

# ***Wellington V8 Car Race***

## **Lally Review of WCC Statement of Proposal**

**McDermott Miller  
Technical Rebuttal: Summary**

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#### **Introduction**

- (1) Wellington City Council has published a Statement of Proposal for a V8 Supercars Championship Series Street Race to take place in Wellington City in April 2006, and invited public submissions on whether this should happen or not.
- (2) McDermott Miller was commissioned by the Council to prepare a projection of the likely economic impacts of the Street Race if it proceeded as planned. McDermott Miller completed its report entitled *V8 Supercars Street Race Wellington 2006 Projected Economic Impacts* and the results of McDermott Miller's projections were incorporated in the Council's Statement of Proposal.
- (3) Mr Martin Lally, Associate Professor of the School of Economics and Finance was commissioned by Cr Jack Ruben to review the Council's Statement of Proposal.
- (4) Mr Lally's review published in two versions dated 4 April and 12 April respectively makes a number of selective criticisms about McDermott Miller's methodology for projecting economic impacts and some general conclusions about the results. He also comments on other aspects of the Council's Statement of Proposal.
- (5) In particular, Mr Lally contends the economic benefits of the V8 Street Race will be lower than projected by McDermott Miller, saying that the case for or against the Street Race is not proven on economic grounds.
- (6) When Cr Ruben referred Mr Lally's initial (19 March) comments to the Mayor, Councillors and Management, the CEO invited Cr Ruben (and of course his advisors) to meet McDermott Miller consultants to discuss in detail the basis of its economic impact projection for the V8 Supercar event. Cr Ruben declined and Mr Lally has made no attempt to contact McDermott Miller for explanations of its report.
- (7) The Council has asked McDermott Miller to provide a technical response to Mr Lally's paper.
- (8) This paper is a summary of McDermott Miller's technical response to Mr Lally's claims. A full and detailed rebuttal is provided separately in the form of annotated versions of Mr Lally's reviews.

## Economic Impact Projections – Local Versus National Perspectives

- (9) Mr Lally appears to be confused between a national economic cost-benefit analysis and a projection of economic impacts of the event on the local (city) economy.
- (10) An economic impact projection is intended to show likely economic impacts on the city economy that can be fairly attributed to the event.
- (11) It is not an economic cost-benefit analysis. Such an analysis would adopt a national perspective and project economic costs and benefits of the proposed V8 Street Race across the national economy, not simply compare the city's economic benefits with the Councils operating expenditure.
- (12) McDermott Miller has adopted a local perspective and projected likely economic impacts only on the Wellington City economy.
- (13) McDermott Miller has not carried out a national economic cost-benefit analysis, nor has it carried out a financial cost-benefit analysis of the Council's likely revenues and expenditures for the proposed V8 Street Race event. The former would be inappropriate; the latter has been undertaken by Council officers and forms the substance of its report to WCC (etc).

## Standard Methodology Used

- (14) McDermott Millers methodology for projecting Wellington City economic impacts follows widely used New Zealand and international precedents, examples of which include:
  - Victoria University's own report on its economic contribution to the Wellington Region (*Victoria University of Wellington: Economic Contribution to the Wellington Region* (October 1998). A report prepared for Victoria University of Wellington by New Zealand Institute of Economic Research and KPMG)
  - The Auckland V8 Street Race Assessment made in July 2004
  - Commercially confidential economic impact assessments of other race events in the V8 Championship Series in Australia.
- (15) This methodology has been explained and is well-known to Wellington City Council, having been used by McDermott Miller and other consultants in estimating and projecting economic benefits for the City and Region over a wide range of events and attractions.
- (16) McDermott Miller's methodology projects the external impacts of events on the city economy. These include:

- Net increase in visitation to Wellington City as a result of the V8 Street Race and net increase in spending within the City by these visitors.
  - Net increase in spending by businesses from outside Wellington on goods and services required from Wellington City businesses as a result of the V8 Street Race.
- (17) The New Zealand Institute of Economic Research, in its *NZIER UPDATE April 2005* reinforces McDermott Millers approach when it says “Although difficult to quantify and particular to each event, external effects are the primary consideration when deciding whether an event warrants public support”. The external effects of events which NZIER advises should be weighed include: “The net increase in visitor value brought to the locality which does not accrue to the promoter, such as increased business for local accommodation, restaurants, shops, taxi services”. This is the focus of McDermott Miller’s report.
- (18) Mr Lally does not follow this recognised methodological approach, preferring to construct some kind of mismatched cost benefit analysis.
- (19) McDermott Miller traces local economic impacts of events through three inter-linked measures:
- **Total New Spend**, which is the **initial direct additional spending** on goods and services purchased in Wellington City by **visitors** (out of town spectators and participants projected to attend the V8 Street Race) and **other new purchasers** (spending by out of town businesses) **that would not have occurred unless the V8 Street Race was on.**
  - **Direct Value Added**, which is the amount of total new spend remaining in the city after Wellington businesses have purchased inputs (eg wages, raw materials) to supply the goods and services initially purchased by visitors and new businesses. This process occurs over several rounds of spending as total new spend works its way through the city economy. Direct value added also changes depending upon the mix of business involved (eg hotels, cafes, retailers, buses and taxis, other attractions).
  - **Total Value Added**, which is the net gain to Wellington City gross city product after all rounds of spending caused by total new spend are completed.

## Economic Impact Analysis Procedure

- (20) Our economic analysis focuses on spending associated with *V8 Supercars Street Race* in Wellington City by spectators and other sources, and projects the effects this is likely to have on the Wellington City economy. This approach discounts spending by Wellington City sources (including Wellington City Council) on the basis that such spending is largely a transfer of spending from other Wellington City consumption.
- (21) The standard steps in the economic impact analysis are:
- **Assess the initial (direct) effect.** This is the initial increase in gross economic output and is equivalent, for the purposes of this analysis, to the initial injection of funds that would not otherwise have been spent in Wellington City. This is called “Total New Spend” in the Report.  
The initial (direct) effect is the spending by spectators, sponsors and participants from outside Wellington City at the *V8 Supercars Street Race* and elsewhere in Wellington City.
  - **Project the first round (indirect effect).** This is the immediate purchase of goods and services from the Wellington City economy by the sectors receiving the spending stimulus. In effect it is the difference between gross sales revenue by those businesses receiving total new spend and their direct cost of goods and services incurred in supplying them. This is called “direct value added” in the Report.
  - **The industrial support effect.** This is the second and subsequent indirect rounds of output increases as firms receiving the funds from the first round effects make purchases through the city economy.
  - **The consumption induced effect.** This is the increase in output associated with increased consumption of households whose income is enhanced by the initial and subsequent rounds of purchases.
- (22) The emphasis in our analysis has been to project the initial, direct effect (Total New Spend) as accurately as possible. This was done using visitor profiles (by their origin, purpose of visit to Wellington, duration of stay, demographic characteristics and spending) derived from McDermott Millers database of survey-based visitor data benchmarks together with information supplied by promoters and others.
- (23) The first round indirect effect (direct value added) was projected by applying a set of direct value coefficients to the segmented total new spend shown in table 2.5 of our report. These coefficients were developed by Dr G.V Butcher, consultant economist.
- (24) We projected the cumulative indirect and induced effects by applying estimated “Type II” multipliers for the Wellington City economy (also

developed by Dr Butcher). Ideally, in an economic expenditure analysis an input-output model of the regional economy is applied to estimate these effects, but this was not available to us and we would have had to build one. We decided that the objective of maximizing accuracy subject to available resources was best achieved by concentrating on producing an accurate projection of the direct effect and applying approximate multipliers to this. We consider this gives a more satisfactory result than applying a more sophisticated (but still approximate) economic model to doubtful spending data.

- (25) The combination of the first round indirect effect and industrial support and consumption induced effects is the total value added referred to in the Report.
- (26) This method supports our view that the emphasis of the economic impact analysis should be on accurate estimation of direct effects. We do not wish to follow the common course of applying multipliers to simply “puff up” the benefits of one option for receipt of Council resources and we therefore took as rigorous approach as possible in the measurement of direct effects, within the limits of resources and data quality.

### Quality Inputs and Conservative Assumptions

- (27) McDermott Millers application of standard methodology to project these measures is considerably assisted by utilising data about visitors demographic profiles, residential origin, purpose of visit, likely duration of stay and spending patterns derived from survey-based research it has carried out since 1998 of a wide range of sporting and cultural events that have taken place in Wellington City. This helps overcome the difficulty of quantification referred to earlier by NZIER in its *NZIER UPDATE* April 2005.
- (28) McDermott Miller does not fall into the trap NZIER warns against of attributing all visitors spend to an event. “The *net* gain in visitor value needs to adjust the aggregate effect for displacement of visitors who would have come anyway, and also for the cost of inputs used in providing those services”.
- (29) Instead, it attributes their spending according to their purpose of visit to Wellington. This means all spending by visitors who come to Wellington specifically to attend an event is attributed to that event. On the other hand spending by visitors who come to Wellington for other purposes, and only attend the event as an incidental part of their visit is not attributed to the event. McDermott Miller uses original research derived from survey based data of spectator motivations for attending events to estimate the attribution ratios in the V8 Street Race projection. This makes McDermott

Millers economic impact projection more conservative than most economic impact assessments of events done by others.

### **Accommodation Capacity**

- (30) In his revised review of April 12, Mr Lally questions the ability of Wellington's hospitality industry to accommodate the projected number of visitors staying in the City because of the event.
- (31) McDermott Miller specifically addressed these issues and took account of them in its report. It pointed out that capacity limits are likely to be reached. However the number of visitors projected to use commercial accommodation is consistent with estimated available supply in April 2006, which includes projected additions in capacity over the January 2005-April 2005 period known to Positively Wellington Tourism.
- (32) Mr Lally appears to not understand how the accommodation industry operates on weekends of high demand. He is mistaken in assuming that accommodation will already be 70% taken, so that only 30% percent will be available to visitors attending the V8 Supercar event. In reality, most V8 race visitors will book very early and pre-empt other people. If events promoters thought in terms such as only 30% of accommodation capacity is available to visitors to their event (as Mr Lally would have them do) then there would be no major events such as the Lions tour, the International Sevens, or even the Arts Festival.
- (33) The majority of potential visitors (for other purposes), knowing the event is on, will schedule their visit to Wellington for another weekend instead. Their spend is not lost permanently to Wellington, simply transferred to another time.
- (34) Weekend occupancy on non-event weekends is very much lower than during weekdays. Event weekends give hotels and motels the double benefit of charging at full rack rates and achieving 100% capacity utilisation, whereas on normal weekends they discount very heavily in order to achieve partial occupancy.
- (35) The City's accommodation capacity, to a degree, is elastic. We know from surveys of visitors to other events that the great majority of visitors travel as couples or in larger groups of friends/family and they share their accommodation.
- (36) Statistics New Zealands Accommodation Survey is not comprehensive in its measure of capacity; there is additional commercial accommodation that it does not count, and it doesn't reflect likely capacity expansion over the next few years.

- (37) The supply of accommodation units in Wellington is increasing steadily, and the V8 Supercar race will provide further incentive for expansion.
- (38) Wellington City restaurants, cafes and bars have already coped with, and benefited from, larger audiences than that projected for the V8 Supercars Street Race, and we see no reason why the sector shouldn't continue to handle such large audiences.
- (39) Based on his false estimate of accommodation, Mr Lally claims that McDermott Miller's estimate of visitor spending is too high (fewer hotel beds, less visitors, means less spending on accommodation, eating out and so on). This is not correct. The accommodation spending coefficients used in our analysis are based on evidence from our surveys of visitors to past events, not on current hotel rate cards. High occupancy rates in recent years have allowed providers to increase room rates, so our coefficients are conservative (see Table 2.4 of our report); this means spend on accommodation is likely to be higher than we have projected.

### **Main Economic Measures Used**

- (40) McDermott Miller has reported Total New Spend and Total Value Added as the principal outcomes of its projection (See Executive Summary Section II, and Section 2.3 highlighted figures on pages 9 and 10 respectively of its Report).
- (41) Total New Spend is often used to demonstrate the external revenue benefits of an event to a local economy, because they are the direct tangible impacts initially felt by businesses and people in the economy as a result of the event. Total New Spend also illustrates where this spending will take place, and can therefore be a useful guide to allocating any rates imposts. Finally, total new spend, as the first essential step in projecting economic impacts, is always estimated in any economic impact assessment, whereas the other measures may not be. It is, therefore, often used to compare impacts of different events to aid decision-making about support to be provided to events from limited budgets.
- (42) Wellington City Council has consistently used projections of Total New Spend for comparison purposes for these reasons. The Council is well aware of the significance of Total Value Added.
- (43) Total Value Added is the core result of an economic impact projection because it reflects the events contribution to the city's economic welfare. It can be expressed in terms of dollars added to the city's "gross city product" or new jobs likely to be created by the event.



- (44) Direct Value Added is not emphasised because it is an intermediate step between total new spend and total value added, rather than a key measure in itself.
- (45) The Council has used Total New Spend as a means to compare the benefits of different events for the reasons outlined above. However, if Total Value Added to the city economy is used as a measure to rank events the results would be similar, as the following table shows:

#### Total New Spend and Value Added of Wellington City Events

EVENT	Audience	Total New Spend \$'M	Total Value Added \$'M
Tattoo	78000	17.0	10.8
NZ Festival	42000	22.7	12.7
Telecom 2GO International Sevens	37300	8.6	5.7
Projected V8 Supercars	41000	22.9	15.7

Sources: McDermott Miller, Survey based results, in 2000, 2001

#### Weak Criticism – Sound Results

- (46) Mr Lally debates the most appropriate measure for assessing benefits. He accepts McDermott Miller's definition of Total New Spend and Direct Value Added, but he **completely ignores Total Value Added (the prime measure of local economic benefit)**.
- (47) Mr Lally makes no challenge to McDermott Miller's projection of total new Spend (\$22.9 million), apart from raising questions that McDermott Miller had already addressed about Wellington City's accommodation and restaurant capacity.
- (48) He does challenge McDermott Millers projection of Direct Value Added, simply by asserting it to be "too high" and jumps to the conclusion the project "should be rejected" on the basis of hypothetical examples (Section 3 of his review last paragraph, last sentence).
- (49) He offers no data, or projection of his own to support his partial analysis.
- (50) Although Mr Lally's examples are useful in explaining simplified basic economic concepts to students, they are hypothetical, and do not reflect the nature of the Wellington City economy, or the methodology applied to project economic impacts of the V8 Street Race.
- (51) To suggest that the relationships between revenue received and input costs of all Wellington businesses are correctly represented by the hypothetical examples he puts forward is quite misleading.

- (52) Mr Lally's partial methodological approach and misleading representation of the nature of the Wellington economy, together with his selective use of McDermott Miller's figures do not, in our view, support his conclusion that the benefits to the city economy "are substantially less than \$8.6 million."

### **National and Local Economic Benefits**

- (53) Mr Lally concludes his review with an extraordinary plea for a collective national economic cost-benefit approach by all local Councils to evaluation of events such as the V8 Street Race. This returns us to the point made earlier. A national economic cost-benefit analysis may well be appropriate for Central Government assessment of events it might support (egg Americas Cup), but it is inappropriate for the Wellington City Council which does not have national responsibilities.
- (54) As it happens, the proposed V8 Street Race is intended to be a national iconic event. The controlling body, AVESCO, has made it clear that only one V8 Super cars event will be held in New Zealand as part of the V8 World Championship Series. This means there is likely to be national benefit to New Zealand (through international visitors coming to Wellington to attend the Street Race), as well as local benefit (through both national and international visitors coming to Wellington to attend the event). This presents an opportunity for Wellington City Council to approach the Minister of Tourism for national funds to help support establishment of the V8 Car Race in Wellington, New Zealand.

### **Our Opinion**

- (55) In our view, Mr Lally has raised points, or emphasised points already raised by McDermott Miller, that make no substantive difference to the projection of economic benefits of the proposed V8 Street Race, based on the data available at the time of projection.
- (56) Whether economic benefits for Wellington City are estimated in terms of total new spend, or total value added, the likely performance of the V8 Street Race ranks highly compared to the other iconic Wellington City events of the *Tattoo*, *New Zealand Festival*, and *International Sevens*.

[Ends]

**McDermott Miller Limited**

**15 April 2005**