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NON-AGENDA

With the view of causing an increase to take place in the mass of national wealth, or with a view to increase of the means either of subsistence or enjoyment, without some special reason, the general rule is, that nothing ought to be done or attempted by government. The motto, or watchword of government, on these occasions, ought to be — Be quiet. . . Whatever measures, therefore, cannot be justified as exceptions to that rule, may be considered as *non-agenda* on the part of government.

—— *Jeremy Bentham (c.1801)*

The Queensland IndyCar Grand Prix: Assessing Costs and Benefits

Terry Black

In the past decade, public policy in Australia has increasingly become involved with major sporting and cultural events, such as the 1982 Commonwealth Games, the Australian Formula One, Expo 88, the IndyCar Grand Prix and the Sydney 2000 Olympic Games. These events have typically been evaluated by unsound methods involving, in particular, gross benefits. Instead, such events should be evaluated by cost-benefit analysis.

When the Queensland government decided to fund Indy (which has been held annually since 1991), the Treasurer, Keith De Lacy, did not envisage the need for taxpayers to subsidise the event. Speaking on ABC Television's *7.30 Report* on 16 March 1994, he said that the government's financial analysis in 1991 indicated that the race would break even in the first year and would make money after that. Clearly, the government expected Indy to behave according to the commercial principles of private firms: to maximise the flow of income received by shareholders, with the public-sector analogue being taxpayers.

After incurring losses amounting to A$60m from the running of the four races since 1991, the government shifted ground, and argued that the benefits to the tourism industry justified the use of taxes to subsidise Indy. It commissioned Ernst and Young Consulting to produce an economic impact report, which claims that 'As compared to the economic benefits of $23.0m from hosting the 1994 Australian FAI IndyCar Grand Prix, net financial costs of running the event may be in the vicinity of $10.5 million . . . .' (1994:1).

Ernst and Young use a method that estimates the first-round effects of the additional spending directly generated by the event, and utilises Keynesian multipliers that recognise that recipients of the additional spending will save a fraction of it and spend the balance. Recipients of the second-round spending will in turn save part of it and spend the balance. In this way the initial spending is multiplied several times as it works it way through the economy. This methodology produces estimates of additional direct and indirect spending generated by Indy.

One may object to the consultants' execution of the methodology on several grounds. Corporate ticket holders were excluded from the survey; the estimated length of stay by overseas visitors of 15 nights is approximately double that recorded for Indy or for any other event in 1993; and the multipliers chosen have the effect of increasing the value of additional spending. But the fundamental objection is that the methodology is inappropriate for evaluating Indy. It fails to recognise the costs incurred in generating the benefits of the additional spending; that is, it does not evaluate the opportunity costs of using public funds in alternative ways. Ernst and Young acknowledge in their report that 'it is not a cost-benefit study as it does not investigate either the financial viability of the project or the wider social costs and benefits of the project' (1994:3).

By aspiring to take into account the economic effects of a project, cost-benefit analysis seeks to ascertain whether a project maximises social welfare. Welfare economics recognises two dimensions of social welfare: economic efficiency and distributional justice. Standard cost-benefit analysis facilitates the assessment only of economic efficiency. It recommends that a project should be undertaken only if the winners could fully compensate the losers without themselves becoming net losers. This approach implies the simple addition of gains and losses, and if total benefits exceed total costs, social welfare is enhanced.

The Ernst and Young report bases its estimates of benefits on a random sample of Indy visitors' spending on accommodation, food and drink, retail items, and entertainment. But this figure corresponds to the *sales* of the various businesses, not their *profit*. Since the report does not identify the *costs* of providing services to visitors, it does not indicate whether Indy was profitable. That requires recognition, not just of the costs of providing tourist services, but of the costs incurred by the government in operating the race.

If it is (generously) assumed that tourism spending generates a profit of 10 per cent of sales, the $23m of additional spending net of the cost of providing the services results in a benefit worth approximately $2.3m. This is much less than the $10.5m loss funded by taxpayers. By declining the opportunity to fund the 1994 Indy, private business firms certainly behaved as if they thought it would not be profitable, despite the government offer of a subsidy of $5m. It could of course be argued that each firm privately thought that Indy would generate a net benefit, but rationally tried to obtain a free ride from the event. But for free riding to pay, Indy had to take place. Yet during 1993, when it appeared that the 1994 race would not proceed, private businesses failed to offer to sponsor the race up to the amount of their net benefit — which suggests that they really did not expect to derive any benefit from it.

Would it be beneficial on balance for taxpayers to fund the losses of, say, the first three races, if Indy were likely to be profitable in the future? For Indy to be a worthwhile investment for taxpayers, taxes on future profits by businesses from Indy races not only have to cover the $60m spent by the government to date, but must also provide a better return on the investment than taxpayers could have provided for themselves. The Ernst and Young report claims that the 1994 race generated $1.5m-2m in State government revenues. If we make the heroic assumption that 1995-98 races do not add further losses to the taxpayers' $60m investment, it will take some 30-odd years to pay it back before taxpayers start to receive a return on their investment. For taxpayers to earn a market return of, say, 7 per cent on the $60m investment over the next four races, each race has to generate $18m annually in State revenues: over ten times the amount generated by the 1994 race.

By recently extending Indy for a further four years, the Queensland government appears they have rejected the 'dollar is dollar' weighting and adopted differential weighting in favour of business firms and race attendees and at the expense of taxpayers.

Taxpayers in general incurred the opportunity cost of forgone hospitals, teachers, police and other services of $10.5m in 1994. Either the government could have spent the money on such services or taxes could have been reduced to enable taxpayers to spend the money as they wished. Most probably, the majority of taxpayers would prefer more government services to Indy.

The government views its continued support of Indy as a politically rational decision. Whether voters agree is not so clear.

Reference

Ernst & Young Consulting (1994), *The Economic Impact of the 1994 Australian FAI IndyCar Grand Prix Report*, Brisbane.

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