this area.

Council also recognise that in considering the matter in the larger context, there would have been a requirement to appreciate the financial difficulties faced by the company and the community benefits generated by job targets achieved. Furthermore Council would have considered the impact of their decisions based on the facts, including the opportunity cost of pursuing the company at the expense of the existing 116 full time employment positions.

Conclusion

4.119 While many local government councils are actively involved in business development, their activity in investment attraction and facilitation is not as extensive as might be anticipated. In addition, the type of assistance given by councils is frequently part of their normal business of providing local infrastructure and services, making an estimation of the full extent of assistance difficult to gauge.

4.120 In those cases where councils are actively pursuing investment attraction, assistance is frequently to large, strategic investments that also have been facilitated by the Department. In more recent years, this assistance by councils is more likely to be in-direct than in the form of cash or land.

4.121 The Council's relationships with the Department remain informal, with evidence of overlapping of assistance between DIIRD and local government. Several councils are seeking more structured relationships, greater availability and transparency of information and guidance in successful investment assistance.

Recommendations

4.122 We recommend that:

- when determining the degree of their involvement in industry assistance, all Councils be mindful of the experience of Melton Shire Council and ensure that:

- the benefits to be generated by any proposed industry assistance are identified for the community and the Council and that the achievement of the agreed milestones are publicly reported;
- a risk assessment is undertaken that includes identification of risks to the industry and the council and how they might be managed and reduced;
- mechanisms are identified and responsibilities allocated to provide the council with the means of monitoring the success or otherwise of the venture and protecting the interests of the community.
- the Department continue working closely with other public sector agencies and other levels of government, particularly local government, to ensure the co-ordination of investment attraction and facilitation, and subsequent monitoring, measurement and public reporting.
- the Department provide regular briefings to local councils, and other relevant public sector agencies, on strategic directions in economic development, as:
 - part of the process of increasing transparency of government investment attraction and facilitation;
 - a means of providing supporting mechanisms for the transfer of knowledge between the Department and local councils.

RESPONSE provided by Melbourne City Council

In regard to the first part of the recommendation in paragraph 4.122, the City of Melbourne believes that it currently complies, through the procedures already in place, with these recommendations.

The City of Melbourne also strongly endorses the recommendations relating to a formal and ongoing relationship between local government and the Department of Innovation, Industry and Regional Development.

RESPONSE provided by Latrobe City Council

We believe the comments in the report in relation items 4.104 to 4.107 to be a fair summation of discussions between the office of the Auditor-General and our officer.

We also believe that general comment in the report will assist Government in ensuring that the process will increase transparency of investment attraction and facilitation. Appropriate support mechanisms recommended by the Auditor-General will assist in facilitation and transfer of knowledge between Government and Local Government.

RESPONSE by Department of Innovation, Industry and Regional Development

The Department will continue to work closely with other public sector agencies and will seek to strengthen the common understanding with all agencies including local government on investment matters.

Part 5

Effectiveness of government investment assistance in Victoria

BENEFIT TO VICTORIA

5.1 Investment attraction and facilitation in Victoria is provided on a selective project basis, within a broad framework of industry sectors in which Victoria has strategic competitive advantage. Performance targets for this investment assistance are set within the Department of Innovation, Industry and Regional Development's Business Output Group, and are based on expected investment and employment outcomes as set out in Table 5A.

TABLE 5A
TARGET AND PERFORMANCE OF EXPECTED OUTPUTS FROM INVESTMENT ASSISTANCE
(\$million)

Performance measures- industry development	1998-99		1999-00		2000-01	
	Target	Performance	Target	Performance	Target	Performance
New investment facilitated and announced	1 000	1 496	1 000	1 668	1 200	1 689
Investment attracted in rural Victoria	250	410	250	457	300	646
Investment projects under investigation	4 000	7 662	4 000	4 674	5 000	4 592

Source: Department of State and Regional Development, Annual Reports from 1998-99 to 2000-01.

5.2 As indicated by the table, there is no measurement or reporting on actual investment and employment achieved in Victoria, nor is there analysis of the impact of this assistance on the State's economy.

Investment performance measurement

5.3 Traditionally, investment initiatives are measured against a range of criteria, including level of capital expenditure, jobs generated, increased sales, strategic benefit and net exports. These measures collectively provide a surrogate for the level of economic activity, direct and in-direct, which flow from the investment.

5.4 The Government's recent *Strategic Audit of Victorian Industry Overview*, published by the Department, identifies a number of less tangible characteristics of successful companies in an innovative economy. These characteristics include:

- being part of networks, including supply chain management;
- innovation, flexibility and responsiveness to customer needs;
- new forms of work organisation encompassing flatter structures, multi-skilled employees, investments in firm-based training, teamwork and co-operative relationships between employers, employees and their representatives; and
- being entrepreneurial with a culture of risk taking.

5.5 In accordance with this strategic direction, the Department is increasingly seeking to attract firms that exhibit these features. This, in turn, is leading to a move away from the traditional approach of targeting industry sectors to focusing on investments that contribute to the development of strategic capabilities across the industry base, including knowledge-based investments.

5.6 As part of this approach, the Department is developing a new investment evaluation model that rates a proposed investment project against a range of intrinsic and other strategic benefits. The model complements traditional tools of evaluating projects, such as input-output and CGE models, and measures both the “static” and “dynamic” benefits to a project.

5.7 The encouragement of investment in strategic sectors of the economy, particularly in clusters, relies on accurate information for the identification of companies and the mapping of the directions of technological change. The measurement of success of clusters is often characterized in broad terms of “technological spill-over”. Metrics need to be developed that can capture the impact of such investment attraction activity.

5.8 A further issue with developing appropriate measurement tools is their capacity to identify longer-term flow-on benefits from investments. One illustration of the importance of such benefits is shown in the following example which demonstrates the importance of supply networks and the flow-on effects of business investment. Such benefits are just as likely to arise from facilitative assistance as from any direct financial assistance, a result that is discussed in more detail below. Program reporting and evaluation that focuses solely on measuring the benefits arising from funds committed may not capture many of these sorts of outcomes.

CASE STUDY

Victoria began discussions about an Asia-Pacific reservations/shared services centre for the hospitality industry in December 2000. The project initially involved a new service centre centralising reservations and back office functions for 9 hotels in Australia and New Zealand.

In order to attract the investment to Victoria a number of activities were undertaken by the Department, including detailed presentations supporting Victoria’s business case, co-ordination of site visits, site identification, promotion of staff training facilities and assistance with executive relocation.

The company decided to locate the investment in Victoria providing a minimum of 60 new jobs and \$1.5 million in new investment over 2 years. Although direct financial assistance was provided, the majority of the assistance was facilitative.

The attraction of the investment has contributed significantly to positive outcomes for local manufacturers. A Victorian office furniture designer and manufacturer secured work with the company, including design and fit-out of a call centre, and as a result, design work with the company in Europe, linking it with company’s global supply chain, resulting in a number of project prospects.

Issues relating to performance measurement

5.9 Issues relating to performance measurement are not unique to Victoria. Other States do not use indexes, regression models or longitudinal studies as part of their regular measurement approaches in assessing the effectiveness of programs. There is great disparity between States on measurement techniques employed for investment. We acknowledge the difficulties in accurately measuring the benefits of investment attraction and facilitation. However, such measurement is fundamental to the Department's own effectiveness and its accountability to Parliament, and should be undertaken.

5.10 We also acknowledge the government's position that the publication of details of funds paid to individual companies may, in some way, reduce the effectiveness and increase the costs of investment facilitation. However, we do not believe that the government or the Parliament is being provided with sufficient information about the outcomes, as opposed to the claimed benefits, of investment facilitation to make an informed judgement about the effectiveness, or otherwise, of the program. The Parliament requires information on the progressive achievement of aggregate performance milestones by company and/or industry sector, including details of whether job targets and capital investment associated with projects had been achieved, as well as the level of government commitments and assistance expected into the future.

5.11 To some extent, the Department already undertakes this type of economic evaluation of projects prior to any decision being made to provide financial assistance, yet the same rigour is not applied to the measurement of outcomes. Measurement and reporting of this performance subsequent to the facilitated investment taking place would help to resolve questions of public accountability, provide valuable information on the return that the public is getting for the investments made, and form the basis for further internal analysis and advice regarding investment attraction activity.

5.12 The Department does collect some data on actual performance through its monitoring of investment projects in receipt of direct financial assistance. This monitoring provides assurance to the public that the investment outcomes are in line with the Government's intention and the potential financial loss to the State is reduced through progressive grant payments against performance milestones. However, the data gathered on actual achievements, particularly on the actual value of investment and number of new jobs, is not used to measure and analyse the impact of this investment assistance on the economy or industry sector.

Impact of investment facilitation on employment and sales of Victorian firms

5.13 In order to assess the benefit to Victorians of the Government's investment attraction and facilitation services, we undertook the following analyses:

- the effects of investment facilitation on enterprise employment and sales;

- a comparison of the announced, expected performance with total Victorian investment, employment and exports; and
- a satisfaction survey of facilitated companies with successful investment projects.

5.14 To assess the effects of investment facilitation on enterprise employment and sales, we compared the change in the employment or sales outcome for companies that had received assistance with similar companies, which did not receive assistance.¹

5.15 The data was drawn from a time series of company records from the IBISWorld database and covered the period 1989 to 2001.² Companies that received Victorian Government facilitation services since 1995, including those that received direct financial assistance, were identified and matched with other companies in the same industry sector that had not received assistance (the control group). The number of firms included in the analysis was limited to those that had complete records on the IBISWorld database. It therefore excludes overseas companies that were attracted to Victoria post-assistance.

5.16 Estimates of the effect of facilitation on company outcomes suggest that companies that received facilitation had annual employment levels that were, on average, 558 higher than the control group, and annual sales that were on average \$147 million higher than the control group. These estimates were significant at the 10 and 5 per cent levels, respectively.

5.17 Estimates for the group which received direct financial assistance were not statistically significantly different from those who did not. This was possibly due to the small number of firms in the sample (14 and 18) and the larger size of the standard errors.

5.18 The absolute size of the estimates suggest that the average firm which received financial assistance had employment levels that were 2 351 per annum higher than the control group, and annual sales that were on average \$34 million higher. For every \$1 000 paid in financial assistance, a total of 5 jobs per annum were created, along with an extra \$500 000 in annual sales revenue.³

Conclusion

5.19 This analysis does not allow us to conclude that facilitation or financial assistance caused firms to raise their annual sales and employment. Instead, it suggests that either the targeting of the programs was successful in selecting the firms with the best growth potential or that the programs were successful in raising employment and sales. Neither conclusion support the view that the program is operating poorly.

¹ See Blundell, R. and Costa Dias, M. (2000). "Evaluation methods for non-experimental data" in *Fiscal Studies*, 21 (4), pp 427–468.

² Information was included as far back as possible, which in some cases led to the time period ranging from 1989 to 2001.

³ To more fully assess the costs and benefits of the program, the administrative costs to the Department of Innovation, Industry and Regional Development should be included, but this has not been done here.



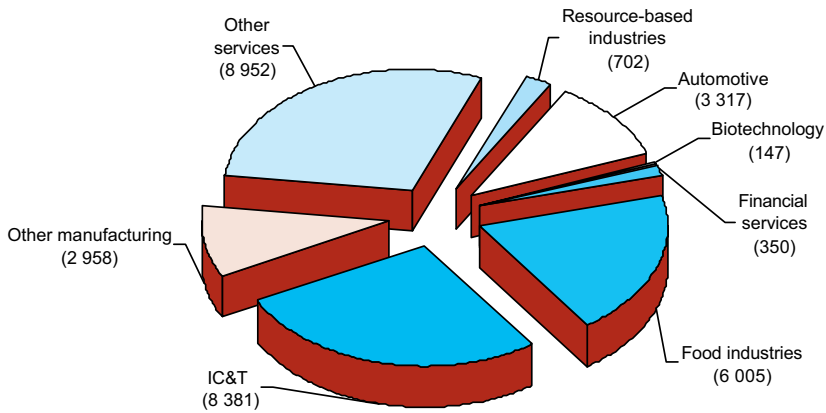
Food industries: a sector given priority by the Victorian Government.

Comparison of the announced, expected performance with total Victorian investment, employment and exports

5.20 Between 1995-96 and 2000-01, facilitation services were provided to projects that were estimated as likely to produce investment of \$8.3 billion, 30 812 permanent full-time jobs and exports of \$5.8 billion.

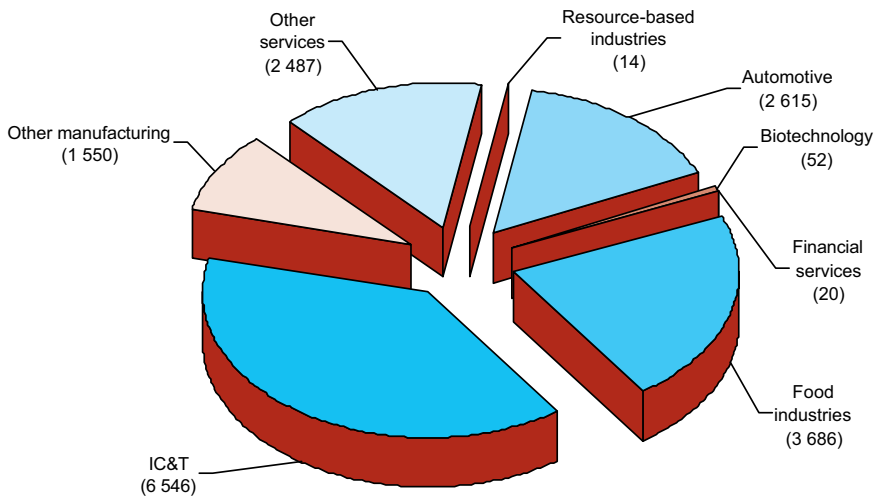
5.21 Charts 5B and 5C provide the breakdown of the expected employment created by industry sector from all facilitated projects and from financially assisted projects, respectively. Charts 5D and 5E provide the breakdown of the expected exports created by industry sector from all facilitated projects and from financially assisted projects, respectively.

CHART 5B
EXPECTED EMPLOYMENT CREATED FROM ALL FACILITATED PROJECTS
BY INDUSTRY SECTOR, 1995-96 TO 2000-01



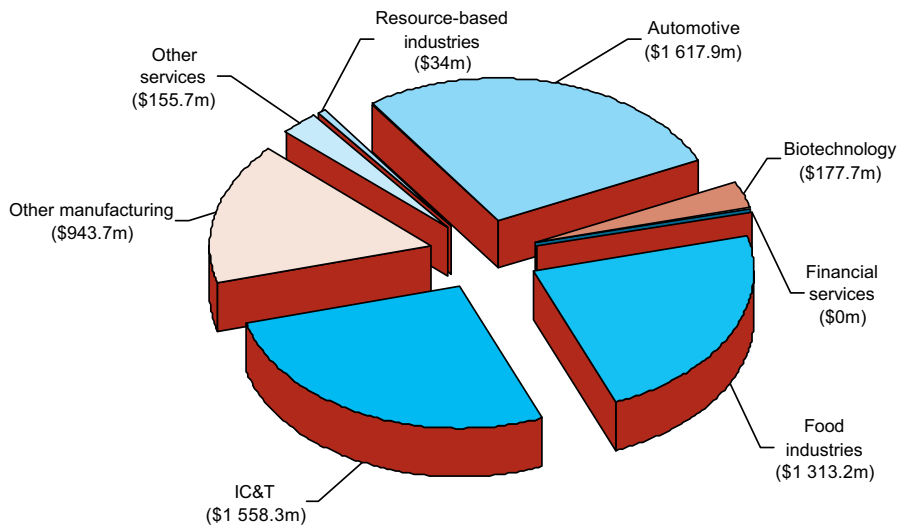
Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

CHART 5C
EXPECTED EMPLOYMENT CREATED FROM FINANCIALLY ASSISTED PROJECTS
BY INDUSTRY SECTOR, 1995-96 TO 2000-01



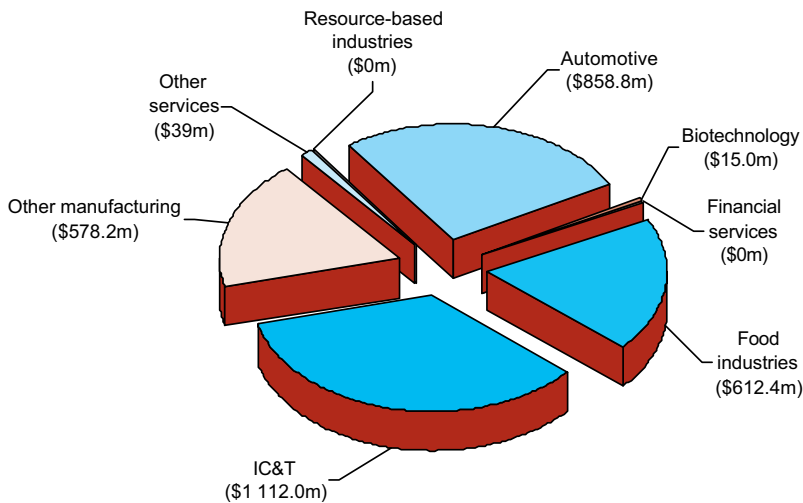
Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

CHART 5D
EXPECTED EXPORTS CREATED FROM ALL FACILITATED PROJECTS
BY INDUSTRY SECTOR, 1995-96 TO 2000-01



Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

CHART 5E
EXPECTED EXPORTS CREATED FROM FINANCIALLY ASSISTED PROJECTS
BY INDUSTRY SECTOR, 1995-96 TO 2000-01



Source: Victorian Auditor-General's Office, based on data provided by DIIRD.

5.22 We sought to establish how realistic these expectations were by comparing them with total Victorian investment, employment and exports.

5.23 Table 5F compares the expected investments for projects receiving facilitation only or direct financial assistance. If these investments were realised, for manufacturing, facilitation services would have been provided to a 22.9 per cent of all Victorian investments between 1995-96 and 2000-01. Over the same period, direct financial assistance would have been provided for 10.2 per cent of Victorian manufacturing investment. The percentage for all industries was 9.3 and 4.4 per cent for the facilitated only and financially assisted groups, respectively.

5.24 Bearing in mind that about 3 times as many companies received facilitation only compared with those receiving direct financial assistance, facilitation appears a much more cost-effective way to promote investment. Recall from paragraphs 4.3 and 4.17 that the cost per successfully facilitated project was about 12 per cent of the average cost of direct financial assistance. However, this does not necessarily mean that replacing direct financial assistance with facilitation only would be efficient. Our data relates to expected, not actual, investment. Furthermore, what is true for the average is not necessarily true for marginal cases.

TABLE 5F
EXPECTED INVESTMENTS FOR PROJECTS RECEIVING FACILITATION AND DIRECT FINANCIAL ASSISTANCE, 1995-96 TO 2000-01

Industry sector	Expected investment, 1995-96 to 2000-01				Total actual investment (a)	
	Facilitated only		Direct financial assistance		National accounts	
	\$ million	Percentage of total investment	\$ million	Percentage of total investment	\$ million	Percentage of total investment
Manufacturing	4 537.2	22.9	2 019.8	10.2	19 829.0	100.0
Services (b)	1 111.0	2.7	622.7	1.5	41 047.0	100.0
Total	5 648.2	9.3	2 642.5	4.4	60 876.0	100.0

(a) Total investment data is derived from the national accounts.

(b) Excludes Agriculture, Forestry and Fishing, Mining, Government Administration and Defence, Education, Health and Community Services, Other services (96).

Sources: Victorian Auditor-General's Office, based on data provided by DIIRD; ABS Cat. No. 5646.0, Private New Capital Expenditure: State Estimates, various issues.

5.25 DIIRD records do not include the total employment level of the company. However, by combining the DIIRD data with data from IBISWorld we are able to make some estimates for companies included in both data sets.

TABLE 5G
EXPECTED ANNUAL EMPLOYMENT GENERATED BY PROJECTS RECEIVING
FACILITATION AND DIRECT FINANCIAL ASSISTANCE,
1995-96 TO 2000-01 AS A PERCENTAGE OF TOTAL EMPLOYMENT, 2001

<i>Industry sector</i>	<i>Facilitated companies on IBISWorld database</i>		<i>All companies in Victoria</i>
	<i>Facilitated only</i>	<i>Direct financial assistance</i>	
Automotive (a)	5.4	15.1	-8.6
Biotechnology	2.1	0.2	-
Financial services	0.5	-	-2.4
Food industries	0.8	1.1	10.0
IC&T (b)	4.5	3.9	9.2
Other manufacturing	4.3	14.0	2.1
Other services	1.6	0.8	11.3

(a) Machinery and equipment.

(b) Communication services.

Sources: Victorian Auditor-General's Office based, on data provided by DIIRD; ABS Cat. No. 6203.0, Labour Force Australia, various issues; IBISWorld.

5.26 Table 5G shows the amount of additional employment that the assisted projects were expected to employ as a percentage of the companies' total employment in 2001. The first 2 columns include companies that were facilitated only, or directly financially assisted, and included on the IBISWorld database. This selection is biased toward companies that are larger, but not necessarily faster growing. Note that the total employment levels are for the whole Australian operation, not just those located in Victoria. The third column is derived from ABS national accounts and represents actual employment increase as a percentage of 2001 levels.

5.27 Table 5G suggests that the expected employment increments are very high in the "automotive" and "other manufacturing" sectors compared with both the total level of employment in these companies and the rate of employment growth across the whole sector in Victoria. This may have occurred because of a shift of employment within the industry from low productivity jobs to more efficient jobs in the project receiving assistance. However, it may also reveal an exaggeration of the additional employment claims or a redeployment of labour within the company to the assisted project.

TABLE 5H
EXPECTED ANNUAL EXPORTS ARISING FROM RECEIVING
FACILITATION AND DIRECT FINANCIAL ASSISTANCE,
1995-96 TO 2000-01

Industry sector	Claimed export value				Exports from Australia	Exports from Victoria ^(a)		
	Facilitated only		Direct financial assistance					
	\$m	% of total exports	\$m	% of total exports				
Automotive	759.1	8.8	858.8	9.9	8 660.0	100.0	-	-
Food industries	703.8	1.1	612.4	1.0	61 629.0	100.0	-	-
IC&T	546.3	23.1	1112.0	47.1	-	-	2 362.0	100.0

(a) Estimated as twice the value for 1998-2000.

Sources: Victorian Auditor-General's Office based, on data provided by DIIRD; ABS Cat. No. 6203.0, Labour Force Australia, various issues.

5.28 Table 5H compares, where possible, companies' claims of additional exports from the projects with total actual export data (either from Australia or Victoria) for the whole sector over the same period. Comparative data is only available for the automotive, food industries, and IC&T industries. These reveal that the facilitated only projects were claimed to be related to a significant minority of Australian exports from the automotive industry, a very low proportion from the food industries sector, but over two-thirds of Victorian exports from the IC&T industries. While these export claims would appear to be high, especially for IC&T, what it does show is that the projects that were only facilitated had in total an expected export value that was about the same size as companies that received both facilitation and direct financial assistance in automotive, and food industries. In IC&T it was 50 per cent.

Conclusions

5.29 Investment attraction and facilitation has been associated with positive outcomes for the state. However, these outcomes are significantly lower than initially anticipated. Reporting of the outcomes of the investment attraction program have been focused on claims made by recipients about proposed increases in investment (\$8.3 billion), jobs (31 812 full time) and exports (\$5.8 billion) at the time assistance was provided rather than on the actual investment, jobs and exports achieved. While this is not unreasonable, as it is the only information available at the time, it gives an inflated impression of the likely effectiveness of investment attraction. The publicly announced estimates do not appear to be revised as time goes by.

Satisfaction with the Department's investment facilitation services

5.30 A survey was undertaken of 82 businesses that had received investment facilitation assistance from the Department and that had located their project in Victoria. Ideally, we should have included in our survey companies that were not successfully facilitated, but current contact details were difficult to obtain. The sample contained 13 small companies, 40 companies of medium size, and 29 large businesses. Over half (57 per cent) were in the manufacturing sector.

PROFILE OF BUSINESSES IN SURVEY, 2002
(82 businesses surveyed)

<i>Classification of business</i>	<i>No. of businesses</i>	<i>No. of employees</i>	<i>Percentage of survey population</i>
Small	13	Under 20	16%
Medium	40	20 - 199	49%
Large	29	Over 200	35%

Source: Victorian Auditor-General's Office, Investment attraction and facilitation survey, 2002.

5.31 Just over three-quarters of larger companies surveyed had used the Department's services on more than one occasion, compared with 38 per cent of small businesses and half of medium-sized businesses. Of the services provided, Table 5J shows the percentage of survey respondents who used the range of investment facilitation services.

TABLE 5J
PERCENTAGE OF RESPONDENTS WHO USE SERVICES PROVIDED BY DIIRD
(82 businesses surveyed)

<i>Range of investment facilitation services provided</i>	<i>Total (per cent)</i>
Provide you with names of contacts	65
Give you general information about doing business in Victoria	61
Give you financial assistance	60
Assist you with your business development programs	49
Introduce you to relevant industry networks, either in person or by letter	45
Assist you to get appropriate training programs for your staff	37
Tell you about the relevant government regulations for your company	35
Assist you with infrastructure and utility requirements	35
Assist you with your planning approvals	30
Assist you with location and site selection for business premises	17

Source: Victorian Auditor-General's Office, Investment attraction and facilitation survey, 2002.

Main findings

5.32 The following are the main findings of the survey:

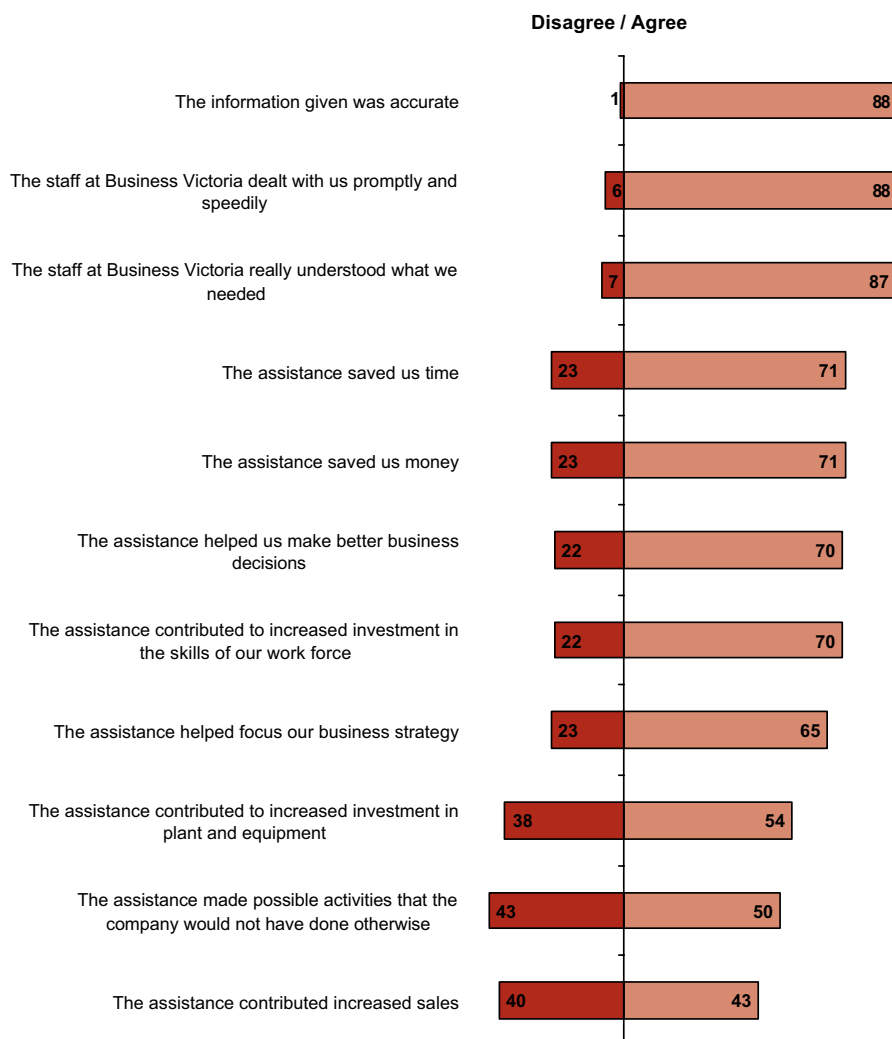
- over half of respondents had received investment facilitation assistance with contact names, general information and financial assistance of some kind;
- when rating the value of this assistance, “location and site selection” and “planning approvals” were given the highest rating. Most other services were also rated satisfactorily with slightly weaker results for:
 - assistance to get appropriate training programs for staff;
 - assistance with business development; and
 - advising on relevant government regulations.
- results indicate that the Department excels at:
 - providing accurate information;
 - delivering prompt and speedy service; and
 - understanding the needs of its clients.
- overall, 91 per cent of businesses contacted said they were satisfied with the service they had received. However, it should be borne in mind that the survey sample was only selected from a population of companies that were facilitated and investment projects went ahead in Victoria. There are indications that smaller businesses have been less well served than others.

5.33 While 50 per cent of the respondents reported that the assistance helped them to undertake activities they would not otherwise have done, over 40 per cent indicated that they would have done the activities anyway.

5.34 Chart 5K shows a number of different attitude statements and the level of agreement and disagreement for each.⁴

⁴ The chart does not show those who gave a “don’t know” response, nor does it show those who said they neither agree nor disagree with the statements.

CHART 5K
RATINGS OF THE DEPARTMENT'S INVESTMENT ATTRACTION AND FACILITATION SERVICES



Source: Victorian Auditor-General's Office, Investment attraction and facilitation survey, 2002.

Conclusion

5.35 The overall conclusion from the survey is that the Department has been very effective helping businesses, although further analysis suggests it is less well oriented to assisting small businesses than medium or large companies.

Overall Conclusions

5.36 Assistance to industry is a generally accepted role of governments, especially the provision of an appropriate economic environment to support business and the provision of information and facilitation for all firms establishing businesses and investment projects. However, it is difficult to estimate whether the benefits to the economy generally, and directly to the State budget from increased payroll and other tax revenues as a result of increased business activity, do or do not outweigh the costs of the assistance.

5.37 Companies have an incentive to try to maximise the grant received by overstating both the importance of government assistance to, and the likely benefits in terms of growth, employment and exports of, the investment decision.

5.38 The ad hoc nature of the data collection by the Department makes it difficult to assess how effective assistance has been, compared with what might have happened if no action had been taken. There are no systematic data collection on company performance indices, both pre and post-assistance.

5.39 Our analysis suggests that either the targeting of the programs was successful in selecting the firms with the best growth potential or that the programs were successful in raising employment and sales. Neither conclusion support the view that the program is operating poorly.

5.40 Our view, which is informed by our assessment of its cost-effectiveness, is that facilitation is an effective expenditure of government funds. We recognise that the Department commences all investment cases with a range of offerings and works to construct a ‘least cost’ package in order to attract potential investors. These offerings can include both facilitation and the possibility of direct financial assistance. Therefore some measure of facilitation is present in all cases of investment assistance.

5.41 Decisions regarding an appropriate balance between facilitation only and financial assistance need more information on the actual investment outcomes and net benefits to Victoria from this assistance. Where financial assistance is provided, the Department should undertake more extensive checks of the reasonableness of expected investment and employment claims, since these should be a factor in determining the level of direct financial grant to a company.

Recommendations

5.42 We recommend that:

- an ongoing program monitoring system be established to assess program effectiveness, in particular:
 - measuring the net benefits and effects of the program for Victoria;
 - the actual results for all companies that have been offered facilitation services or direct financial assistance.
- the information derived from this monitoring be used to:
 - inform the Government's decision-making regarding the program, including the appropriate balance between facilitation and financial assistance;
 - adjust the criteria against which investment attraction decisions are made to maximise the effectiveness of the assistance provided;
 - revise the design of investment attraction programs to maximise their efficiency, and effectiveness;
 - actively promote facilitation services, including the provision of information to industry, as a more effective means for the Government to overcome market imperfections and stimulate investment.

RESPONSE by Department of Innovation, Industry and Regional Development

The Department will examine options (and associated costs) for the systematic capture of outcome information for investment projects assisted and its use in program evaluation and design.

SELECTED FINANCIALLY ASSISTED PROJECTS

5.43 In order to ascertain whether the assistance provided had generated the claimed economic and other benefits to the State, we examined the progress of six projects that had received direct financial assistance.

5.44 A total commitment of \$27.1 million of assistance had been approved for the projects, \$17.2 million of which had been paid at 31 December 2001, and a further \$1.6 million due to be paid in July 2002.

5.45 The outstanding balance of \$8.3 million is committed to be paid to the companies in progressive payments, generally tied to the achievement of project milestones such as employment and investment. Some of the outstanding balance is not likely to be paid, due to the failure of the investment projects to realise the expected outcomes in the agreements.

5.46 Around two-thirds of the amount given in financial assistance to these companies has been returned in payroll tax payments over the past 5 to 6 years.

Case Study 1

5.47 In 1994, the Department received a proposal from a company requesting assistance to establish its operations in Melbourne.

5.48 The investment was expected to realise export sales and create 100 new engineering and manufacturing jobs. Sales over the next decade were projected to reach \$500 million, most of which would be exported. This company also planned to spend \$8.9 million to refurbish and equip the project office and set up an international marketing and business management organisation.

Relevance to government policy

5.49 The company investment met most of the Government's investment attraction guidelines:

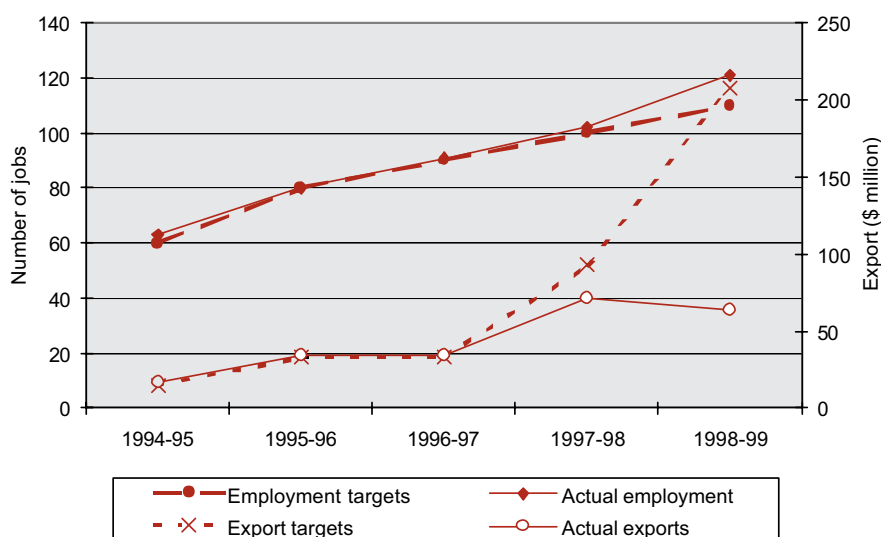
- the project is in a key industry sector for Victoria. It is a sector in which approximately half of Australia's industry is located in Victoria and key organisations have strong relationships with major overseas companies. About a third of Victoria's output for this sector is exported;
- the direct capital investment in the project was \$9 million, with the expected creation of 40 engineering jobs and 60 jobs in the manufacturing sector.

5.50 There was also pressure on the company to establish the project in Adelaide given that it has a direct relationship with companies located there.

Government assistance package

5.51 In September 1994, the Government agreed to provide financial support to consolidate the project marketing, engineering and manufacturing operations in Victoria, and meet specified employment targets and export orders as set out in Chart 5L.

CHART 5L
COMPANY A: TARGET VS ACTUAL EMPLOYMENT AND EXPORTS,
1994-95 TO 1998-99



Source: DIIRD, Legal agreement and audit certificates of actual expenditure and employment.

5.52 The company met its employment and export targets for the 5 years from 1994-95 to 1998-99. However, it was unable to meet its 1998-99 export targets. The company's performance during the term of the agreement is set out in the chart above.

5.53 Despite being unable to meet its export targets in 1997-98 and 1998-99, the project exceeded its employment targets with payroll tax amounting to approximately \$1.2 million over the period of the grant.

5.54 Under the terms of the agreement, the Minister could, at his absolute discretion, require repayment of any grant instalment, together with interest, if the company failed to achieve its performance targets. However, as the company had existing export options worth up to \$80 million per annum, for the following 10 years, the Minister exercised this discretion and the company was not required to repay the final grant instalment.

5.55 In addition to employment, export and expenditure targets, the company was required to provide written reports each year, from the period November 1994 to 1999, covering progress of project, company expenditure, increase in the employment and exports levels and identifiable benefits to Victoria resulting from the project. The reports were provided as required, except for the 1996-97 progress report which was delayed due to the purchase of the company by another company.

Subsequent project developments

5.56 In March 1999, the Department further assisted the new company to expand in Melbourne.

5.57 In 1999, this company and another company merged to create a third company. The third company undertook a review of its operations and subsequently restructured, rationalised its facilities to Adelaide and trimmed its work force. The effect of this on the investment project was that project staff numbers were reduced from 126 to around 60 and the new company did not occupy the new building being constructed. The initial project remains located in Melbourne as per the original agreement.

5.58 In January 2001, it became clear that the new company was in default under the grant agreement and the Department sought repayment of the amount paid to that time. Accordingly, in April 2001, the company repaid that amount. The interest of \$350 000 was waived.

Conclusion

5.59 The original assistance package was a success. Most targets were met and the State budget received additional payroll taxes which exceeded the direct cost of financial assistance paid to the company.



*Investment attraction and facilitation enhances
Victoria's capabilities and global competitiveness.*

Case Study 2

5.60 In 1994, the Department provided a company with assistance to negotiate a 42 year lease for a 5 hectare site for the construction of an \$18 million central distribution facility.

Relevance to government policy

5.61 The proposed \$18 million investment was designed to improve the company's competitive edge in world markets, specifically in Asia, creating further opportunities for substantial growth by a major exporter. In particular, it would:

- expand exports through cost, quality and service efficiencies. With improving productivity, exports were projected to increase from \$480 million to \$650 million within 5 years;
- secure a long-term throughput of 200 000 tonne of product against growing competition from interstate;
- create 40 jobs during the construction phase and 18 direct jobs in the distribution centre;
- introduce state-of-the-art distribution technology and world best practices;
- raise the international image of Victoria as a leading-edge supplier and distributor; and
- improve the infrastructure of the area in which the project is located, making it more attractive for other major exporters to locate similar facilities there.

Government assistance package

5.62 In January 1995, a legal agreement was signed with the company. The Government agreed to provide financial assistance, on the condition that the company provide a copy of lease, planning and other approvals for the construction of the distribution centre and the total land tax paid for the site, and total payroll tax paid for employees at the centre, 1994-97, to be at least the amount of the financial assistance received by June 1997.

5.63 The key obligations and commitments of the company under the legal agreement and its progress are set out in Table 5M.

TABLE 5M
COMPANY B: GRANT CONDITIONS

<i>Grant agreement conditions</i>	<i>Progress</i>
Prepayment condition	
Provide a copy of lease agreement for the site, for a term of at least 10 years from the date of the legal agreement.	Copy of lease, planning and other approvals received January 1995.
Provide evidence of planning and other approvals for the construction of the centre.	Payment made in February 1995.
Payroll and land tax requirements	
Total land tax paid for the site, and total payroll tax paid for employees at the centre, 1994 to 1997, to be at least the amount of the financial assistance received by June 1997.	44 per cent only achieved by October 1997. 100% achieved by June 1999, 2 years later than required.
Written reports	
Annual company and project progress reports by 31 December and 30 September, respectively.	Received as scheduled, except for September 1996 progress report which was received with the 1997 report in October 1997.
The project reports to give details of progress, capital expenditure, the full-time equivalent employment levels as averaged for the year, and the total amount of land tax and payroll tax.	

Source: DIIRD, legal agreement, file review and audit certificates of actual expenditure and employment.

5.64 The Victorian Government subsequently has assisted the company with several other projects in regional Victoria. Of these, only one received financial assistance.

Conclusion

5.65 Despite the achievement of payroll and land tax targets 2 years later than set out in the grant agreement, the project achieved its expected benefits of \$18 million investment in a central distribution facility with 41 additional full-time permanent jobs – 23 more than the required 18 – according to the agreed timelines. The delay in achieving the payroll and land tax targets was due to delays in the construction of the facility and consequent delays in the application of land tax.

Case Study 3

5.66 In March 1995, a company was provided financial assistance to relocate from interstate. The investment was expected to realise export sales of \$500 million for Victoria.

Relevance to government policy

5.67 The company investment met most of the Government's investment attraction guidelines:

- the project is in a key industry sector for Victoria. It is a sector in which approximately half of Australia's industry is located in Victoria and key organisations have strong relationships with major overseas companies. About a third of Victoria's output for the sector is exported;

- although the direct capital investment in the project was marginally below the \$5 million minimum level set by the Government, its benefits to Victoria, particularly in the 80 new jobs and substantial flow-ons of work to other Victorian companies, was considered to justify the exemption in this case;
- there was pressure on the company to relocate to Sydney because its sister company and other Australian partners are located there;
- other sectors of the company's conglomerate were considering Melbourne-based regional headquarters and/or alliances with Victorian companies.

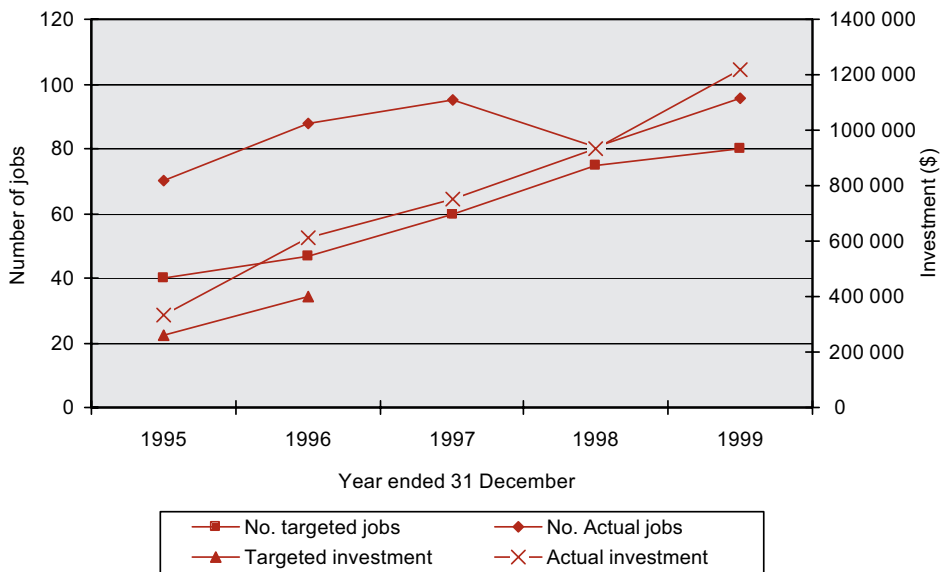
Government assistance package

5.68 In June 1995, a legal agreement was signed, providing a grant on condition that the company:

- proceed with relocating its operations to Victoria by August 1995 and retain its headquarters (for the Asia-Pacific region) in Melbourne for a period of 10 years from the date of the agreement;
- meet targets over each of the next 5 years for employment generated from its operations in Victoria;
- supply written reports upon the project providing, among other things detailing:
 - progress of the project;
 - employment levels associated with the project;
 - expenditure upon the project; and
- provide a copy of its annual report each year for the term of the agreement.

5.69 We found that, apart from the late submission of some progress reports, the company had met all the grant conditions prior to payment of the grant instalments. In fact, the company has significantly exceeded its employment and capital expenditure targets as shown in the Chart 5N.

CHART 5N
COMAPNY C: EMPLOYMENT AND CAPITAL EXPENDITURE
TARGET VS ACTUAL, 1995 TO 1999



Note: No investment targets for 1997 to 1999.

Source: DIIRD, legal agreement, file review and audit certificates of actual expenditure and employment.

5.70 Following the relocation of its entire operations, in August 1995, to Melbourne, the company has continued to develop its activity in the Asia-Pacific region and to pursue proactively, new business opportunities.

Conclusion

5.71 The project was successful in achieving the employment and capital expenditure targets. The company created 95.5 jobs by 1999, invested \$1.2 million and paid approximately \$1.4 million in payroll tax to the State over the period.

Case Study 4

5.72 In 1993, a company owned by a major overseas company, was established with significant State and Commonwealth assistance as the first and only producer of a particular product in Australia with a \$120 million facility, employing 100 people and projected export growth of \$40 million.

5.73 The proposed investment was required to:

- create 150 jobs and provide n-direct employment to design engineers, contractors, fabricators;
- inject \$25 million into the Victorian economy during the construction phase;

- generate sales of \$71 million per annum, made up of \$31 million in exports and \$40 million in import replacement;
- benefit major Victorian “downstream” users of the new product by reducing their response times and stock levels;
- potentially stimulate flow-on investments in processes that use the new product as a major raw material input;
- introduce state of the art technology; and
- create a demonstration effect by establishing, for the first time in Australia, a world class plant.

Government assistance package

5.74 In June 1995, a legal agreement was signed with the company. The Department agreed to provide a grant to the company, on condition that it establish a plant in Melbourne to manufacture the new product and meet the grant conditions set out in Table 50.

TABLE 50
COMPANY D: GRANT CONDITIONS

<i>Grant agreement conditions condition</i>	<i>Progress</i>
Payment Receipt of an audit certificate confirming investment expenditure of: <ul style="list-style-type: none"> • \$25 million before 31 March 1995; and • \$70 million on the project. Prior to payment, the company must also provide certified copies of deeds of guarantee by certain companies regarding commitment to product purchases from the company; and evidence that appropriate financial support has been secured from bank financiers and the plant supplier.	Audit certificates confirming investment expenditure of: <ul style="list-style-type: none"> • \$26.9 million was provided in April 1995; and • \$85.1 million was provided in May 1996. Certified copies of deeds of guarantee and evidence of financial support secured from bank financiers and the plant supplier was provided in April 1995
Written reports Project reports in respect of the financial years 1994, 1995, 1996 and 1997, including details of progress, any increase in the level of exports or import replacement and number of equivalent full time employees as at June of each year commencing 1994 to 1997.	Received as scheduled.

Source: DIIRD, legal agreement, file review and audit certificates of actual expenditure and employment.

5.75 Following the commissioning of the plant in November 1996, the company had 130 employees and export sales of \$16.8 million for the 1996-97 financial year. Good sales and productivity continued with more than 60 per cent of turnover coming from sales to Europe.

Subsequent project developments

5.76 Following changes in economic circumstances, the company developed a technical strategic alliance with another business to acquire technology and markets for the production of a different product, while at the same time retaining production of the original product for the domestic market. This allowed the company to retain at least 60 of the threatened staff.

5.77 In June 2000 the Department provided the company with another grant to assist with the establishment and operation of a facility for the new product. This project resulted in an additional \$14 million investment and the retention of around 60 jobs.

Conclusion

5.78 From 1994 to 1997 the company met its targets, paid approximately \$400 000 in payroll tax and invested around \$110 million in the new facility. The subsequent provision of assistance again reinforces the reliance of some companies on ongoing support from government.

Case Study 5

5.79 In 1995, a company was offered assistance to secure its investment in a service centre attracting \$50 million in investment and increasing employment by 340 people.

Relevance to government policy

5.80 The investment met most of the Government's investment attraction guidelines, in particular:

- the sector was identified as high priority by the Government;
- the value of the investment exceeded the minimum requirement;
- the investment was footloose. The functions of this service centre could be performed outside Australia, and there was some possibility that, as the customer service centre developed, it could perform these functions for similar services offered in the Asian region; and
- Victoria was competing with South Australia and Queensland, and the proposed government assistance was thought to be a critical factor in securing the service centre to Melbourne.

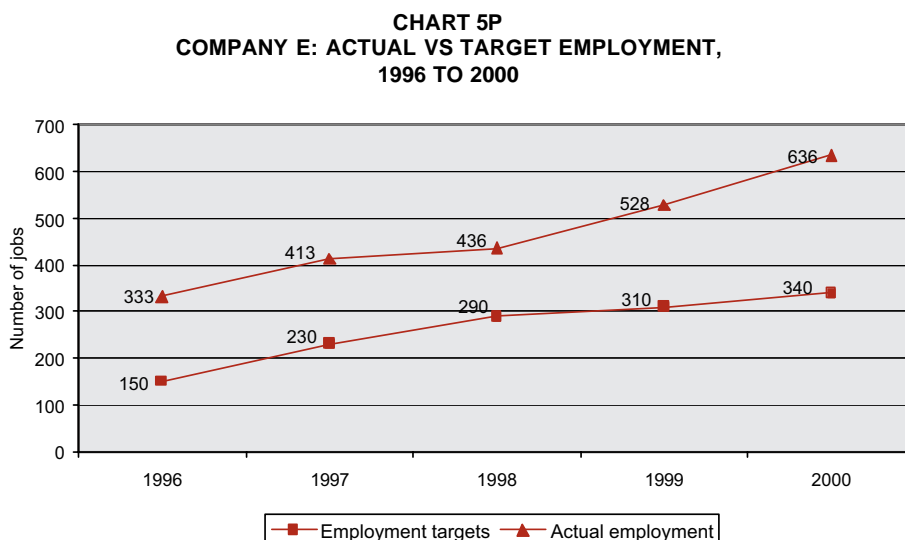
Government assistance package

5.81 In July 1995, a legal agreement was signed with the company, with the Government providing a grant comprising the following:

- land in a suburban location; and
- direct financial assistance for the establishment of the permanent facility on the land acquired by the Government.

5.82 Direct financial assistance was payable to the company, following the provision of proof to the Minister's reasonable satisfaction that the company had executed a contract with the land owner to purchase the land for the purpose of establishing the service centre.

5.83 We found that, since the company commenced business in 1995 it has grown to be a large and successful Australian company. It has exceeded its employment target each year and now employs over 600 staff at the service centre which is one of Australia's largest and most technologically advanced. Chart 5P shows the target and actual employment from 1996 to 2000.



Source: DIIRD, legal agreement, file review and audit certificates of actual expenditure and employment.

5.84 Notwithstanding these successes, the company is still operating its service centre from a temporary facility, while the vacant block of land provided by the Government, now valued at \$5.4 million, remains unoccupied. The legal agreement between the Government and the company envisaged that the construction of the permanent facility on the site would have been completed by 31 December 1997.

5.85 As the new facility has not been built, the Department and the company are negotiating to bring the grant agreement to a conclusion, including resolution of the issues regarding the unoccupied block of land.

Conclusion

5.86 In terms of increased employment to Victoria, facilitation of this investment has been successful as the company has exceeded the Government's target of 340 new jobs by 296 jobs. Nevertheless, the land purchased by the State in 1995 for \$2.25 million and granted to the company, under certain conditions has not been developed.

5.87 This case highlights the risk associated with the granting of land as an incentive to locate in a particular area. The company now holds the site as freehold and on occasions sought to claim the establishment grant without constructing the permanent facility at the site in line with the Government's requirements. In 1998, the company also wrote to the Government stating that "property ownership is not a core activity the company and hence its requirements are better served by lease hold tenancy rather than construction and ownership of property". As discussed elsewhere in this report, some local councils provide location incentives to companies through developing the land infrastructure, building the facility and entering into a lease back arrangement with the company. If the company subsequently defaults, the council retains ownership of the developed asset.

Case Study 6

5.88 In 1995, a company was provided assistance to establish its centre in Melbourne facilitating an investment of \$150 million, potential export of \$15 million and increased employment of 310 jobs.

Relevance to government policy

5.89 The investment met most of the Government's investment attraction guidelines, in particular:

- the proposed investment of a global regional headquarters was new to Victoria and "footloose", with the South Australian government reportedly offering a \$22 million package of land, building and payroll tax rebates for a period of 10 years;
- the trade exposed sector is a high priority for development. The investment was expected to significantly add to Victoria's competitive strengths and act as a magnet for other developments;
- the company had positioned itself as a leader in the sector and the centre was to be the first major international centre of its kind in Australia.

Government assistance package

5.90 In February 1995, the Government and the company signed a grant agreement for the establishment of its centre in Melbourne. The grant was in two parts. The first for the establishment of the centre and the second related to achievement of ongoing employment targets.

5.91 The total grant was to be paid in instalments over 7 years, ending July 2002, and subject to certain conditions, including the employment of staff, and an obligation to maintain the centre in Melbourne until 2003.

5.92 The establishment grant payments also specified achievement of levels of employment. The company met these employment targets. However, the quantum of the payments included a loading for establishment of the facility far greater than the benefits to be generated for the State by the number of newly created jobs.

5.93 This “up front loading” of assistance has meant that the payback period for the grant is longer than for one that is more closely tied to more targeted employment levels.

5.94 A summary of the timeline associated with the respective parties’ obligations and commitments under the legal agreement is shown in Table 5Q.

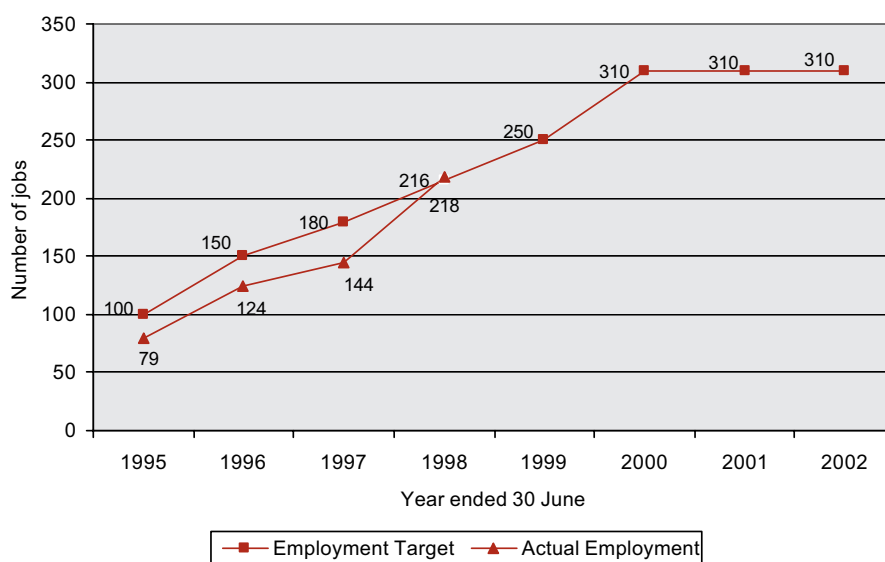
TABLE 5Q
COMPANY F: GRANT CONDITIONS

<i>Grant condition</i>	<i>Progress</i>
Establishment of centre	
<ul style="list-style-type: none"> 70 full time equivalent persons for a period of 3 months ending May 1995. 	Instalment paid in May 1995.
<ul style="list-style-type: none"> 120 full time equivalent persons for a period of 3 months ending May 1996. 	Pro-rata instalment payment of made in June 1996 after shortfalls in projected employment. Balance of payment made in March 1997 after reaching employment targets.
<ul style="list-style-type: none"> 140 full time equivalent persons for a period of 3 months ending May 1997. 	Instalment paid in May 1997.
Employment targets	
<ul style="list-style-type: none"> 100 employees in 1995 	Pro-rata instalment payment made in January 1996 after shortfall in projected employment
<ul style="list-style-type: none"> 150 employees in 1996 	Pro-rata instalment payment made in August 1996 after shortfall in jobs. Balance made after reaching employment target.
<ul style="list-style-type: none"> 180 employees in 1997 	Instalment paid in May 1998
<ul style="list-style-type: none"> 216 employees in 1998 	Instalment paid in May 1999
<ul style="list-style-type: none"> 259 employees in 1999 	No instalment paid
<ul style="list-style-type: none"> 310 employees in 2000 	No instalment paid
<ul style="list-style-type: none"> 310 employees in 2001 	No instalment paid
<ul style="list-style-type: none"> 310 employees in 2002 	No instalment paid
Written reports	
Quarterly written reports from March 1995 to December 2002 detailing jobs, total wages and payroll tax paid.	A number of reports were not received. In August 2001, after the commencement of this audit, the Minister wrote to the company requesting annual progress reports to March 1996, 1997, 1998, 1999, 2000 and 2001 and annual financial reports for 1995, 1996, 1999 and 2000. All outstanding reports were subsequently submitted by October 2001.
Yearly written progress reports to 2002 detailing value of exports, the accrued benefits including technology skills transfer.	
Annual audited financial statements as soon as possible.	

Source: DIIRD, legal agreement, file review and audit certificates of actual expenditure and employment.

5.95 The second part of the grant under the terms of the agreement provided for additional funds paid in, instalments and also tied to employment targets. The company met these employment growth targets until June 1998, and the June 1997 and June 1998 employment targets were 10 months late. The company attributed this slowing down of growth to the "Asian Crisis" and the changing economic environment and also indicated that it was unlikely to meet the future employment targets as set out in the agreement due to changes in the market. Chart 5R shows the company's employment performance against targets.

CHART 5R
COMPANY F: ACTUAL VS TARGET EMPLOYMENT,
30 JUNE 1995 TO 2002



Note: 1998 actual March 1999.

Source: DIIRD, legal agreement, file review and audit certificates of actual expenditure and employment.

5.96 A number of reports had not been received by the Department by the due date. Consequently, Department client managers are limited in their assessment of the project, and whether the specific benefits of export value and skills transfer accruing through the centre have been of benefit to Victoria.

Ongoing project developments

5.97 In February 2001, the company advised the Department that the centre would continue operating beyond 2003, but is likely to decrease its staff numbers. Given that the employment target set at 310 employees to 2003 will not be met, the Minister has a number of options under the agreement. These are:

- terminating the grant agreement and seeking repayment of grant funds paid. Legal advice sought by the Department indicates that it would be difficult to recover a refund of the grant. The grant was structured so that instalment payments were made on the achievement of specific targets rather than with a view to seeking repayment for failure to achieve future milestones; and
- continue to monitor the grant agreement until completion in February 2003 with no further payment made if the company maintains employment at the levels now projected.

5.98 The Minister determined on August 2001 that the grant agreement would be monitored with no further payments. A consideration in this decision was the company's services to government and its commitment to remain in Victoria until 2003, thus continuing to generate economic benefits.

Conclusion

5.99 There is always a risk that the overall economic impact of an attracted investment may not be as great as initially expected by the government.

5.100 This risk was compounded when, in order to secure the investment in Victoria, the assistance package was "up front loaded" and not tied to the achievement of investment or employment milestones related to the size of the first part of the grant instalments.

5.101 As a result of the company's inability to meet the overall expectations of the grant it will take far longer than anticipated for the project to achieve the expected net benefits for the State.

5.102 If written reports had been provided to the Department it may have monitored this situation better. We also note the difficult position the Government may be placed in if a company is both a grant recipient and a major supplier of services to government.

Part 6

Public reporting of government investment assistance in Victoria

REPORTING ON INVESTMENT ASSISTANCE

Issues in reporting on investment assistance

6.1 Striking a balance between maintaining transparent reporting to the public and the need for commercial confidentiality is a sensitive issue in relation to government assistance to industry.

6.2 The Department of Innovation, Industry and Regional Development's Annual Report discloses a comparison of output targets specified in the State budget with the (expected) investment performance against those targets. The Annual Report also discloses the names of companies provided with investment related financial assistance, together with the aggregate total of direct financial assistance for investment projects expended during the year. The amount of assistance provided to each company has not been disclosed. For other Business Assistance Programs not related to investment the Department's Annual Report discloses program details and actual grants to companies.

6.3 The Department's nondisclosure of details of direct financial assistance has been the policy of successive Governments, on the basis that it is necessary to maintain the confidentiality of commercial relations with the firm receiving the assistance. The publication of the level of assistance provided to a recipient of investment assistance could cause harm to a company's competitive position and undermine the Department's future bargaining position in relation to other jurisdictions, thus damaging the capacity of the Government to compete for investment in the future. According to the Department, such disclosure would also raise expectations among existing companies and potential investors and encourage rent seeking behaviour.

6.4 While we agree that disclosure may raise the costs of the program, 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 further enhanced by the provision of reliable information.

6.5 The Public Accounts and Estimates Committee in its *Inquiry into Commercial in Confidence Material and the Public Interest* developed a set of draft principles on commercial information provided to Victorian Government agencies by individuals and organisations. The principles developed by the PAEC include the following:

“... in assessing whether or not there is public interest in disclosure, agencies should bear in mind that both the Parliament and public have rights of access to information which enhance the activities of government agencies and which is necessary to monitor the use of public funds and the probity and integrity of the processes used.”

6.6 The Government's non-disclosure of the amount of investment grants to companies is sustained by the Rangedale FOI decision by the Victorian Civil and Administrative Tribunal in 1999. The judge in that case stated that:

"The overall public interest in the desirability or not of making grants per se to industry is not served by the release of these particular documents. There are public records as to the level of expenditure involved in the total grants afforded by the various State Governments. There are public records in the nature of budget documents which disclose the level of economic activity in the various States of the Commonwealth and of the Commonwealth of Australia as a whole. Moreover, there are reports of Government Commissions or Departments. The proposed grant to "Rangedale Abattoirs Pty. Ltd" is not a matter of specific public interest such that the release of the documents is necessary to maintain public confidence in the procedure".¹

6.7 The issue of commercial confidentiality and sensitivity should not override the Government's obligations to be accountable for financial arrangements involving public moneys. Reporting could be enhanced by disclosing the progressive achievement of aggregate performance milestones by company and/or industry sector, including details of whether job targets and capital investment associated with projects had been achieved, as well as the level of government commitments and assistance expected into the future.

6.8 In the 1995 Auditor-General's report, *Promoting industry development: Assistance by government*, the following comments were made in regard to reporting company or project specific assistance:

"Given the importance of adequately informing the Parliament and the community of the manner in which the [Industry, Regional and Trade Support] Program has been managed, future Annual Reports should disclose actual performance against all performance targets set for the reporting period. Audit also considers that the [Business and Development] Department's accountability to the Parliament and the community would be strengthened by annual reporting of the amount and type of financial assistance provided to each company assisted under the Program." (p. 64)

6.9 The current level of annual reporting by the Department of Innovation, Industry and Regional Development and local governments still does not provide sufficient information to enable the nature and extent of industry assistance to be adequately determined.

6.10 Clearly, the objectives of industry assistance and the criteria used to assess proposals for assistance have become more transparent since our last audit, however, meaningful evaluation and reporting of regular monitoring of progress and performance against established milestones needs to be improved.

¹ Bracks v Department of State Development [1999] VCAT 579 (15 January 1999)

Conclusion

6.11 There is insufficient transparency in the reporting of investment attraction and facilitation programs. It is accepted that some level of confidentiality is required in the negotiation with companies of direct financial assistance. However, once those amounts have been determined, we see no reason for the public to be denied information relating to progress against agreed milestones and other program outcomes, particularly as this assistance is being provided to private individuals/companies in preference to others who might have similar requirements.

6.12 The information required to be disclosed for these investment attraction packages includes the expected outcomes and the milestones against which the package is to be monitored and the actual outcomes in future years. The annual report of the DIIRD and other relevant public sector and local government agencies, together with their respective websites, would be appropriate vehicles for reporting this information.

Recommendations

6.13 We recommend that the Department:

- report annually the details of new investment projects that have been provided with assistance. The report should include the expected performance outcomes and milestones against which these projects are to be monitored and identify the sectors of the economy in which Victoria has strategic competitive advantage to which the projects are related.
- report annually, the progress of committed projects, for the duration of the contract, detailing the initial claims and the subsequent outcomes, including any performance outcomes and milestones against which the project has been monitored and the sectors of the economy in which Victoria has strategic competitive advantage to which the projects are related.
- report annually the aggregate performance of sectors of the economy in which Victoria has strategic competitive advantage and which are targeted for investment assistance.

RESPONSE by Department of Innovation, Industry and Regional Development

The Department will examine options (and associated costs) for the systematic capture and increased aggregate reporting of outcomes for investment projects assisted.

Part 7

Follow-up of the 1995 audit

PROGRESS SINCE THE 1995 AUDIT

7.1 The Auditor-General's 1995 report, *Promoting industry development: Assistance by government* assessed the effectiveness of strategic and operational policies within the Department of Business and Employment for the management of its Industry, Regional and Trade Support.

7.2 Our follow-up of recommendations from our 1995 report indicates that the Department continues to refine the activities of investment attraction and facilitation. However, further attention to monitoring, verifying, measuring and reporting of these services is required, especially of the economic benefit and other outcomes for Victorians.

7.3 Specific recommendations from the 1995 report, together with our comment on the action taken, is set out in the table below.

TABLE 7A
STATUS OF THE IMPLEMENTATION OF RECOMMENDATIONS OF 1995 REPORT

<i>Summary of recommendations</i>	<i>Comment</i>
Economic benefits expected to the State	
<i>Implemented, but additional targets required</i>	
The Department needed to set specific targets for all key economic benefits expected from the assistance.	<p>Budget output targets are set for the level of investment, including that attracted to rural Victoria and the number of investment projects under investigation.</p> <p>Internal targets also include expected jobs and exports from facilitated and announced investments along with inbound investor visits supported and Industrial Supplies Office Import Replacement.</p> <p>These targets are measured as the "announced" investment value, jobs or export and do not reflect the Department's experience with the actual economic benefits to Victoria through such investment projects. Additional targets for realised economic benefits several years after project commencement are required.</p>
Analysis of anticipated economic benefits by industry sector	
<i>Partly implemented</i>	
The Department needed to develop clear priorities between industry sectors and establish targets for the level of economic benefits on an industry basis.	<p>The Department has developed industry sector priorities, which are reflected in internal resource allocations in the food, IC&T, automotive, manufacturing and business service sectors.</p> <p>In 1998-99, the Department trialed industry sector investment targets; however, this has been discontinued because of the difficulty of setting such targets on an annual basis.</p>
Reduced focus on projects only receiving non-financial assistance	
<i>Implemented</i>	
The Department needed to maintain a suitable balance over time between direct financial assistance to industry and the valuable non-financial services available to augment industry activity.	<p>Since 1993-1995 the balance has changed. Three-quarters of the 477 investment projects facilitated since the previous audit have received facilitation assistance only, with no financial incentive. Whereas during 1993-1995, 44 of the 105 projects (44 per cent) received facilitation only.</p> <p>The Department continues to monitor the level and extent of its incentive levels compared with other jurisdictions.</p>

TABLE 7A
STATUS OF THE IMPLEMENTATION OF RECOMMENDATIONS OF 1995 REPORT - continued

<i>Summary of recommendations</i>	<i>Comment</i>
Limited emphasis on projects dealing exclusively with import substitution	
<i>Implemented</i>	
The Department needed to reassess its targeting of import substitution projects to reflect the priority attached to import substitution within the Government's industry policy statement and the program's assistance criteria.	<p>The Department now funds the Industrial Supplies Office (ISO) as the principal mechanism to encourage import substitution. The funding agreement stipulates performance targets in terms of import replacement or exports achieved.</p> <p>The launch in April 2001 of the Victorian Industry Participation Program (VIPP) requires government agencies and bidders for large government projects to consider local content opportunities. For projects over \$50 million, it is mandatory for the preferred bidder to consult with the ISO and obtain certification.</p> <p>Imports replaced are treated as equivalent to exports as one of the key criteria in assessing investment projects, together with the size of the investment in dollar terms and jobs created.</p>
Scope for improved recording and monitoring of costs of facilitation services	
<i>Partly implemented</i>	
The Department needed to implement a management information system to separately record and monitor costs incurred in the provision of facilitation services to enhance decision-making and resource management.	<p>Combinations of project time recording systems and percentage estimates of costs are used to monitor resource allocations to investment facilitation. The Investment Database also records team members who contribute to each individual investment project.</p> <p>These costs could be better recorded, monitored and reported to assist in discussions regarding the balance of assistance provided.</p>
Co-ordination with the Australian Government's regional development strategy	
<i>Partly Implemented</i>	
In order to achieve maximum benefit to the State from the national regional development strategy, the Department needed to:	The Department offers assistance to regions to develop strategies identifying their economic strengths and needs.
<ul style="list-style-type: none"> • finalise development of profiles identifying the economic strengths and needs of each region; • alleviate the existing uncertainty over the future of regional development organisations beyond their current funding term which expires in June 1997; • clarify the functions of regional development organisations in order to facilitate co-ordination with, and rationalise existing structures; and • avoid unnecessary duplication of services at the Commonwealth and State levels. 	<p>As-of-right funding to regional development organisations has been withdrawn and replaced with direct funding of projects through council and regional development bodies. New programs include:</p> <ul style="list-style-type: none"> • Living Regions Living Suburbs which supports initiatives promoting economic and social renewal in rural, regional and suburban communities throughout Victoria; and • regional development organisations which assist groups (councils, regional development bodies etc.) to undertake projects that have a regional perspective beyond a single local government area. <p>At both a policy and operational level department staff work closely with their Commonwealth Government counterparts. However, the Commonwealth Government has, for some time, reduced its involvement in regional economic development.</p>

TABLE 7A
STATUS OF THE IMPLEMENTATION OF RECOMMENDATIONS OF 1995 REPORT - continued

<i>Summary of Recommendations</i>	<i>Comment</i>
Need for greater focus on regional infrastructure studies	
<i>Implemented</i>	
The Department needed to identify, in conjunction with local government, those regions requiring urgent infrastructure works that will enhance economic growth and to establish priorities for the funding of such works through the national regional development strategy.	<p>The Regional Infrastructure Development Fund (RIDF) is providing \$170 million over 3 years in capital works funding to regional communities to support new industry development, improve critical transport links, build up tourism infrastructure and improve linkages to education and information technology.</p> <p>The Victorian economy has been able to leverage off the RIDF with companies and councils contributing to the investment projects, in some cases with Commonwealth Government support.</p>
Approach by the Department to measurement of program performance	
<i>Partly Implemented</i>	
The Department needed to develop performance measures in specific areas of the program.	As discussed elsewhere, the Department's performance measures continue to be based on the projected value of investments and exports and on the number of jobs expected to flow from these investments. These do not reflect the performance outcomes of the program, nor the net economic and other benefits to the State of Victoria.
Reporting of program performance	
<i>Partly Implemented</i>	
Given the importance of adequately informing the Parliament and the community of the manner in which the program has been managed, future Annual Reports of the Department needed to disclose actual performance against all performance targets set for the reporting period, and the amount and type of financial assistance provided to each company assisted under the program.	<p>The Department's Annual Report discloses the names of companies provided with investment related financial assistance, together with the aggregate total of financial assistance expended during the year. The amount of assistance provided to each company has not been disclosed.</p> <p>For other Business Assistance Programs not related to investment attraction, the Department's Annual Report discloses program details and actual grants to companies.</p> <p>The government's stance on non disclosure of investment grants to companies relies on the Rangedale FOI decision by the Victorian Civil and Administrative Tribunal in August 1998.</p>

PERFORMANCE AUDIT REPORTS **of the Auditor-General** **issued since 1997**

<i>Report title</i>	<i>Date issued</i>
Major civic projects: Work in progress	April 1997
Metropolitan Ambulance Service: Contractual and outsourcing practices	April 1997
Metropolitan Ambulance Service: Fulfilling a vital community need	November 1997
Victorian Rural Ambulance Services: Fulfilling a vital community need	November 1997
Schools of the Future: Valuing accountability	December 1997
Victoria's multi-agency approach to emergency services: A focus on public safety	December 1997
Victoria's gaming industry: An insight into the role of the regulator	March 1998
Child care and kindergartens: Caring about quality	April 1998
Acute health services under casemix: A case of mixed priorities	May 1998
Public transport reforms: Moving from a system to a service	May 1998
State Revenue Office: A customer service focus towards improving taxation collection	October 1998
Automating fare collection: A major initiative in public transport	November 1998
Victoria's prison system: Community protection and prisoner welfare	May 1999
Road construction in Victoria: Major projects managed by VicRoads	December 1999
Land use and development in Victoria: The State's planning system	December 1999
Represented persons: Under State Trustees' administration	May 2000
Building control in Victoria: Setting sound foundations	May 2000
Reducing landfill: Waste management by municipal councils	May 2000
Non-metropolitan urban water authorities: Enhancing performance and accountability	November 2000
Services for people with an intellectual disability	November 2000
Grants to non-government organisations: Improving accountability	November 2000
Implementing Local Priority Policing in Victoria	May 2001
Teaching equipment in the Technical and Further Education sector	May 2001
Managing Victoria's growing salinity problem	June 2001
Management of major injury claims by the Transport Accident Commission	October 2001
Teacher work force planning	November 2001
Management of injury claims by the WorkCover Authority	November 2001
Departmental performance management and reporting	November 2001
International students in Victorian universities	April 2002

The Victorian Auditor-General's Office website at **www.audit.vic.gov.au** contains a more comprehensive list of all reports issued by the Office. The full text of the reports issued over the past 10 years is available at the website. The website also features a "search this site" facility which enables users to quickly identify issues of interest which have been commented on by the Auditor-General.



AUDITOR GENERAL VICTORIA

150

Years of Auditing in the Public Interest

AVAILABILITY OF REPORTS

Copies of all reports issued by the Victorian Auditor-General's Office are available from:

- Victorian Auditor-General's Office
Level 34, 140 William Street
Melbourne Vic. 3000
AUSTRALIA

Phone: (03) 8601 7000
Fax: (03) 8601 7010
Email: comments@audit.vic.gov.au
Website: www.audit.vic.gov.au
- Information Victoria Bookshop
356 Collins Street
Melbourne Vic. 3000
AUSTRALIA

Phone: (03) 1300 366 356 (local call cost)
Fax: (03) 9603 9920