

**LOCAL GOVERNMENT FORUM**

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Submission on Proposal that Wellington City Council  
Subsidise the V8 Supercar Championship Series

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**April 2005**

## **1. Introduction**

- 1.1 This submission is made by the Local Government Forum (the Forum). The Forum was established in 1994 to promote greater efficiency in the local government sector and to contribute to debate on policy issues affecting the sector. The Forum comprises business organisations that have a vital interest in local government. Their members are among the Wellington City Council's (the Council's) largest ratepayers. A list of Forum members is attached as Appendix 1.
- 1.2 The submission comments on the proposal that the Council should contribute up to \$3.95 million per annum for seven years towards the costs of holding the V8 Supercar Championship series (V8 race) in Wellington city from April 2006.<sup>1</sup>

## **2. Overview comments**

- 2.1 The Forum has no objection in principle to the Council supporting activities that have a strong local public good element but which might be under-funded by the private sector, as long as support by those ratepayers bearing most of the rate burden is clearly indicated.<sup>2</sup>
- 2.2 The Forum believes the case for the Council subsidising a commercial venture, such as a car race, is much less clear. There are few public benefits from the event itself since most spectators can be made to pay for access. Any residual public benefits in terms of publicity, 'warm glow' and so on are likely to be offset by the negative effects of noise, disruption to travel and restrictions in access to work, shops and apartments within the race zone. Thus, there are unlikely to be any net 'spillover' effects that would justify Council funding.
- 2.3 The Council's case for subsidising the event is based primarily on the additional economic activity that it would generate in Wellington. Analysis by McDermott Miller suggests that the V8 race would increase 'new spending' in Wellington by \$22.9 million, 'direct value' by \$8.6 million and 'direct value over a series of rounds of spend' by \$15.7 million per annum for the seven years the

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<sup>1</sup> The Council's proposal assumes that external funding of \$0.65 million per year could be obtained, implying a net cost of \$3.3 million.

<sup>2</sup> A public good has two characteristics: it is difficult or costly to exclude people from the benefit of the public good; and one person's 'use' of the output does not prevent another from enjoying the output.

event is held in Wellington.<sup>3</sup> The costs to the Council are estimated at \$3.95 million per annum (or \$3.3 million if external funding is obtained).

- 2.4 The Forum believes the case for providing funding and in-kind support to the commercial organisers of the V8 race is weak at best. The Council's case is based on a seriously flawed analytical approach. For a detailed discussion of the problems with the approach, see the attached report, *Should Governments Subsidise Stadiums and Events?* prepared by Professor Tyler Cowen of George Mason University for the New Zealand Business Roundtable in 1999.
- 2.5 As discussed further below, the Council's calculations grossly overstate the potential benefits and understate the costs of hosting the V8 race. The Forum is sceptical that net benefits could be established using proper cost benefit analysis. It does not, therefore, support the Council providing a subsidy to the promoters of the V8 race, or providing in-kind support.

### **3. The Council's presentation of the case for funding**

- 3.1 The Council's presentation of its case for funding of the V8 race is misleading. It emphasises the economic impact figure of \$22.9 million as if it were net economic benefit. The Council's summary of the proposal does not refer to the alternative measures of economic benefit calculated by McDermott Miller which, although seriously flawed, are more appropriate than the economic impact figure.<sup>4</sup> McDermott Miller's alternative figures are included in the Council's more detailed statement of proposal although emphasis is still given to the economic impact figure.<sup>5</sup> Total economic impact is not an appropriate measure of benefit.
- 3.2 The Council's presentation of the proposal also focuses on the increased rating requirement of \$2.58 million rather than the total cost to the Council of \$3.3 million assuming external contributions are obtained, or \$3.95 million if they are not. The focus on the \$2.58 million arises because the Council has already budgeted to spend \$0.8 million on events. However, the appropriate focus is the total cost to the Council.

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<sup>3</sup> McDermott Miller, *V8 Supercars Street Race Wellington April 2006: Projected Economic Impacts*, 28 February 2005.

<sup>4</sup> Wellington City Council, *V8 Supercar Championship Series: Street Racing in Central Wellington? Have Your Say*, 2005.

<sup>5</sup> Wellington City Council, *Statement of Proposal: V8 Supercar Championship Series*, 2005.

#### 4. Calculation of net economic benefit

- 4.1 The net new spend (or net economic impact) figure does not measure net economic benefit. Economic value or net economic benefit is calculated as net new spend less the costs of producing goods and services. It is not, for example, appropriate to treat wages paid as a net benefit since an employee has either given up alternative work (which has an opportunity cost) or forgone leisure (which also has an opportunity cost). Given the choice of a gift of \$100, or wages of \$100 paid for eight hours work, most would choose the gift, given the opportunity cost of leisure. Similarly, if one could work for \$90 in the absence of the event, but would be paid \$100 if the event proceeded, the benefit of employment would be \$10 not \$100. Using net new spend as if it were economic value or net benefit grossly overstates the benefits.<sup>6</sup>
- 4.2 The direct value estimate of \$8.6 million used by McDermott Miller may also overstate economic value. The figure is obtained by deducting money spent on goods and services 'imported' from outside Wellington from the net new spend figure. It is not clear whether McDermott Miller's approach takes account of the fact that many locally supplied inputs would also have an imported component. If not, using the consultant's framework, its direct value estimate may be overstated.<sup>7</sup> Further, as noted above, all costs of inputs including labour, whether supplied locally or imported, should be deducted in deriving net benefit unless the opportunity cost of the resources is zero.
- 4.3 McDermott Miller also calculate a benefit figure of \$15.7 million, which allows for the 'multiplier' effects of expenditure. While multipliers are commonly applied in economic analysis of this type, their validity is doubtful. A multiplier approach assumes that the resources used would otherwise have been unemployed, an assumption that makes little sense in Wellington.<sup>8</sup> Other reasons why multipliers should not be used are explained in detail in Professor Cowen's report.
- 4.4 Auckland City Council commissioned Market Economics to report on the costs and benefits of hosting the V8 race in Auckland. Market Economics observed that net economic benefits are only a small proportion of the net new spend or

<sup>6</sup> See for example, Cowen, T, *Should Governments Subsidise Stadiums and Events?*, New Zealand Business Roundtable, 1999, p 14 and ACT Auditor-General's Office, *Performance Audit Report: V8 Car Races in Canberra – Costs and Benefits*, July 2002, p 17.

<sup>7</sup> Dr Lally provides a detailed discussion of this. See Lally, M, *A Review of the Proposal for the Wellington V8 Car Race*, April 14, 2005, pp 3-6.

<sup>8</sup> ACT Auditor-General's Office (2002) pp 82-84.

value added ('direct value' in McDermott Miller's analysis). They note that net economic benefit can be approximated by operating surplus (gross profit) which broadly corresponds to 8-12 percent of value added or 3-5 percent of output.<sup>9</sup> The Council's 'rule of thumb' that events should return \$20 for each \$1 of Council funding spent is consistent with net economic benefit being in the order of 5 percent of net new spend.

- 4.5 Market Economics' figures indicate that the net economic benefits (including tax paid to central government) of holding the race in Wellington might be in the order of \$0.5-\$2 million. This suggests that the benefits of the Council hosting the V8 race would not exceed the direct costs of the event. Application of the Council's rule would also lead to rejection of the proposal using the Council's own figures.
- 4.6 It should also be noted that from an overall New Zealand perspective, payment to attract events such as the V8 race largely transfers economic activity and income from one part of New Zealand to another, yielding no overall economic benefit.<sup>10</sup>

## **5. Omissions from the calculated costs and benefits**

- 5.1 McDermott Miller and the Council acknowledge that the street race would result in adverse impacts. They estimated a negative impact of \$0.2 million resulting from disruption to businesses on the Friday of the race. These costs are not subtracted from the estimated benefits.
- 5.2 McDermott Miller did not calculate other disruption costs. Given that the race is held over three days, and that disruption to road transport would occur over five to seven weeks, the costs are likely to be high. A third of the residents surveyed indicated that they would be adversely affected by the event. Many would change their travel plans, and their travel route into and across town. Such adjustments to avoid possible congestion and parking problems involve economic costs that are additional to the effect on business activity of the event. They are likely to be significant and should have been assessed. Given McDermott Miller's \$0.2 million estimate of the cost of disruption to businesses

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<sup>9</sup> Market Economics, *Auckland V8 Street Race: Economic Impact Assessment*, report prepared for Auckland City Council, July 2004, pp 10-11.

<sup>10</sup> Dr Lally elaborates on this point in section 5 of his report.

in the race zone on the Friday of the race, the overall disruption costs could be in the order of \$0.5 million to \$1 million.<sup>11</sup>

- 5.3 The Council suggests that there would be substantial benefits arising from international media coverage of the event. There is no analysis of whether any such benefits would arise and, if so, their extent. The calculation of 'notional expenditure' on media gives no indication of the positive publicity value of any media coverage.

## **6. Risks**

- 6.1 While the Council claims that the promoter bears all commercial risk, the Council also bears substantial risk. The Council would incur capital and other costs, but would obtain no benefits were the promoter to withdraw from the series. It is not clear what protection the Council has against this risk.
- 6.2 While an independent consultant has provided the cost estimates, there are likely to be substantial uncertainties and risks associated with such estimates. Experience suggests that costs may well be underestimated given the difficulty of analysing all possible contingencies in an exploratory study of this kind.
- 6.3 In a review of the V8 race held in Canberra during 2000 and 2001, the Office of the Auditor-General of the Australian Capital Territory found that Canberra Tourism and Events Corporation's analysis had exaggerated the benefits achieved by hosting the race. Further, the actual net direct financial costs of the races were found to be greater than the government's original expectations and the net cost of the 2001 race was almost twice the forecast cost.<sup>12</sup>
- 6.4 Further risks arise in relation to the estimates of the likely benefits of the race. The Forum has not reviewed the net economic impact of the race as assessed by McDermott Miller and the Council in any detail. However, it notes Dr Lally's analysis of capacity constraints applying to accommodation and restaurants, which suggests that McDermott Miller's estimate of the benefits is likely to be a significant overstatement (by as much as 70 percent in the case of accommodation).<sup>13</sup>

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<sup>11</sup> The ACT Auditor-General's Office provided an indicative estimate of the road congestion and noise costs for the V8 car races held in Canberra of \$0.5 - \$0.8 million. The road congestion costs were estimated for the three to five working days the roads were closed, and did not include the cost of disruption during the setting up and dismantling of the track. See ACT Auditor-General's Office (2002) p 19.

<sup>12</sup> ACT Auditor-General's Office (2002) pp 1-3.

<sup>13</sup> Lally (2005) pp 6-7.

## **7. Proposed funding of costs**

- 7.1 The Council proposes that its additional \$2.58 million contribution towards costs should be funded 50 percent by downtown commercial ratepayers, 40 percent by all commercial ratepayers and 10 percent by residential ratepayers.
- 7.2 The Forum does not believe that non-downtown commercial ratepayers would receive significant benefits from the event. It does not therefore support the allocation of a disproportionate share of the rates burden to these ratepayers. It also notes that while some downtown ratepayers would benefit from the event, others would be harmed. Imposition of higher rates on all such businesses is not therefore justified. Given that commercial ratepayers are expected to provide 90 percent of the rates funding, the Council should survey them to obtain further information on their willingness to pay (with results perhaps weighted by the quantum of their likely contribution).
- 7.3 The Forum has no objection to the V8 race going ahead on a commercial basis provided normal planning and other requirements are met. However, it does not support Council funding of the event on the basis of analysis available to date. The promoter, businesses and others lobbying for it should put their hands in their own pockets, not ratepayers'.

## **8. Summary**

- 8.1 The onus is on the Council to establish that the event would benefit the Wellington community and ratepayers as a whole. The assessment in the McDermott Miller report is based on a methodology that is inadequate for the purpose and all relevant costs and benefits are not taken into account. Thus the merits of the proposed event have not been established. The Forum is sceptical that net benefits could be established using proper cost benefit analysis. Unless this can be done it does not support the Council providing a subsidy to the promoters of the V8 race, or the provision of in-kind support.

## **The Local Government Forum**

Member organisations include:

- Business New Zealand
- Electricity Networks Association
- Federated Farmers of New Zealand
- New Zealand Business Roundtable
- New Zealand Forest Owners' Association
- Property Council of New Zealand