# Breaking a nasty habit?

## Gaming policy and politics in the state of Victoria

**A REPORT COMMISSIONED BY THE INTERCHURCH GAMBLING TASKFORCE**

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24 April 2002

# PREFACE

This report was commissioned by the Interchurch Gambling Taskforce in November 2001. It became clear to us that the Victorian government was so financially dependent on gambling to balance the state budget that it was not able to attack the very serious social issue that people with gambling problems now represent in our society, without falling victim to the equally serious charge of being financially irresponsible. The opposition are equally captive to the gambling dollar, and only independents with their limited political clout recognise the dilemma.

This report traces what the true dependence of the Victorian government is on gambling as a source of revenue. It looks at how dependent that revenue is on a decreasing number of gamblers losing increasing amounts that today represent 20% of the state's income.

Finally, it looks at a way to reduce Victoria's income from people with gambling problems by $400m and yet remain fiscally responsible. It is the only way we can also be an ethically and socially responsible community.

The Interchurch Gambling Taskforce was established in 1994 by the Heads of Churches in Victoria. Its members are taken from the Roman Catholic, Anglican, Uniting, Baptist and Salvation Army churches. We have sought to provide governments of both political persuasions with an alternative to the grab for the quick gambling dollar. We campaigned for a state cap on poker machines, regional caps, elimination of poker machine venues in shopping strips, and the establishment of effective anti-gambling advertising and programs to help problem gamblers. We know we must keep up the pressure because so many people are now victims of this pursuit of political and corporate opportunism.

**John Dalziel**
**Chair of the Interchurch Gambling Taskforce**

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## Executive Summary

Last year, poker machine losses surged past the $2.3b mark, up almost 10% – or $141m – on the previous year. This growth occurred despite the industry introducing its own Responsible Code of Practice in 1997. It has also occurred despite the Bracks Labor government introducing a range of new socially responsible gaming policies over the last two and a half years.

Why do poker machine losses keep rising? In answering this question, we locate the problem in the context of the 'system of gaming provision' approach. This approach looks at the various actors involved in the provision and use of poker machines, and how and why they combine to ensure that turnover growth and, by implication, growth in losses are the norm.

We show that the state government is one of the key players, and that it plays a contradictory role. It has a social policy interest in limiting the extent of gaming losses associated with hardship, but it also has an economic interest in seeing gaming expenditure continue to grow. Taxes on poker machines account for almost two-thirds of state gambling taxes, and the latter now account for close to one-fifth of state taxation. This leaves the state in an awkward position. If it puts social policy considerations to the fore, it will necessarily have to find other sources of revenue to make up the difference. If it puts financial considerations to the fore, it might well be jeopardising the wellbeing of a significant number of Victorians.

This raises the question of the proportion of the gambling population that fits into the broad 'problem behaviour' range. It also raises the question of whether this means that the consumers of poker machines are amenable to growth in turnover and losses in a way that is against their interests. This is the second key question addressed by our research: to what extent do gaming machines pose a danger to consumer welfare?

The third question addressed by our report follows from the second: what, if anything, needs to be done to bring our gambling expenditures under control? If it is necessary to do so, what might be done to enable the state to break free of the contradictory position it now finds itself in, so that it can elevate social policy concerns above all others?

## Part One: The system of gaming provision

Playing the pokies involves a person outlaying money so they can use a machine, which is pre-programmed to ensure that over a given period of time the machine wins. The longer a person plays, the greater their chance of a loss. The machines in use have become progressively more complex over the last decade, enabling multiple types of play at one push of a button. The Australasian Gaming Machine Manufacturers Association points out that the machines are so complex that information about odds on winning payouts would be pointless.

How much a player loses is a product of luck; skill plays no part. The maximum average loss is defined in legislation, currently 13% of the total money spent. Machine play is extremely volatile, and the extent of losses will vary depending on the particular games played and most importantly the time period over which play takes place.

Australian poker machine players face a narrower, higher-risk range of options than their counterparts in other countries, who have a bigger band of low risk machines from which to choose. At 20.4%, Australia has the second highest market share of high intensity machines after the United States.

## The key players

The gaming machine industry in Victoria has five key players:

- The state government;
- Gaming machine operators;
- Owners and operators of gaming machine venues;
- The gamblers; and
- Gaming machine manufacturers and suppliers,

Of these, the latter are of only a minor interest to this study and will not be examined any further in this report.

### The state government

The amount of money that can be pumped through gaming machines each year ($24b in Victoria alone last year) leaves the industry open to the ever-present threat of corruption, one of the main reasons for extensive levels of government regulation. This has rendered the state government the single most important industry player, with legislative power to determine whether, to what extent and by whom gaming machines are operated and used.

The state regulates the way that revenues from gaming machines are used. Currently, 87% of player expenditures is to be returned as winnings. Legislation also specifies how this ‘net cash balance’, or player bets less prizes, is split between the industry participants and how much goes in tax. Hotels account for approximately two-thirds of state gaming machine tax revenue.

Over the last 10 years, the state has become increasingly dependent on gambling taxes as a source of revenue. Gambling taxes have more than tripled between 1991/2 and 2001/2. Almost all of this growth is accounted for by EGM (electronic gaming machine) taxes, which have grown from zero to over $1b by 2000/1. EGM taxes now account for 62% of state gambling taxes. In 2001/2 EGM taxes are projected to increase by a further 13.9%, courtesy of continued growth in losses in conjunction with the tripling of the gaming machine levy to $1,533 per machine.

Over the last five years the state has introduced a number of regulations designed to make the industry more socially responsible. Most of the measures are modest, allowing the industry long lead times to adjust. For example, the much-heralded regional cap legislation was announced a year before it was put into effect, and it is to be progressively implemented over a four year time frame that only began in February 2002.

### The gaming machine operators

In 1992 TABCORP and Tattersall's were granted exclusive licences to operate gaming machines for 20 years. The Government legislated to allow the number of poker machines operated by these two companies to increase from zero to 27,500 in the space of 7 short years (a further 2,500 are operated by TABCORP for Crown).

The limited amount of financial data suggest that poker machines have become a very lucrative source of revenue for the company over the last decade. As a private company, Tattersall's financial results are not disaggregated by division, nor by state, and it did not publish financial results back in the early 1990s, so it is not possible to be precise about the impact of gaming machines in Victoria on the company's profitability. Its financial statements show that in 2000/1 gaming machines accounted for $1.276b, or three-quarters of the company's gross gambling revenues (turnover less prizes paid)

Gross company profits before income tax for 2000/1 amounted to $108m, and $68m after income tax. Given that EGMs accounted for 75% of company net revenues, it would seem safe to assume that around three-quarters of the company's profits, or $81m before income tax and $51m after income tax, come from EGMs.

TABCORP has increased its profits each year of operation since it was privatised in 1994. In 1997, profit after tax was $100.8 million, an increase of 15.6% on the preceding year, resulting in an increased dividend to shareholders. By 2000 profit after tax had continued to increase at double digit rates, rising to $174.8 million. In 200/01 TABCORP's profit after tax grew by a further 16.5%. The Gaming division is the company's principal source of earnings, accounting for almost 60% in the last financial year.

TABCORP's financial success is reflected in the payments made to the company's directors and senior executives. Per person, the non-executive directors enjoyed a real pay increase of 278% between 1994/5 and 2000/1, while the executives experienced a real increase of over 600%.

### The venue operators

TABCORP and Tattersall's operate 27,400 machines in 544 venues, run by 470 separately licensed companies. The venue operator industry is fragmented, but with high concentrations at the top. One company (AHL) has control of almost 3,300 machines in hotels, or 12% of the industry total. One individual (Bruce Mathieson) has financial interests in 6% of Victoria's gaming machines in hotels and clubs. The control is spread across 22 licences equally split between clubs and hotels. Many of the clubs in which Mathieson has an interest are associated with football clubs. Together, AHL and Mathieson operate 18% of gaming machines in Victoria.

Gaming machines are required to be split 50:50 between hotels and clubs. However, it is increasingly difficult to distinguish between the two sectors, with a number of clubs using hotel operators to run their gaming venues.

#### *Gaming, competition and profitability*

Within the rules imposed by the state, the two gaming machine operators have only a limited number of ways to maximise profits. Their costs are largely fixed in that the payments they make to venues is legislated as a proportion of net revenue. The duopolists are also heavily constrained in how they chase revenues. The only form of price competition they can choose is to opt for a higher payout rate so that average losses fall. But as they are duopolists they have no economic reason to engage in price competition of this type. Rather, they can be expected to act as a pair rather than in competition, which is what they do in reality with both keeping losses at 10%.

The focus of competition then falls on non-price related activities. The goal is to keep turnover per machine maximised each hour of the day that the machines are available for use. Foremost here is the nature, type and in particular the location of venues, as well as marketing schemes tailored to particular demographic groups. It is particularly important to focus marketing in a way that ensures high levels of patronage by different demographic groups at particular points in the day. Seniors are attractive, for example, because they offer one way of ensuring that the machines are well-patronised during working hours.

The growing losses experienced by a shrinking proportion of Victorians has its mirror image in the rapidly improving financial fortunes of the duopoly. Marsden Jacobs argue that the operators enjoy 'amazing' excess profits from their gaming activities, valued at between

$400m and $500m per annum. The state government's review of business taxes agreed that the operators enjoy large surplus profits, but estimated these to be closer to $150m per annum.

What about the venue operators? The key to success of venues is keeping the duopolists on-side. As we have seen, their interest is with maximising returns per machine, and they have been happy to shift machines around venues in order to meet this objective. It is to this tune that the venue operators must dance, and must do all that they can to keep their venues attractive, through meals, entertainment, and the regular upgrading of facilities.

### The punters

Less than one third of adult Victorians use poker machines each year, and that less than a quarter play machines outside of the casino. Of those who play, there is a hard core group of approximately 35% who do so regularly (at least monthly). This means that only about 10% of adult Victorians are regular players, and there are even fewer regular players at venues outside of the casino. The Productivity Commission estimates that of those who play weekly, 15%-27% are problem gamblers.

Local government areas with the lowest socio-economic indicators have the highest densities of gaming machines and losses per adult. Household expenditure survey data confirms that gaming expenditure accounts for a disproportionate share of the household income of the bottom 60% of households, and is least significant amongst the richest 20%.

Poker machines appear not to figure as a major motive for most visits to venues in the first place. The main reasons for playing as identified by the VCGA's survey of consumer attitudes is 'I may get lucky' (66%), followed by 'the thrill of winning' (64%) and 'to make a quick buck' (45%). Yet we know that the odds are stacked heavily against an individual player, and that the longer people play the less likely this will be the case.

When gamblers have been probed about their reasons for playing the pokies, a significant minority respond with answers that suggest a fundamental misconception about gaming machines, or which suggest they are not able to control their behaviour, or act in a way that causes concern either to themselves, friends or family. For example, only 41% of EGM players admit to limiting their gambling to what they can afford.

To what extent is this indicative of a bigger problem? The available research suggests that between 2% and 5% of adults are at risk from gambling, scoring more than 5 according to SOGS. These are heavy gamblers account for a very high proportion of total gambling losses. The Productivity Commission estimates they account for more than 40%. But we are also interested in those who do not always gamble sensibly, responsibly or rationally.

The VCGA's aggregate data for all those who have gambled in the last 6 months shows that more than 20% fit into this category.

Most Victorians do not rank playing the pokies very highly as a leisure or recreational activity. On a scale of 1 to 10, playing EGMs gets only a 2.2 rating, well below relaxing at home (7.7), going out for dinner (7.6), going to the movies (6.2), and playing sport (5.9). Even amongst gamblers, EGMs score only 2.4. Only regular EGM players rank pokies at 5, but even then they prefer going out to dinner (7.6), relaxing at home (7.5), going to the movies (5.5) and playing sport (5.8) .

Sharp and Romaniuk report that only 35% of the 1,000 Victorians they surveyed agreed (10.7% strongly) with the statement, 'I derive entertainment and pleasure from the money I spend on gambling'. On the other hand, 57% disagreed with this view, and 39% felt this way strongly. The KPMG survey of attitudes toward gambling reports similar findings with most pokie players surveyed stating they were 'relatively dissatisfied with their experiences'. Similarly, in the 2000 VCGA survey of community attitudes toward gaming, approximately 40% of players claim not to get any satisfaction at all from playing the pokies. When asked why they continue to play, around one third (34%) say because it is a social activity, while 20% say it offers a chance to win easy money. 14% say they do so because of boredom.

What does all this data mean? A significant proportion of poker machine expenditure in Victoria is based on player's inability to manage their behaviour because of irrational perceptions about luck, difficulties limiting levels of expenditure to within their budget, or other troubling motivations, which manifest themselves in a tendency toward over-spending and excessive player losses. We can also say that this varies geographically. In regional centers like Ballarat, the problem appears to be significantly worse. This significant minority – conservatively estimated at one fifth of all regular players – fit into this category, and they account for a disproportionate share of player losses. Extrapolating from the Productivity Commission estimate that problem gamblers account for over 40% of losses, it can be safely concluded that of the $2.4b that was lost on poker machines last year, between $1b and $1.4 billion is likely to be accounted for by this group of players. A disproportionate share of these people are drawn from lower income groups.

## Part Two: Breaking the habit

The state must, as a matter of priority, wean itself off gaming machine taxes so that it can give social policy considerations the attention they deserve. This will not be an easy task. Targets and a firm time line will need to be set. There are some useful milestones already in place that might help in this regard. In 2007/8 it is estimated that the revenue from the GST will become revenue-positive for the state. At this point revenues will begin to pour in, and the state will be increasingly better off than had it remained under the previous regime. These funds could be used to help reduce the state's reliance on gaming taxes. The other key milestone is 2012, which is when the existing licence arrangements for the duopoly expire.

But what target should the state aim for? A useful benchmark is provided by the per capita gaming tax figures for all states. Victoria's overall per capita taxes are slightly higher than the all-state average, but significantly less than those of New South Wales. One tax in particular accounted for almost all of Victoria's above average tax levels: gambling taxes, which in 2000/1 were 39% higher than those of all the states combined, and 31% higher than those of New South Wales. Victoria's above average gambling tax take is equivalent to approximately $400m per annum.

This provides a very useful target. As part of a broader reform package, Victoria should aim by 2007/8 to reduce its per capita gambling taxes to the all state average. This requires reductions in gaming taxation of approximately $400m (in constant 2001/2 prices). This is a substantial sum, so how might it be financed? Any number of different combinations are possible. One scenario is outlined in Table below uses a combination of measures that kick in at different points in time over the next five years. The useful starting place would be for the state to commit $100m of the unexpectedly large budget surplus to be announced in the forthcoming budget. The government was budgeting for a surplus of $510m. It will come in closer to $1b.

To this might be added an increase in non-gambling taxes, initially set at 1.5% rising to 2% by 2006/7. This should raise an additional $150m. Declining gaming turnover implies falling revenues for the Community Support Fund. We recommend that this be allowed to happen, thereby funding an additional $5m and eventually $25m by 2007/8. These three measures should generate approximately $325m of the $400m needed to finance the gaming tax cut. The balance could come from the Commonwealth, which might well take a leadership role and in the spirit of partnership and the common good agree to pay Victoria (and any other state that might follow its lead) $1 for every $4 raised through gambling tax reductions that are linked to a responsible gambling policy. The Commonwealth contribution could peak in 2007/8, and be scheduled to fall to zero as the GST revenue becomes increasingly revenue positive from that year onward.

**Table 1: Funding a gaming tax cut ($m)**

| | 2002/3 | 2003/4 | 2004/5 | 2006/7 | 2007/8 |
|---|---|---|---|---|---|
| Portion of 2001/2 unanticipated surplus | $100 | $100 | $100 | $100 | $100 |
| GST revenue contribution | | | | | $50 |
| Increase in non-gambling taxes | | | $100 | $125 | $130 |
| Decline in CSF takings | $5 | $10 | $20 | $30 | $40 |
| Sub total | $105 | $110 | $220 | $255 | $320 |
| Commonwealth contribution | $26 | $28 | $55 | $64 | $80 |
| TOTAL | $131 | $138 | $275 | $319 | $400 |

(1) Would require an increase of 1.4% in non gambling taxes in 2004/5 and a further 0.4% in the following year.
(2) Estimated effect of falling turnover on Community Support Fund Levy.
(3) Assumes that the Commonwealth agrees to a $1 for every $4 raised by the state.

Tax cuts, however, are only part of the solution and only part of a broader reform package. They re a pre-condition for a reform package.

## Cutting the industry down to size

There are some urgent industry reforms needed, independent of any decision to wind back gaming turnover. Foremost is a requirement that Tatersalls be required to publish an annual report containing financial details of similar quality and quantity to that of TABCORP, including the names of the beneficiaries of the trust as Tattersall's
financial success and very existence is a product of government legislation. At the very least, its legislated duopoly status as a gaming operator should be sufficient justification for a requirement of this type.

Second, it is imperative that the state government improves the transparency of its gambling tax revenue data as published in the budget papers and annual financial report. The total amount of gaming and gambling revenue, with and without the GST contribution should be fully disclosed in the interests of public accountability. Also there is no justification for the government continuing to publish gambling tax data that do not provide a clear breakdown by venue type (Hotels and Clubs) and source (EGM venues and EGMs at the Casino. Currenlty, there is no publicly available information showing the contribution to the budget of taxes on EGMs at the casino.

A core part of a gaming reform package must be a commitment to reduce gaming turnover, and break the strong economic incentives for the duopoly to increase intensity of play and machine use. We recommend that the government aim for a $400m reduction in turnover to be put into effect over the next 5 years, rolled out roughly in proportion to the new revenue measures proposed. The beauty of a 40% reduction is that it would match the proposed reduction in tax revenues. From 2007/8 onward, turnover could be allowed to increase at a rate no greater than inflation.

For the most part, the industry could be left to decide how best to achieve this reduction. There are, however, a number of reforms that must be considered compulsory. Included here are:

- Legislation requiring the machine population to better reflect the international distribution of machine types, with a view to increasing the proportion that are low intensity at the expense of the existing high intensity ones.
- The elimination of 24 hour gaming in all venues.
- The imposition of a cap on maximum continuous hours of operation to 16 hours per day, with a break of 8 hours between each 16 hour period of continuous play.
- Shutting down all gaming venues located in strip shopping and shopping centres.
- Ensuring that no gaming machines are located in areas where people gather for daily activity other than entertainment, such as travel (train and bus stations) or education.

The turnover reduction could involve any number of different measures, such as:

- Machines automatically turn off for 10 minutes after 60 minutes of continuous play.
- Ban all note-taker machines.
- Reduce maximum bet for stand-alone machines to $1.
- Require a minimum wheel spin-time of 3.5 seconds and a minimum passage of time of 1.5 seconds in idle mode, during which at least one standard data block must be transmitted (slow down rate of play by 43% in New South Wales).
- Ban play-through (the facility to cut short the pay cycle by simply playing the next game) and auto-gamble.
- Redesign of button function to prevent continuous play without further button press.
- Limit the number of credits per line to four.
- Set maximum prize limits for stand-alone machines to $500.
- Only allow one double-up attempt of a single play.
- Limit accumulated credits with a win.
- Limit accumulation of credits to no more than $500.
- Eliminate free spins.
- Wins of $250 or more automatically paid out in cheque.
- Restrict loss per hour to $50.
- Remove all ATMs and EFTPOS facilities.
- Ban all advertising and incentives.
- All new machines be required to demonstrate their effect on problem gamblers.

No matter how compelling the evidence for policy reform might be, governments inevitably are swayed by public opinion. The significant reforms proposed here will undoubtedly be controversial. But they will also be popular.

### Public opinion and gaming policy reform

Over the last five years, public opinion on gaming has shifted decisively, in much the same way as have poker machine participation rates – indeed, the two trends are likely to be related. According to the VCGA's research, 84% of Victorians believe that gambling related problems have worsened in recent years and 83% believe that gambling is now a serious social problem. 78% believe that gambling is too widely accessible in Victoria, and 73% believe that the number of poker machines should be reduced. These findings are confirmed by other recent research. In their study of 1,000 Victorians, Sharp and Romaniuk found 'an overall high level of disagreement with the statement 'increased gambling activity is good for the economy' (61%). They also found 64% disagreed with the statement 'there are sufficient controls and restrictions on the gambling industry' while 78%. KPMG also found widespread hostility to current poker machine policy settings, with over 90% of their respondents believing that gambling does more harm than good, and only 10% felt that poker machines had been good for their local area .NCS Pearson found overwhelming support for measures designed to lessen intensity of play, with for example ,68% of 400 respondents agreed that poker machines should be banned from accepting notes ,and 71% felt that poker machine players should be forced to take regular breaks from gambling.

No matter how compelling the evidence for policy reform might be, governments inevitably are swayed by public opinion. The significant reforms proposed here will undoubtedly be controversial. But they will also be popular.

## Part One: The system of gaming provision

### Introduction

Last year, almost $24b was spent on poker machines in Victoria, up 10% on the year before; poker machine losses surged past the $2.3b mark, also up almost 10% on the year before (VCGA, www.ogr.gov.au/domino/web_notes/ogr/ogrsite.nsf/pages/research, 2002). This growth occurred despite the industry introducing its own Responsible Code of Practice in 1997. It has also occurred despite the Bracks Labor government introducing a range of new socially responsible gaming policies over the last two and a half years, including legislation requiring clocks on machines and natural light in gaming venues, restrictions on 24 hour operations, restrictions on advertising and the imposition of regional caps to be put into effect over the next four years.

The government argues that these measures have had some success, for the rate of growth of losses per machine has slowed from 17% six years ago to 9% last year. Nevertheless, at 9% – or the equivalent of $141m – the growth in losses is far in excess of inflation (3% excluding the GST), and real gaming losses are continuing to mount rapidly. The question is: why is this so? This is one of three questions addressed by this report. In answering it we locate the problem in a broader context which we call the 'system of gaming provision' approach. Our interest is with the various actors involved in the provision and use of poker machines, and how and why they combine to ensure that turnover growth and, by implication, growth in losses are the norm.

We show that the state government is one of the key players in the system of provision, and that it plays a contradictory role. It has a social policy interest in limiting the extent of gaming losses to the extent that this is associated with hardship, but it also has an economic interest in seeing gaming expenditure continue to grow. Taxes on poker machines account for almost two-thirds of state gambling taxes, and the latter now account for close to one-fifth of state taxation (Victorian Government, 2001). This leaves the state in an awkward position. If it puts social policy considerations to the fore, it will necessarily have to find other sources of revenue to make up the difference. If it puts financial considerations to the fore, it might well be jeopardising the wellbeing of a significant number of Victorians.

Whether and to what degree the state faces this dilemma depends on the extent to which poker machines pose a danger to consumers. Economists like those from ACIL (1999, 2001) argue that consumers are rational creatures who are the best judges of their own welfare. As such, the growth in gaming is a product of rational consumer choice, and if people choose to spend increasing proportions of their income on poker machines, this is because it makes them happier than spending their money on other things.

This rational view of poker machine consumers has been challenged by a variety of studies. It is widely accepted that around 1% of adults and between 2% to 5% of players are 'problem gamblers', and there are greater numbers who also exhibit troubling behaviours that are broadly reflective of non-rational decision-making (Productivity Commission, 1999, Volume 1, Table 6.15). This raises the question of the proportion of the gambling population that fit into the broad 'problem behaviour' range. It also raises the question of whether this means that the consumers of poker machines are amenable to growth in turnover and losses in a way that is against their interests. This is the second key question addressed by our research: to what extent do gaming machines pose a danger to consumer welfare?

The third question addressed by our report follows from the second: what, if anything, needs to be done to bring our gambling expenditures under control? If it is necessary to do so, what might be done to enable the state to break free of the contradictory position it now finds itself in, so that it can elevate social policy concerns above all others?

We begin by looking at the system of gaming provision.

## Playing the pokies: what it is that's being bought and sold

Playing the pokies involves an outlay of money by a person so that they can use a machine which is pre-programmed to ensure that over a given period of time the machine wins, and the longer a person plays the greater their chance of a loss. There are a wide variety of games of differing levels of complexity and with differing chances of winning various amounts with different coinage required for a single spin (Productivity Commission, 1999, Attachment F; Australasian Gaming Machine Manufacturers Association, 1999). The machines in use have become progressively more complex over the last decade, enabling multiple types of play at one push of a button:

> The complex payoff distributions in gaming machines mean that the returns that gamblers make from games vary significantly in the short run. The corollary to this is that the return rates realised by players will vary considerably from playing session to session…(T)his implies that players will not be able to readily determine the 'price' of single machine (play), except after many trials (Productivity Commission, 1999, Appendix U: U6).

Almost no information is published on the machines explaining how they should be played, or explaining what the odds of winning are. The Australasian Gaming Machine Manufacturers Association points out that these machines have become so complex with so many types of options that information like this would be pointless:

> AGMMA is not in favour of the provision of (payout) information because, given the complexity of games and machines, the range of outcomes is very broad and the information to be complete would be voluminous and complex. It would also be very difficult to understand (1999, p. 19)

How much a player loses is a product of luck; skill plays no part. The maximum average loss is defined in legislation, currently set at 13% of the total money spent. Machine play is extremely volatile, and the extent of losses will vary depending on the particular games played and most importantly the time period over which play takes place:

> A once a week hour long session of gambling will produce significant differences in returns from week to week. It would not be unusual to win $100 one week and lose $100 the next. In the game simulated by the Commission around one in five are net winners in any given session. Over a month, however, returns are much less volatile, with significantly reduced probabilities of being a winner overall. Now only 7% are net winners in any given month. And over the year none won in 1,000 simulations undertaken. The average recorded a loss of $1,365 and the least loss was $484. Over a lifetime of regular playing (30 years), the probability of winning overall…is so remote that it might as well be regarded as impossible (Productivity Commission, 1999, Appendix U: U9-U10).

Poker machines can be played alone, but the activity takes place in a social venue. The recent review of gambling in Britain has recommended that reforms should seek to disentangle gambling from other social activities such as entertainment in private clubs, so as to ensure that consumers are clear about the purposes of their visits (Gambling Review Report, 2001). With this in mind, the emphasis is to be on the development of a larger casino industry and tighter regulation of gambling and gaming outside of these venues.

In Victoria we have followed a different path, and gaming is combined with a broad range of social events and dining options, often at gambling-subsidised prices. Venues have also been allowed to open in shopping centres. Pokies Plus, for example, is located at Highpoint Shopping Centre, wedged between Toys R Us and the Hoyts Cinema Complex. Patrons are promised 'complimentary cappuccinos, glass of wine, meal bonus, Hoyts Movie Ticket offers, and much more' (http://www.pokiesplus.com.au/gaming.asp visited on 8 April, 2002).

Australian poker machine players face a narrower, higher-risk range of options than their counterparts in other countries, who have a bigger band of low risk machines from which to choose. At 20.4%, Australia has the second highest market share of high intensity machines after the United States (Productivity Commission 1999, N21). All the gaming machines in Australia are high intensity machines with maximum spending per game and high speeds of play. Not only are the machines high intensity, they also have other features associated with high risk of problem gambling, such as a high number of lines and high accessibility (Productivity Commission, 1999, N23).

## The key players

The gaming machine industry in Victoria has five key players:

- The state government;
- Gaming machine operators;
- Owners and operators of gaming machine venues;
- The gamblers; and
- Gaming machine manufacturers and suppliers,

Of these, the latter are of only a minor interest to this study and will not be examined any further in this report.

### The state government

The amount of money that can be pumped through gaming machines each year ($24b in Victoria alone last year) leaves the industry open to the ever-present threat of corruption, which is one of the main reasons for the imposition of extensive levels of government regulation. This has rendered the state government the single most important industry player with the legislative power to determine whether, to what extent and by whom gaming machines are operated and used. It also specifies how much is to be returned to punters, how much of the surplus is returned to operators and venues, and how much is taken as tax. The state also regulates the conditions, locations and opening hours of venues, the regional distribution of gaming machines, and is about to legislate to regulate which currency can be used, the way that winnings are paid, and the availability of electronic banking in venues. In all these ways, the state ensures that the gaming industry is more than any other a creature of government regulation, for it defines almost every conceivable aspect of gaming. As Marsden Jacobs put it::

> (T)he state is the monopolist, and can segment and discriminate within the potential gambling market in order to maximise tax revenue and other economic benefits and to minimise adverse social consequences (2000, p. 21).

In return for the right to operate gaming machines, the state imposes a licence fee on gaming machine operators. TABCORP paid a once-off $520m price (Auditor-General, 1998) for its eighteen year licence, while Tattersall's pays an annual fee equivalent to 7% of its net revenues. TABCORP's licence fee was retrospectively determined out of the proceeds of the privatisation in 1994. Tattersall's did not start paying a licence fee until 1995/6. As the Auditor-General (1998) describes:

> Specifically, in 1991, the Government granted a licence to Tattersall's to operate gaming machines in licensed clubs and hotels in Victoria for a period of 20 years, from April 1992. At the same time, a licence was issued to the TAB (TABCORP's predecessor) for a period of 18 years. These licences were issued at no cost to either operator. However, as part of the privatisation of the TAB in 1994, the proceeds received from the sale implicitly incorporated a share of the future profits to be made from its gaming activities, upon which the licence issued to the TAB could be valued… As a result of the sale of the TAB, this

> action placed the 2 industry gaming operators in different competitive positions for their exclusive access to the same market. Consequently, the Treasurer of Victoria directed that negotiations should be undertaken with Tattersall's, with a view to obtaining a licence payment with similar conditions to TABCORP.

Effectively, the duopolists were granted licences to operate gaming machines as a gift, which lasted for three years in the case of TABCORP and five years in the case of Tattersall's.

The state heavily regulates the way that revenues from gaming machines are used. Currently, 87% of player expenditures is to be returned as winnings. In addition, legislation also specifies how this 'net cash balance', or player bets less prizes, is split between the industry participants. In the case of clubs, one-third goes to the gaming machines operators, one third-goes to the venue operators and the balance goes to the state (almost 10% via the Commonwealth in the form of the GST imposed on gaming, which is returned to the state as a federal grant). In the case of hotels, the split is similar except that the hotel operators receive 25%, and 8.3% is paid as a tax into the Community Support Fund (see Table 1).

**Table 1: Distribution of Net Cash Balance**

| **Distribution of net cash balance** | **Clubs** | | **Hotels** | |
|---|---|---|---|---|
| | **Tattersall's** | **TABCORP** | **Tattersall's** | **TABCORP** |
| Gaming Operators | 26.3% | 33.3% | 26.3% | 33.3% |
| Gambling Venue | 33.3% | 33.3% | 25% | 25% |
| | | | | |
| State government EGM tax | 40.3% | 33.3% | 40.3% | 40.3% |
| Community Support Fund | | | 8.3% | 8.3% |
| Total state government share | 40.3% | 40.3% | 48.6% | 48.6% |

Note: Tattersall's pays the state a licence fee equivalent to 7% of net cash balance. TABCORP paid its licence fee upfront out of its privatisation proceeds in 1994.

Source: Victorian government, Budget Statements, Budget Paper Number 3, 2001/2.

In 2000 the state government introduced a machine levy on the gaming operators of $333. This levy was increased in July 2001 to $1,533, and acts as an off-the-top tax applied at a set rate irrespective of turnover. In 2000/1 this levy raised $10m. In 2001/2 it will generate $50m (Victorian government, Budget Statements, 2001/2, Budget Paper Number 3). If we add together the gaming taxes plus the CSF levy together with the gaming machine levy, it can be seen that the hotels account for approximately two thirds of state gaming machine revenue (see Table 2).

**Table 2: State government poker machine tax revenues, 2000/1 (est.) ($m)**

| | | |
|---|---|---|
| Clubs (1) | $ 270 | 27% |
| Hotels (1) | $ 518 | 51% |
| CSF (paid by hotels) (2) | $ 130 | 13% |
| Licence fee – Tattersall's (3) | $ 89 | 9% |
| Gaming Machine levy (4) | $ 10 | 1% |
| TOTAL | $ 1,017 | 100% |

Note: (1) Clubs and Hotels share derived from Marsden Jacobs estimate of turnover share (Marsden Jacobs, 2000, p. 47); (2) CSF received $105m in 2000/1, but an additional $25m will be levied until 2003 (Marsden Jacobs, 2000:); (3) TABCORP licence fee of $520m was paid in 1994 as part of its privatisation. This is excluded from the table. (4) From Victorian government, Budget Statements, Budget Paper Number 3, 2001/2.

Source: VCGA data on gaming machine losses, Victorian government Budget Paper No. 3, Community Support Fund Annual Report, 2001.

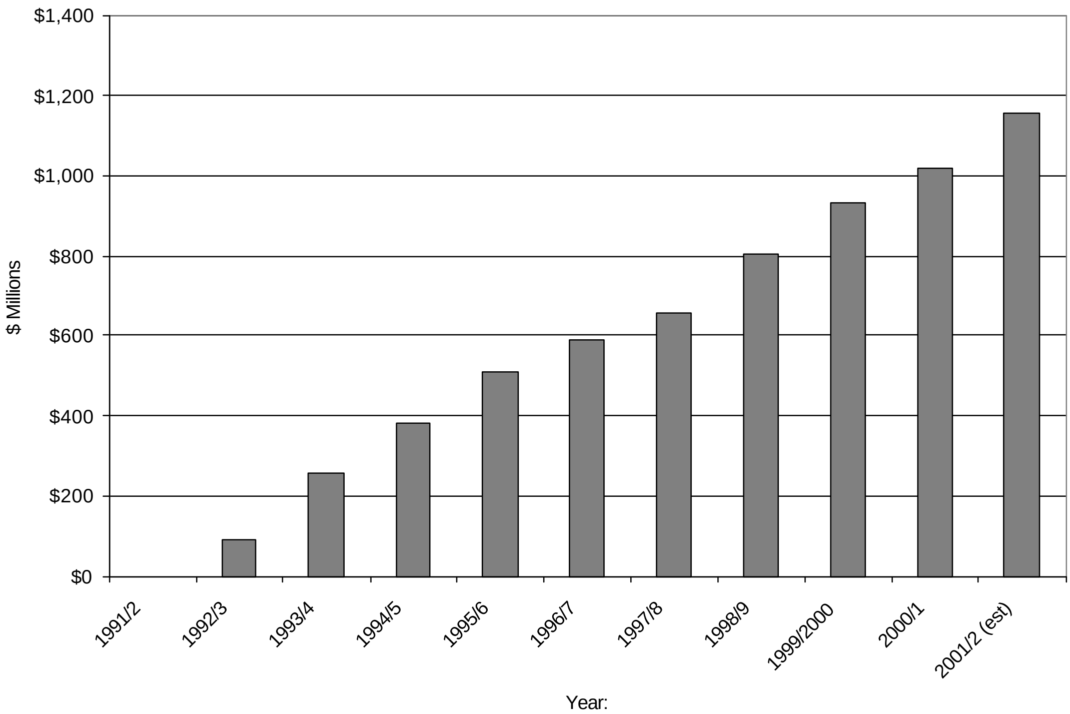
Over the last five years, the state has introduced a number of regulations designed to make the industry more socially responsible. These are summarised in Table 3. Most of the measures are modest, and the industry has been given long lead times to adjust. It took ten years before the industry was required to comply with the most basic consumer protection requirements such as the introduction of natural light in gaming venues and clocks on machines. The much-heralded regional cap legislation was announced a year before it was put into effect, and it is to be progressively implemented over a four year time frame that only began in February 2002.

## Table 3: A potted history of 'responsible' gaming measures

| Responsible Gaming Measures | Date of Implementation |
|---|---|
| Improve amenity of the gaming room for patrons<br>• Introduce natural light or the equivalent<br>• Clocks on machines<br>• Smoking ban | 2 July 2002<br>30 Sept 2001<br>September 2002 |
| Limit Numbers of Machines<br>• Limit maximum number of machines per venue (105)<br>• State cap on machines outside Casino (27,500)'<br>• From December 1997 ban new permits for machines in pubs and clubs in strip shopping centres | From inception 1992<br>From inception 1992 confirmed in ministerial direction 1997<br>December 1997 |
| Restrict Spread<br>• Limit machines in hotels to 50%<br>• Impose regional caps in five areas of high socioeconomic disadvantage and high losses<br>• Introduce 'licensing' process to enable local government to make submissions on socio economic impacts | From inception 1992<br>Announced Feb 2001, gazetted April 2001 imposed over 4 year period 14/2/02 – 14/2/04 progressive increase in annual reductions. NB: No reductions for Darebin Plus<br>Decisions by VCGA from February 2001 |
| Restrict Access<br>• Limit 24 hour operations in rural regions<br>• No more than 20 hours continuous play for new venues – rural<br>• Only 24 hour operations where net social or economic benefit not detrimental- metropolitan<br>• Stop small number of gaming machines in unrestricted areas | March 2000<br>March 2000<br>March 2000<br>March 2000 |
| Assisting with Gambling Problems<br>• Funding (via gaming revenue) counselling services<br>• Distribution of problem gamblers kits to General Practitioners | From inception with progressive developments<br>2001 |
| Prevention of Potential Problems<br>• Industry responsible gambling codes (self exclusion programs)<br>• Restrictions on advertising<br>• Gaming Problem alert advertisements<br>• CSF funding sport and recreational services through revenue from gaming CSF<br>• Restrict access to credit at venue<br>• Adoption of national standards for gaming machines eg. display credits as dollars and cents | 1997<br>April 2001<br>April 2001<br>Inception and revamp June 2000<br>Inception<br>September 2001 |

Over the last 10 years, the state has become increasingly dependent on gambling taxes as a source of revenue. As Table 4 shows, gambling taxes have more than tripled between 1991/2 and 2001/2. Almost all of this growth is accounted for by EGM taxes, which have grown from zero to over $1b by 2000/1 (see Figure 1). EGMs now account for 62% of state gambling taxes, and the latter in turn account for almost one-fifth of state government taxation. In 2001/2 EGM taxes are projected to increase by a further 13.9%, courtesy of continued growth in losses in conjunction with the tripling of the gaming machine levy to $1,533 per machine (Victorian government, Budget Statements, 2001/2, Budget Paper No. 3).

**Figure 1: Victorian Electronic Gaming Machine Tax Revenue, 1991/2-2001/2 (est.) ($m) (including GST gaming tax proceeds)**




Source: Victorian government, Budget Statements, Budget Papers 2 and 3, various years. For 2000/1 and 2001/2, state EGM tax take from Budget Papers to which was added GST EGM tax estimate. This was derived by using EGM GST rate of 9.09% as reported in Victorian government Budget Statement, 2000/1, Budget Paper No. 2 (p. 119 multiplied by EGM expenditures as published by the Victorian Casino and Gambling Authority.

**Table 4: Gambling taxation trends, Victoria, 1991/2, 1995/6, 2000/1**

| | Electronic gaming machines taxes | Total Gambling taxes | Total taxes (1) | EGMs as % of total gambling taxes | Gaming taxes as % of total taxes | Gambling as % of total taxes |
|---|---|---|---|---|---|---|
| 1991/2 | $0 | $513 | $5,778 | 0% | 0% | 9% |
| 1995/6 | $509 | $1,052 | $8,399 | 48% | 6% | 13% |
| 2000/1 | $1,017 | $1,647 | $8,757 | 62% | 12% | 19% |

Notes:

(1) Total taxes for 2000/1 are adjusted to include the $378m of gambling taxes transferred from the Commonwealth as part of the Intergovernmental Agreement on tax reform. Source: 1991/2 and 1995/6 from Victorian government Budget Paper Number 3; 2000/1 by multiplying the value of gaming losses as recorded by the VCGA for 2000/1 by the Victorian EGM tax rates as listed in Victorian government Budget Paper No. 3.

The preceding analysis highlights the contradictory position the state finds itself in. On the one hand, it must regulate the gaming industry to ensure that it protects consumers for social policy reasons. On the other hand, it now depends on the industry's continued success for 12% of its tax revenues. How well the state balances these competing interests is a point to which we shall return presently.

**State gambling taxes: how much are they worth?**

There is some confusion about how much the state government pockets from gambling taxes generally and electronic gaming machine (EGM) taxes specifically.

Gambling taxes have risen dramatically for each of the last 10 years. However, the Victorian budget papers suggest that gambling taxes actually fell between 1999/2000 and 2000/1 by 19% to $1.2b. Similar figures are furnished for EGM taxes, which are also shown to have fallen, by $131m (Budget Paper No. 2, 2001/2, Table 6.8).

What explains this conundrum? The budget papers point out that, as part of the Intergovernmental Agreement, the Commonwealth imposes the GST on gambling expenditure and the states have agreed to adjust their gambling taxes downward to match the amount raised by the GST. The Commonwealth simply transfers the GST revenue on gambling to the states in compensation. All this is revenue neutral – there are no winners or losers.

The technical effect of this, however, is to give the false impression, for 2000/1, that Victoria has reduced its gambling taxes. To get an accurate picture it is necessary to add to state gambling taxes the GST gambling proceeds that are transferred from the Commonwealth.

The Financial Statements show that Victoria received $371m for 2000/1. If we add this to the $1.2b of state gambling taxes, total state gambling tax proceeds in 2000/1 actually came to $1.6b, 8*% more* (not 19% less) than was received the year before.

What about EGM taxation? The budget papers do not contain any accurate data on this issue. But it is possible to work out the answer from other sources.

The Financial Statement for 2000/1 shows state EGM taxation for 2000/1 to be $801m, $20m above the budget estimate. To this we must add the GST on EGM expenditures. The Victoria Casino and Gambling Authority estimates these losses as being $2.4b. By multiplying this by the GST rate (struck at 9.09%), it is possible to estimate how much the GST raised and was returned to Victoria. This is $215m. By adding this to the value of state EGM taxes as listed in the budget papers ($801m), we get an idea of how much the state is actually raising from this source. We also get a good idea why the government chose not to publish these figures.

As Table 5 shows, in 2000/1 Victorian EGM taxes crashed through the $1b barrier for the first time. In 2001/2, total gambling taxation (including the GST component) as a percentage of total taxation will clip the 20% mark, also for the first time.

## Table 5: Victorian Gambling and EGM taxation, 1999/2000 and 2000/1 ($m)

| | EGM Tax revenue | | | Gambling taxes | | | Gambling taxes as % of total taxes | EGMs as % of total taxes |
|---|---|---|---|---|---|---|---|---|
| | State tax component (1) | GST component (2) | Total EGM revenues | State tax component (3) | GST component (4) | Total | | |
| 1999/2000 | $933 | NA | $933 | $1,520 | NA | $1,520 | 16% | 10% |
| 2000/1 | $801 | $215 | $1,016 | $1,276 | $371 | $1,647 | 19% | 12% |
| 2001/2 (est) | | | $1,157 | | | $1,800 | 20% | 13% |

Sources and notes: (1) Victorian government Budget Statement, 2000/1, Budget Paper No. 2 (Table 6.8) and Budget Paper No. 3 (Table 3.2), Victorian government Budget Statement, 2001/2, Budget Paper No. 2: and 2000/1 Financial Report for the State of Victoria (Table 1.3).

(2) GST EGM tax estimated by using EGM GST rate of 9.09% as reported Victorian government Budget Statement, 2000/1, Budget Paper No. 2 (p.119 ) and EGM expenditures as published by the Victorian Casino and Gambling Authority.

(3) Victorian government Budget Statement, 2000/1, Budget Paper No. 2 (Table 6.8) and Budget Paper No. 3 (Table 3.2); 2000/1 Financial Report for the State of Victoria (Table 1.3)

(4) GST gambling tax from Victorian government 2000/1 Financial Report for the State of Victoria (p. 26).

### The gaming machine operators

Victorian legislation allows three gaming machine operators: TABCORP, Tattersall's and Crown Casino. Of these Crown is a special, minor player, and will not be considered any further here. In 1992 TABCORP and Tattersall's were granted exclusive licences to operate gaming machines for 20 years. The government legislated to allow the number of poker machines operated by these two companies to increase from zero to 27,500 in the space of seven short years (a further 2,500 are operated by TABCORP for Crown).

Tattersall's is Australia's largest private company, and as such is not required to publish detailed financial statements of the type required by the publicly listed companies or government departments. Tattersall's Gaming Pty Ltd operates gaming machines in Victoria for the trustees of the Estate of George Adams. Tattersall's has operated lotteries and gaming business for more than 100 years. Its main business has been running lotteries across Australia and in neighbouring Pacific nations such as Fiji, Cook Island and Nauru (www.tattersall's.com.au). The limited amount of financial data suggests that poker machines have become a very lucrative source of revenue for the company over the last decade.

Tattersall's financial results are not disaggregated by division, nor by state, and it did not publish financial results back in the early 1990s, so it is not possible to be precise about the impact of gaming machines in Victoria on the company's profitability. Its financial statements show that in 2000/1 gaming machines accounted for $1.276b, or three-quarters of the company's gross gambling revenues (turnover less prizes paid) (see Table 6).

**Table 6: Tattersall's Holdings Pty Ltd net sales revenue by source, 2000/1**

| Net sales revenue | Type of gambling | % of total |
|---|---|---|
| Gaming machines | $1,275,520 | 74.9% |
| Other | $427,707 | 25.1% |
| Total | $1,703,227 | 100.0% |

Source: Tattersall's (2001)

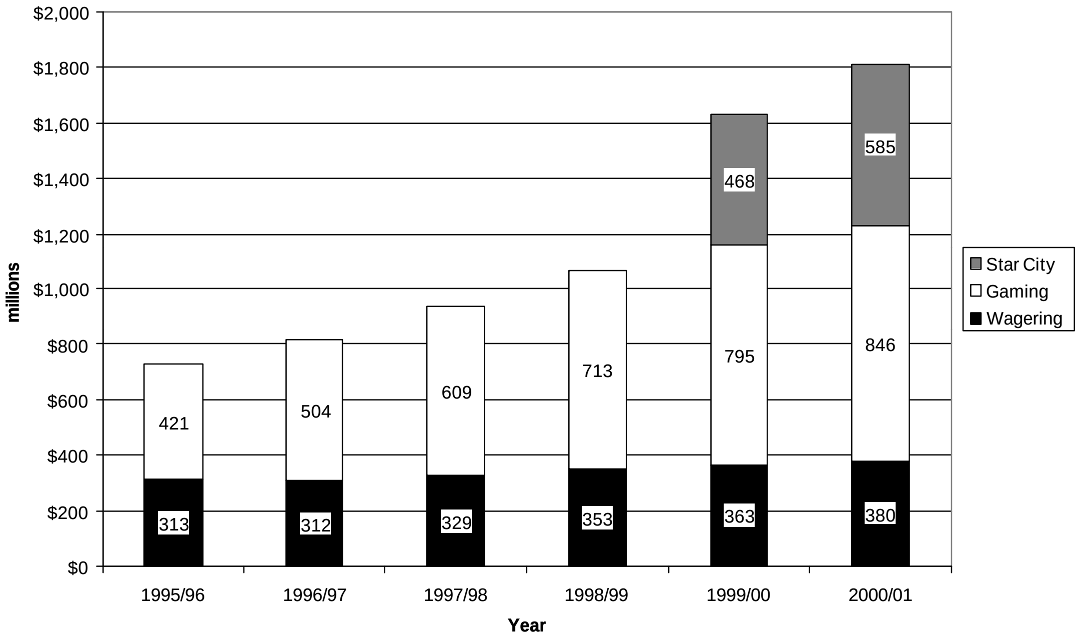
Of this, almost $372m is paid to venues, while $568m is paid in state taxes. This leaves a net $336m in revenues from gaming machine operations. Wages, depreciation and interest come to around $85m, and the only other significant cost item disclosed in the company's financials relates to non-salary operational expenses of $192m, of which the most significant single non-wage related expense is an intra-company licence fee paid to the George Adams Trust, of around $126m. Gross company profits before income tax for 2000/1 amounted to $108m, and $68m after income tax. Given that EGMs accounted for 75% of company net revenues, it would seem safe to assume that around three-quarters of company profits, or $81m before income tax and $51m after income tax, come from EGMs.

As Tattersall's is not a public company, it is difficult translating this into a rate of return. One way to measure the rate of return would be to express net EGM profit as a percentage of the annual licence fee of approximately $90m. This translates into a return of 57%.

TABCORP was privatised in 1994 for $674m, at a price regarded by both the then government and the opposition as below its value (see Magazanik, M. and M. Maiden (1994), 'Brumby attacked for TABCORP stand', *Age*, 5 August, 1994; and Maiden, M. (1994), 'Row rocks TABCORP float', *Age*, 5 August; Bartholomeausz, S. (1994), 'Opposition overplays its hand in TABCORP ploy', *Age*, 5 August, Editorial Opinion (1994), *Age*, 6 August). It has done very well subsequently, largely because of its licence to operate gaming machines. TABCORP's share registry is dominated by institutional investors, although it is noticeable that its CEO is also in the top twenty. Government legislation currently prohibits share holdings greater than 5%, and limits overseas ownership to 40%. The state government has recently agreed to introduce legislation relaxing the individual share holding limit to 10% and abolishing the overseas ownership restrictions completely.

TABCORP has increased its profits each year of operation since the float in 1994. In 1997, profit after tax was $100.8 million, an increase of 15.6% on the preceding year, resulting in an increased dividend to shareholders. By 2000 profit after tax had continued to increase at double digit rates, rising to $174.8 million. In 2000/1 TABCORP's profit after tax grew by a further 16.5%.

**Figure 2: TABCORP operating revenues by division, 1995/6-2000/1**




Source: TABCORP Annual Reports

TABCORP has three principal divisions: wagering, gaming and Star City Casino. The wagering division has the exclusive licence to sell Victorian totalisator betting on thoroughbred, harness and greyhound racing. While this was TABCORP's main source of revenue during the early 1990s, today it accounts for less than 15% of company profits. The gaming division has one of two licences to operate poker machines in Victoria. As Figure 2 and Table 8 show, the gaming division is the company's principal source of earnings, accounting for almost 60% in the last financial year. Returns from the gaming division have been sufficiently robust to help finance the acquisition of the Star City Casino in 1999.

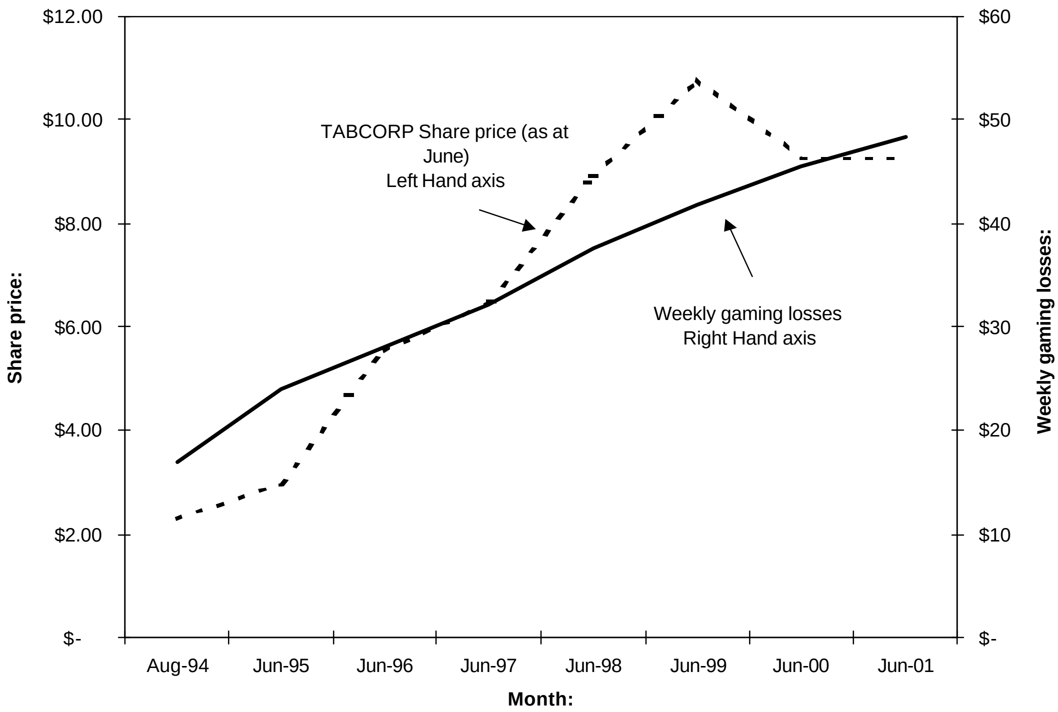
**Table 7: TABCORP profits before interest and tax by Division, 2000/2001**

| | | |
|---|---|---|
| Wagering | $52m | 14% |
| Gaming | $218m | 57% |
| Star city | $112m | 29% |
| TOTAL | $382m | 100% |

Source: TABCORP Annual Reports

TABCORP's share price is highly sensitive to changes in gaming regulations. Its share price skyrocketed when it became clear how much its gaming licence was worth shortly after being privatised, and continued to soar as gaming profits continued to grow each year. The price stabilised once the number of machines in operation hit the cap and the government confirmed that this would not be lifted. In February 2002, it dipped by 2% on the back of a state government announcement that it intended to introduce a new range of gaming regulations.

**Figure 3: Weekly gaming machine losses and TABCORP share price, 1994-2001**




Source: TABCORP share price from Australian Stock Exchange; Gaming losses from VCGA

TABCORP's financial success is reflected in the payments made to the company's directors and senior executives. Per person, the non-executive directors enjoyed a real pay increase of 278% between 1994/5 and 2000/1, while the executives experienced a real increase of over 600% (see Table 10).

**Table 8: Non-Executive Directors and Executive salaries, TABCORP, 1995, 2001 (constant 2000/1 prices)(1)**

| | 1994/5 | 2000/1 | % change |
|---|---|---|---|
| Total Directors' remuneration (excluding CEO) | $324,826 | $1,445,505 | 445% |
| *Average Directors' remuneration (excluding CEO)* | *$64,965* | *$180,688* | *278%* |
| Total Executive Salaries (including CEO) | $1,358,469 | $4,941,028 | 364% |
| *Average Executive remuneration (including CEO)* | *$135,847* | *$823,505* | *606%* |

Note: (1) Deflated by the CPI

Source: TABCORP Annual Reports.

### The venue operators

TABCORP and Tattersall's operate 27,400 machines in 544 venues, run by 470 separately licensed companies. In contrast to the gaming machine operators, the venue operator industry is fragmented, but with high concentrations at the top (see Table 10). One company (AHL) has control of almost 3,300 machines in hotels, or 12% of the industry total. One individual (Bruce Mathieson) has financial interests in 6% of Victoria's gaming machines in hotels and clubs. The control is spread across 22 licences equally split between clubs and hotels. Many of the clubs in which Mathieson has an interest are associated with football clubs. Together, AHL and Mathieson operate 18% of gaming machines in Victoria.

**Table 9: Market share of top 5 venue operators (hotels and clubs)**

| Name | No. of machines | Hotel /Club | % of industry total | Number of licences |
|---|---|---|---|---|
| AHL Group | 3,296 | Hotels | 12% | 1 |
| Bruce Mathieson in association with others primarily Ross Blair - Holt | 1,697<br>(823)<br>(874) | Hotels and Clubs<br>Hotels<br>Clubs | 6.19% | 22<br>11<br>11 |
| John Nicholsen in association with others | 696 | Hotels | 2.5% | 6 |
| Euon Gronow in association with others | 575 | Hotels | 2.% | 8 |
| Taverner Hotel Group | 477 | Hotels | 1.7% | 1 |
| **Total** | **6,741** | | **24.6%** | |

Source: VCGA

Gaming machines are required to be split 50:50 between hotels and clubs. However, it is increasingly difficult to distinguish between the two sectors, with a number of clubs using hotel operators to run their gaming venues. Marsden Jacobs (2000) refer to the emergence of 'quasi clubs', or club based poker machine operations that return few benefits to the community, apparently with the intent of avoiding the 8.33% tax imposed on hotels. The state government has acknowledged this issue, and has signalled that it will be requiring clubs submit to an annual 'community benefit' audit.

Turnover and player losses per machine in clubs are estimated to be half the value they are in hotels (Marsden Jacobs, 2000, p. 47), but the duopolists are not allowed to redistribute machines between these sectors (Marsden Jacobs, 2000; Roy Morgan Research, 1999). TABCORP and Tattersall's can choose who it is that operate their machines within each of the sectors, and up until recently they have been able to switch machines between venues as they have wished.[3] Losses are higher per machine in venues with more machines. It is interesting to note that many football club venues have high numbers of machines and are associated with an operator who straddles both the hotel and club sectors .

As TABCORP points out, *larger venues are more profitable both in aggregate terms and in terms of revenue per machine* (Marsden Jacobs 2000 pp 66).Venue operators know that the gaming machine operators have strict financial targets for each machine, and will switch machines between venues if these targets are not met. The venue operator's behaviour is very much dictated by the financial considerations of the gaming duopoly, and they are perhaps best seen as subcontractors rather than independent operations.

*Gaming, competition and profitability*

Within the rules imposed by the state, the two gaming machine operators have only a limited number of ways to maximise profits. Their costs are largely fixed in that the payments they make to venues are legislated as a proportion of net revenue. The only costs over which they have a significant influence are the payments they make to cover the leasing cost of the machines, and the labour costs associated with monitoring, securing and maintaining the machines. Labour costs are very low; within the industry as a whole, the bulk of the labour costs fall on the venue operators (Tattersall's, for example, employs only 400 people at a per person cost of almost $100,000).

The duopolists are also heavily constrained in how they chase revenues. They cannot increase the number of machines beyond the cap, nor can they lower the payout rate, for this is set in legislation. The only form of price competition they can choose is to opt for a higher payout rate so that average losses fall. But, as they are duopolists, they have no economic reason to engage in price competition of this type. Rather, they can be expected to act as a pair rather than in competition, which is what they do in reality with both keeping losses at 10%.

The focus of competition then falls on non-price related activities. The goal is to keep turnover per machine maximised each hour of the day that they are available for use. Foremost here is the nature, type and in particular the location of venues, as well as marketing schemes tailored to particular demographic groups. It is particularly important to focus marketing in a way that ensures high levels of patronage by different demographic groups at particular points in the day. Seniors are attractive, for example, because they offer one way of ensuring that the machines are well patronised during working hours (Market Solutions, 1997). Middle aged couples might be enticed to come for dinner, while the young are attracted during late-night sessions when older workers will have returned home to relieve babysitters.

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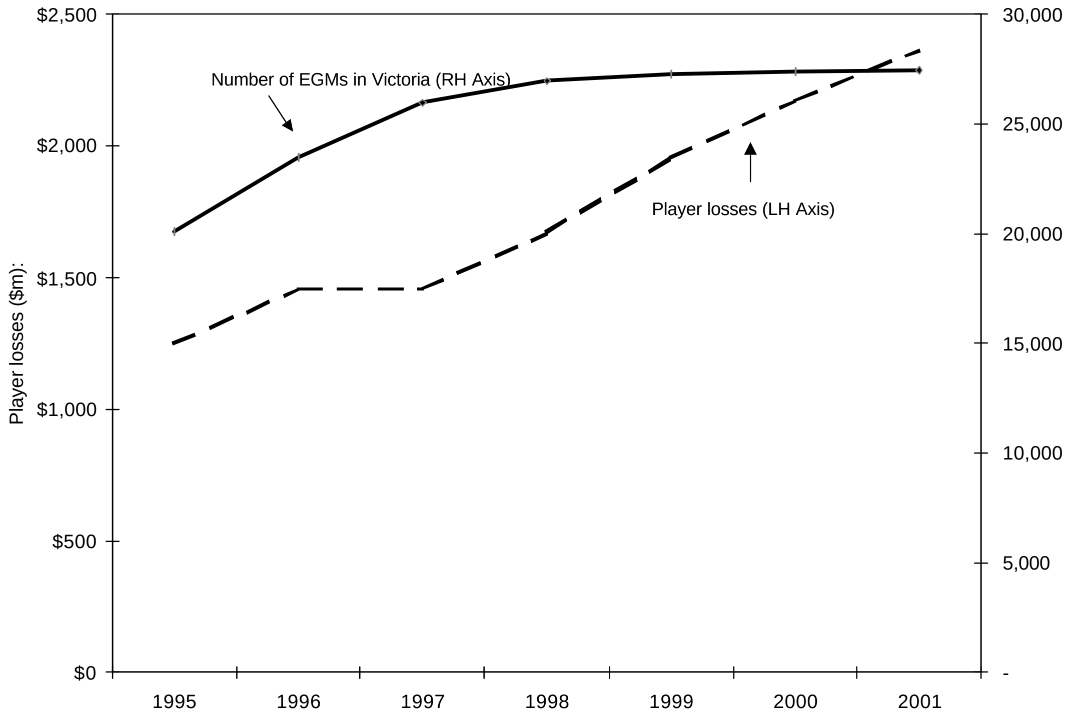
[3] This is now tempered by reforms put into effect in February 2001 enabling local governments to participate in the licensing process. This allows local government to make a submission on the social and economic impacts of gaming to the local area.

As turnover rises, profit as a percentage of turnover might remain unchanged. But the profit rate (profit as a percentage of funds invested) will rise. As Marsden Jacobs put it, the profit-sharing arrangement with TABCORP and Tattersall's 'creates strong incentives to continue to push for maximum gaming levels if not growth'. It should be pointed out that, in pursuing this strategy, the duopolists are in a very favourable position. Excess profits will not be eaten away by new entrants to the industry, for government regulations prohibit this.

How well have the duopolists refined their marketing in ways that increase turnover? In one sense, they have not been very successful. The VCGA's annual survey of Victorians shows that while the proportion of adults using EGMs increased steadily until the mid-1990s, since then the number has been falling steadily, from a high of 41% in 1996 to a low of 30% in 1999. The fall was also significant for those using gaming machines outside the casino, with the proportion falling from 33% to 24% (AGB McNair, 1995; Roy Morgan Research, 2000). This decline in patronage was particularly surprisingly because it occurred against a backdrop of steadily rising machine numbers, which did not hit the legislated cap of 27,500 until 1999.

At another level, however, the industry has been extremely successful in maximising its returns. Even though the proportion of adults using poker machines has been falling, the value of gaming losses has continued to mount at or above double digit rates (see Figure 4). The implication of this is clear. A shrinking minority of Victorians are losing more money. This is shown in Table 11, which plots real annual losses per poker machine player between 1994/5 and 2001. The table shows that losses per player have almost doubled from slightly under $1,500 per year to hit an estimated $2,958 by 2001.

**Figure 4: Number of non-casino EGMs and player losses, Victoria, 1994/5-2000/1**




Source: VCGA

**Table 10: Annual losses per active poker machine player (excluding Casino), 1994-2001 (constant 2000/1 prices)**

| Year to: | Adults | % playing EGMs outside casino | No active adult pokies gamblers | losses per active gamblers | Losses per active gamblers constant prices |
|---|---|---|---|---|---|
| Jun-96 | 3,425,734 | 33.0% | 1,130,492 | $1,288 | $ 1,434.9 |
| Jun-97 | 3,468,786 | 28.0% | 971,260 | $1,719 | $ 1,889.1 |
| Jun-98 | 3,515,935 | 25.0% | 878,984 | $2,223 | $ 2,443.3 |
| Jun-99 | 3,567,710 | 24.0% | 856,250 | $2,535 | $ 2,751.4 |
| Jun-00 | 3,624,648 | *(1)23.5%* | *851,792* | *$2,778* | $ 2,944.8 |
| Jun-01 | 3,686,158 | *(2)23.0%* | *847,816* | *$2,958* | $ 2,958.2 |

Source and notes:

(1) and (2) estimated by assuming rate of decline falls to 0.5 percentage points, and remains at that rate compared to 1 percentage point decline the previous year, and 3 percentage points the year before that

Adults from ABS; EGM participation rates from VCGA, 1995, 1996,1998,1999,2000; deflated by the CPI for Melbourne.

It is noticeable that the operators have so refined their marketing that gaming machine losses even increase in regions where operators have reduced the number of machines (see Table 12). To take but one example, machine numbers in Darebin declined each year between 1999 and 2001 (by 4% in 1999, 1% in 2000 and 2% in 2001), yet player losses increased (by 18%, 9% and 9% respectively)

**Table 11: Electronic Gaming Machines, 1998-2001 (Areas with Regional Caps)**

| | Percentage increase in number of EGMS from previous year | | | | Percentage increase in player losses per EGM from previous year | | | |
|---|---|---|---|---|---|---|---|---|
| | 1998 | 1999 | 2000 | 2001 | 1998 | 1999 | 2000 | 2001 |
| **Darebin** | 1.64% | -3.5% | -1.08% | -1.99% | 15.04% | 19.43% | 8.65% | 8.26% |
| **Greater Dandenong** | 2.39% | -0.17% | 2.86% | - 1.94% | 13.64% | 12.22% | 5.78% | 11.78% |
| **Maribyrnong** | 6.21% | -2.10% | 4.28% | -1.87% | 3.77% | 14.65% | 1.25% | 9.54% |
| **Bass Coast** | 4.7% | -2.04% | 8.75% | 0.00% | 6.15% | 11.43% | 3.61% | 15.83% |
| **LaTrobe** | 1.78% | -1.02% | -2.21% | -0.45% | 4.44% | 11.95% | 6.33% | 7.65% |
| | | | | | | | | |
| **COUNTRY** | 4.48% | 1.69% | -0.95% | -0.05% | 6.81% | 11.45% | 9.46% | 9.47% |
| **METROPOLITAN** | 3.63% | 1.02% | 0.96% | 0.20% | 11.46% | 16.89% | 10.71% | 8.68% |
| | | | | | | | | |
| **VICTORIA** | **3.86%** | **1.20%** | **0.44%** | **0.13%** | **10.37%** | **15.66%** | **10.59%** | **8.86%** |

Source: VCGA

The growing losses experienced by a shrinking proportion of Victorians have their mirror image in the rapidly improving financial fortunes of the duopoly. Marsden Jacobs argue that the operators enjoy 'amazing' excess profits from their gaming activities, valued at between $400m and $500m per annum (Marsden Jacobs, 2000, pp. 45-46). The state government's review of business taxes agreed that the operators enjoy large surplus profits, but estimated these to be closer to $150m per annum.

What about the venue operators? Their options are also highly circumscribed. They do have some influence over their operating expenses in the form of labour costs, but the options here are also limited. The key to success of venues is keeping the duopolists on-side. As we have seen, their interest is with maximising returns per machine, and they have been happy to shift machines around venues in order to meet this objective. It is to this tune that the venue operators must dance, and must do all that they can to keep their venues attractive, through meals, entertainment and regular upgrading of facilities (Roy Morgan Research, 1997). Cost reductions are difficult to come by, without compromising patronage.

It is this regulation-inspired business strategy pursued and dominated by the gaming duopolists that has helped give the Victorian gaming industry a different flavour to that in the other states (Marsden Jacobs, 2000). Victoria has the highest turnover per machine of any of the states and territories, bringing with it a return of around $86,000 per machine. The next highest (the Northern Territory) is almost a third less (Marsden Jacobs, 2000, p. 47).

### The punters

So far we have seen that the system of gaming provision is structured by the rules established by the state government. These rules give a privileged position to TABCORP and Tattersall's, who have a strong economic incentive to increase profits by increasing turnover, a task they have done with remarkable success over the last decade. We have seen that these two operators enjoy large economic rents, which in itself justifies significant government intervention, a point to which we shall return presently. But there is an additional potential motivation for government policy interventions.

Gambling is an unusual form of consumption that can be associated with considerable consumer harm, because it can be addictive. The more poker machine players act in ways that reflect this, the greater the grounds for government intervention, particularly given the power of the two gaming machine operators to appropriate large economic rents. What does the evidence tell us about consumers of gaming machines?

We know that less than one-third of adult Victorians use poker machines each year (Roy Morgan Research, 2000), and that less than a quarter play machines outside of the casino. Of those who play, there is a hard core group of approximately 35% who do so regularly (at least monthly). This means that only about 10% of adult Victorians are regular players, and there are even fewer regular players at venues outside of the casino. The Productivity Commission (1999, Volume 1, Table 8.3, p. 8.23) estimates that of those who play weekly, 15% to 27% are problem gamblers.

We know that the local government areas with the lowest socioeconomic indicators have the highest densities of gaming machines and losses per adult (Doughney, 2000). We also know that a majority of people gamble locally, travelling less than 5 kilometres to gamble (Morgan 2000; KPMG 2000). This implies that EGM consumption is skewed towards the lower income groups or, as TABCORP puts it, 'Gaming machines are, as a general rule, likelier to be a preferred leisure product in lower to middle income areas' (TABCORP, 1999, p. 14). Not surprisingly, household expenditure survey data confirms that gaming expenditure accounts for a disproportionate share of the income of the bottom 60% of households, and is least significant amongst the richest 20% (Table 12).

**Table 12: Household weekly gaming machine expenditure by household income quintile, Victoria, 1998/9**

| Quintile | Average weekly gaming machine expenditure | % of median household income |
|---|---|---|
| Quintile 1 (poorest 20%) | $19.38 | 9.2% |
| Quintile 2 | $12.97 | 3.0% |
| Quintile 3 | $17.39 | 2.7% |
| Quintile 4 | $27.12 | 3.0% |
| Quintile 5 (richest 20%) | $31.91 | 2.3% |

Source: ABS Household Expenditure Survey

The industry downplays these figures, and highlights instead the reasons why patrons attend gaming venues and their perceptions of these visit. Most people (almost 80%) attend for social reasons, and they play the pokies as a small part of a bigger night out. According to VCGA data, only 11% of people attend venues specifically to play the pokies (cf TABCORP, 1999, pp. 4-5).

But attendance at venues is not the key issue. Indeed, what is striking is that poker machines appear not to figure as a major motive for most visits to venues in the first place. For our purposes, of much greater significance are those who not only attend venues but actually play the machines: why do these people play and do they enjoy their experience? The main reasons for playing as identified by the VCGA's survey of consumer attitudes is 'I may get lucky' (66%), followed by 'the thrill of winning' (64%) and 'to make a quick buck' (45%). Yet we know that the odds are stacked heavily against an individual player, and the longer people play, the more likely it is that this will be the case.

When gamblers have been probed about their reasons for playing the pokies, a significant minority respond with answers that suggest a fundamental misconception about gaming machines, or which suggest they are not able to control their behaviour, or act in a way that causes concern either to themselves, friends or family. For example, only 41% of EGM players admit to limiting their gambling to what they can afford (Roy Morgan Research, 2000, p. 80). Similarly, over a quarter of respondents surveyed in 1999 mistakenly believed that 'A poker machine is more likely to pay out soon if someone has been playing it for an hour and lost their money' (Sharp and Ramaniuk, 1999, Table 18). This is simply not true, and those who try to use this as a principle to guide their gambling decisions will end up losing large sums of money (Productivity Commission, 1999).

To what extent is this indicative of a bigger problem? One of the most commonly used measures to estimate the extent to which gamblers make rational choices is the South Oaks Gambling Screen (SOGS), or a modification of it. This was designed to identify at 'risk gamblers', or those who gamble so heavily that they end up bearing large financial and social costs. SOGS requires respondents to answer a set of questions about their gambling behaviour. While someone answering 'yes' to any of the SOGS questions could be considered to have experienced a gambling problem, those who score less than 4 are deemed not to be at risk. Those who score more than 5 are seen to be an at risk group, with those scoring more than 10 being a very high risk.

The available research suggests that between 2% and 4% of adults are at risk from gambling, scoring more than 5 according to SOGS. These are heavy gamblers, who account for a very high proportion of total gambling losses. The Productivity Commission estimates they account for as much as 42%. But our interest is broader than this, for we are interested also in those who answer 'yes' to any of the SOGS questions. While these people are not a high risk group, by answering 'yes' to any one of these questions respondents are suggesting that they do not always gamble sensibly, responsibly or rationally. The VCGA's aggregate data for all those who have gambled in the last six months show that while 76% scored zero, more than 21% scored between 1 and 4 (Roy Morgan Research, 2000, p. 91). A further 1.6% scored more than 5. In sum, the available data suggests that a high proportion of gaming losses are accounted for by a small proportion of players.

Unfortunately, there is no published research in Victoria which reports answers to SOGS questions for poker machine players only (although see the recently released ACIL (2001) study summarised below). The VCGA has, however, published data for the 35% of regular EGM players. One-fifth answered yes to questions such as 'I don't tell my family or friends the full extent of how much I bet or gamble' (20%), 'After losing money when having a bet or gambling, I have told others that I have lost a smaller amount (19%), and 'After losing money when having a bet or gambling, I have another bet to try and win it back (20%)' (Roy Morgan Research, 2000, p. 79).

It could be argued that this is not necessarily a problem, because even though these people might not be acting in a sensible or controlled way, many might be happy losing money like this. Perhaps losses are a price they are happy to pay for the prospect of getting a buzz from playing the odds. The is the argument offered by the industry (see for example TABCORP, 1999), and the consultants they have hired to put their case (ACIL, 1999, 2001). For them, '98%+ of Australians who participate in gambling activity (see it as) an enjoyable recreational activity of choice (and) do not have a problem' (TABCORP, 1999, p. 8). What does the data tell us about this view?

Most Victorians do not rank playing the pokies very highly as a leisure or recreational activity. On a scale of 1 to 10, playing EGMs gets only a 2.2 rating, well below relaxing at home (7.7), going out for dinner (7.6), going to the movies (6.2) and playing sport (5.9) (Roy Morgan Research, 2000, p. 75). Even amongst gamblers, EGMs score only 2.4. Only regular EGM players rank pokies at 5, but even then they prefer going out to dinner (7.6), relaxing at home (7.5), going to the movies (5.5) and playing sport (5.8) (Roy Morgan Research, 2000, p. 74).

TABCORP (1999) itself reports that a survey of 268 gaming machine players at five of its locations found that one-fifth of those who played their machines were dissatisfied with their experience (TABCORP, 1999, Table 8). These findings will be skewed towards the views of regular gamblers because of the population that were sampled and the location of the survey. In their more representative longitudinal study, Sharp and Romaniuk report that only 35% of the 1,000 Victorians they surveyed agreed (10.7% strongly) with the statement, 'I derive entertainment and pleasure from the money I spend on gambling'. On the other hand, 57% disagreed with this view, and 39% felt this way strongly (Sharp and Romaniuk 1999, Table 33). The KPMG (2000) survey of attitudes towards gambling reports similar findings. Most of the pokie players they surveyed were 'relatively dissatisfied with their experiences: on a scale of 0-100 , the average response was 47' (KPMG, 2000). Similarly, according to the 2000 VCGA survey of community attitudes towards gaming, approximately 40% of players claim not to get any satisfaction at all from playing the pokies (Roy Morgan Research, 2000, p. 135). When asked why they continue to play, around one-third (34%) say because it is a social activity, while 20% say it offers a chance to win easy money. 14% say they do so because of boredom (Roy Morgan Research, 2000, p. 135).

These figures are for Victoria as a whole, and we can expect that they will vary by region. ACIL (2001) reports findings from a survey of 1,000 people living in the regional centre of Ballarat which provide an interesting picture of how gambling patterns vary across the state. ACIL found that 41% of their respondents had played the pokies in the previous 12 months, which is significantly higher than the equivalent figure for Victoria (30%). This probably reflects the presence of 16 gaming venues in Ballarat servicing a population of only 80,000.

When respondents who had gambled over the last 12 months were asked to rank their own experience of problem gambling on a scale of 1 to 10, with 1 meaning ‘no problem’ and 10 meaning a ‘major’ one, 21% self-identified as having a problem of some type.

**Table 13: Rating of problem gambling by respondents who had gambled in last 12 months, Ballarat, 2001**

| Ranking | Percentage of respondents |
|---|---|
| 1 (no problem) | 79% |
| 2-4 | 17% |
| 5-6 | 3% |
| 7+ | 1% |

Source: p. A6-28, Table 12

Respondents were also asked if they knew someone in Ballarat with a serious gambling problem. 39% said ‘yes’, with almost 80% of these said to be experiencing a current rather than a past problem. ACIL admits that this is ‘higher than most estimates of the number of problem gamblers in Australia’ (p. A26-29).

ACIL asked other questions about behaviours which are considered to be indicative of problem gambling. The proportion of players who displayed at least one of these troubling behaviours exceeded the earlier estimate of one in five. According to this measure, 49% of respondents who played the pokies had experienced a troubling behaviour (A-6: 31, Table 13). Of those who were in this category, 27% identified one troubling behaviour, while 12% answered two. As ACIL explains:

> There were five questions that produced notably higher affirmative response rates than other questions:
>
> - gambled more than intended (29%)
> - sense of guilt about gambling (20%)

- gambling criticised by others (9%)
- unable to stop gambling (7%)
- falsely claiming to be winning money (7%) (p. A6-31).

There are good reasons for believing that ACIL's data – like all those derived from surveys – significantly understates the extent of the problem. It is well known that people who have a gambling problem are reluctant to tell or simply do not know the truth about the extent of their losses, and surveys of this type can be expected to significantly underestimate the incidence of problem gambling as a result. One way of estimating this would be to extrapolate from the amount of gaming losses declared by the respondents to the survey, in order to estimate losses for Ballarat as a whole. These self-declared losses could then be compared with those officially recorded by the Victorian Casino and Gaming Authority. ACIL did this comparison and found that declared losses 'were only 11% of net gaming expenditure in Ballarat for 2000-2001' (p. A6-19).

What does all this data mean? A significant proportion of poker machine expenditure in Victoria is based on players' inability to manage their behaviour because of irrational perceptions about luck, difficulties limiting levels of expenditure to within their budget, or other troubling motivations, which manifest themselves in a tendency towards over-spending and excessive player losses. We can also say that this varies geographically. In regional centres like Ballarat, the problem appears to be significantly worse. This significant minority – conservatively estimated at one-fifth of all regular players – fit into this category, and they account for a disproportionate share of player losses. Extrapolating from the Productivity Commission estimate that problem gamblers account for over 40% of losses, it can be safely concluded that of the $2.4b that was lost on poker machines last year, between $1b and $1.4b is likely to be accounted for by this group of players. A disproportionate share of these people are drawn from lower income groups.

## Part Two: Breaking the habit

There are important policy implications from the preceding analysis. First, most Victorians do not play the pokies, and the proportion who do so has been declining. Less than one-third play machines, and less than a quarter play them outside of the casino. Of these players, up to 40% do not enjoy the experience, and the overwhelming majority of people who attend gaming venues do so for non-gaming reasons. There is a hard core of one-third of players who play regularly, and around one-fifth appear not to be in control of their gambling in that they gamble more than they intended or lie to family and friends. A small proportion of heavy gamblers account for the majority of gaming machine losses, and it is likely that a disproportionate share of these come from lower income households.

**Table 14: Estimate of problem behaviour player numbers**

| % | Based on | Number of adults (2) | Are likely to account for this percent of losses | Are likely to account for this amount of losses | Losses per player |
|---|---|---|---|---|---|
| 2%-5% of players (1) | Estimated number of problem gamblers | 17,000-42,000 | 42% | $1b | $24,000-$59,000 |
| 20% of players (3) | Includes PC problem gamblers plus all those who exhibit at least one type of problem behaviour | 170,000 | 70% (4) | $1.7b | $9,900 |

Notes and Sources:

(1) estimate of poker machine problem gamblers and percentage of losses from Productivity Commission, 1999, Volume 1, Table 6.15; (2) ABS and VCGA estimates of proportion of active players; (3) derived from responses to SOGS questions as published in Roy Morgan Research (2000); (4) derived from Smith (1998, p. 32).

Second, the main beneficiaries of gaming machines are the duopolists and, to a lesser extent, the venues. The industry is structured in a way that gives undue power and large economic rents to the duopolists. Their goal is to maximise turnover, for this determines overall levels of profitability. Venues are little more than subcontractors who can be dispensed with as the duopolists see fit. The venues have a strong economic interest to operate in a way that maximises turnover per machine in order to ensure that they do not have their machines taken off them by the duopoly. Annual before income tax profits for the duopolists in 2000/1 amounted to over $400m. Executives and directors of these companies have also done extraordinarily well.

Third, the state is also a major beneficiary by virtue of the revenue it receives from gaming taxes. These account for 12% of total taxes today, compared to 6% five years ago and almost zero ten years earlier. Under current policy settings, the state is becoming more dependent on gaming taxes. In 2001/2, EGM taxes are tipped to increase by 14%, compared to 4% growth for taxes as a whole. It is no coincidence that while EGM taxes now amount to over $1b, since their introduction the state has cut taxes by about the same amount (see Table 14). While EGM taxes are regressive in that their incidence falls most heavily on low income households, the tax cuts have been focused on business, which has pocketed $760m of tax reductions (in constant 1999/2000 prices).

Fourth, and relatedly, while there are compelling grounds for the state government to wind back the level of gaming activity, it has an economic incentive not to do so. This means that policy action is likely to be slow in coming and indirect in form. We have already seen that it took until 2000 before the state agreed to even the most fundamental of reforms such as the introduction of clocks and natural light, and even then venues were given substantial notice before these measures were put into effect. However you look at it, most of the reforms are striking precisely because they are so very mild.

**Table 15: Tax cuts since 1994/5 (1999/2000 prices) ($m)**

| | |
|---|---|
| Wagering taxes reduced | $76 |
| Land tax capping introduced. | $23 |
| State Deficit Levy abolished. | $204 |
| Lower cap on land tax removed. | $7 |
| Marketable securities duty for listed shares reduced. | $151 |
| Mortgage Duty Exemption for refinancing business loans. | $1 |
| Halving of rental duty. | $5 |
| Extension of first home-buyer and pensioner stamp duty concessions. | $6 |
| Removal of lucky envelope, bingo and raffle surcharge. | $6 |
| Payroll tax cut from 7% to 6.25%. | $106 |
| Petrol and diesel franchise fees cut. | $109 |
| Abolition of deed duty. | $1 |
| Land tax reforms.(b) | $43 |
| Payroll tax cut from 6.25% to 6%. | $97 |
| Increased thresholds for stamp duty on conveyancing. | $43 |
| payroll tax cut from 6% to 5.75% | $97 |
| Payroll tax | $50 |
| Land tax | $5 |
| Stamp duty | $38 |
| TOTAL | $1,067 |
| | |
| *Estimated Business share* | *$740* |

Source: Victorian government, Budget Statements, Budget Paper No. 2, various years. Deflated by the CPI for Melbourne.

The one exception to this would seem to be taxation. Here the government has been much tougher, introducing a new $333 levy per machine in 2000, which was subsequently increased by more than 400% to $1,533 the following year. The government increased this tax following the recommendations of two major reviews, one on the gaming industry, the other on state taxation. The first, by Marsden Jacobs (2000), was established under national competition policy which requires all restrictive legislation to be reviewed. In this case, the legislation under examination was the Gaming Machine Act 1999. The second was the Harvey Review of Business Taxation (2001), which was established by the Bracks government shortly after winning office in order to recommend a suite of business tax cuts to be put into effect over the next few years.

Marsden Jacobs undertook pioneering research on the structure of the industry, and concluded that the legislation was anti-competitive, to the benefit of the duopoly. They argued that the legislation encouraged the duopolists to increase turnover rather than cut costs, because this was the principal way in which they could increase profitability. The existence of the gaming machine cap exacerbated the problem because it meant that the operators would re-allocate machines to maximise returns:

> Because the two operators are strongly profit focussed and have total control over the allocation of machines, machines have been re-allocated to maximise performance per machine and profits to the two operators (2000, p. 34).

Marsden Jacobs concluded that the legislation needed substantial change. They recommended that duopolists be paid on a flat fee-for-service basis, in order to remove their monopoly profits estimated at $400m to $500m per year, and that new entrants to the industry be allowed as soon as possible (pp. 47-48).

The government responded to the Marsden Jacobs report in most uncompromising terms, rejecting its key recommendations outright:

> The review erred in presenting the option of a further (review) of profit sharing and taxation arrangements.(T)he previous government removed that provision from the legislation and the licenses…Changes to the profit sharing and taxation arrangements before 2012 would require a fundamental change to the operating environment established for the terms of the licenses. The Government has given an undertaking to honour the principles and commitments given at the time the licenses were issued (2001, pp. ii-iii).

The Harvey Review tried a different tack to Marsden Jacobs. It recommended that the government tax away the excess profits by increasing the gaming machine levy from $333 per machine to $4,000, and use the proceeds to help fund a package of business tax cuts. The government responded by increasing the levy to $1,533 at the same time as it announced tax cuts for business valued at over $700m.

The problem with this policy response – and Harvey's analysis on which it is based – is that it ignores the structure of the industry. Without modifying this in the way suggested by Marsden Jacobs, an increase in the gaming machine levy is unlikely to be effective, for it can be expected to be passed on to consumers by virtue of new poker machine products and targeted marketing that successfully increase turnover per machine. This is what happened in 2000, after the government first introduced the gaming machine levy. Even though the gaming machine cap had been hit the previous year, the operators still managed to increase losses per machine by almost 9%. In the 2000/1 Annual Report, TABCORP's Managing Director pointed to *'an increase of 7.1% in the average gaming machine revenue (net revenue of $212 to $227) due to the introduction of new gaming products particularly in the last quarter of the year'*.

**Table 16: Player losses per machine, 1996/7-2000/1**

| | Player losses | EGMs at 30 June | Losses per machine $ | Increase in losses per machine from previous 12 months % |
|---|---|---|---|---|
| 1996/97 | $1,456,489,104 | 23,478 | $56,100 | |
| 1997/98 | $1,669,633,522 | 25,962 | $61,918 | 10.4 |
| 1998/99 | $1,954, 271,215 | 26,965 | $71,613 | 15.7 |
| 1999/2000 | $2,170,581,994 | 27,289 | $79,195 | 10.6 |
| 2000/2001 | $2,366,016,584 | 27,408 | $86,212 | 8.9 |

Data Source VCGA

Note: machine numbers as at December 2000 for year 2000/1

## What is to be done?

The state government has given a very strong impression that it has been captured by the industry in general and the duopoly in particular, leaving two major policy problems to be fixed. First, there is an urgent need to address the economic rents being enjoyed by the gaming duopoly. The second problem is the extent to which a minority of Victorians are losing money through excessive gambling in an industry designed to extract ever greater returns from those left playing. Under current arrangements, the state government has lost its legitimacy in the area of gaming machine policy because it has become so dependent on it for tax revenues.

The first thing that needs to be done is for the state, as a matter of priority, to wean itself off gaming machine taxes so that it can give social policy considerations the attention they deserve. This will not be an easy task. Targets and a firm timeline will need to be set. There are some useful milestones already in place that might help in this regard. In 2007/8 it is estimated that the revenue from the GST will become revenue-positive for the state. At this point, revenues will begin to pour in, and the state will be increasingly better off than had it remained under the previous regime. These funds could be used to help reduce the state's reliance on gaming taxes. The other key milestone is 2012, which is when the existing licence arrangements for the duopoly expire.

But what target should the state aim for? A useful benchmark is provided by the per capita gaming tax figures for all states shown in Table 17. Victoria's overall per capita taxes are slightly higher than the all-state average, but significantly less than those of New South Wales. One tax in particular accounted for almost all of Victoria's above average tax levels: gambling taxes, which in 2000/1 were 39% higher than those of all the states combined, and 31% higher than those of New South Wales. Victoria's above average gambling tax take is equivalent to approximately $400m per annum.

**Table 17: Per capita taxes by type, Victoria, NSW and all states, 2000/1**

| Taxation | **All states** | NSW | Victoria | Victoria compared to NSW | | Victoria compared to all states | |
|---|---|---|---|---|---|---|---|
| | | | | $ | % | $ | % |
| Payroll Tax | **$494** | $613 | $529 | ($84) | -14% | $35 | 7% |
| Land Revenue | **$115** | $143 | $124 | ($19) | -13% | $9 | 8% |
| Stamp Duty on Conveyances | **$268** | $349 | $268 | ($81) | -23% | $0 | 0% |
| Financial Transaction Taxes | **$165** | $199 | $175 | ($24) | -12% | $10 | 6% |
| Stamp Duties on Shares and Marketable Securities | **$48** | $82 | $55 | ($27) | -33% | $7 | 14% |
| ***Gambling Taxation*** | ***$247*** | ***$261*** | ***$343*** | ***$82*** | ***31%*** | ***$96*** | ***39%*** |
| Insurance Taxation | **$69** | $64 | $75 | $11 | 17% | $6 | 9% |
| Heavy Vehicle Registration Fees and Taxes | **$26** | $18 | $27 | $9 | 50% | $1 | 4% |
| Other Vehicle Registration Fees and Taxes | **$124** | $138 | $95 | ($43) | -31% | ($29) | -23% |
| Stamp Duty on Motor Vehicle Registrations and Transfers | **$72** | $72 | $89 | $17 | 24% | $17 | 24% |
| Drivers' Licence Fees | **$14** | $19 | $10 | ($9) | -47% | ($4) | -29% |
| Subtotal | **$1,642** | **$1,958** | **$1,790** | **($168)** | **($1)** | **$148** | **$1** |
| Other | **$351** | **$399** | **$294** | ($105) | -26% | ($57) | -16% |
| **Total Taxation** | **$1,993** | **$2,357** | **$2,084** | ($273) | -12% | $91 | 5% |

Source: Commonwealth Grants Commission, Report on State Revenue Sharing Relativities, 2002 Update, Supporting Information, Table 2-34.

This provides us with a very useful target. As part of a broader reform package, Victoria should aim by 2007/8 to reduce its per capita gambling taxes to the all state average. This would require reductions in gaming taxation of approximately $400m (in constant 2001/2 prices). This is a substantial sum, so how might it be financed? Any number of different combinations are possible. One scenario is outlined in Table 17, using a combination of measures that kick in at different points in time over the next five years. We suggest that a useful starting place would be for the state to commit $100m of the unexpectedly large surplus to be announced in the forthcoming budget. The government was budgeting for a surplus of $510m. It will come in closer to $1b.

To this might be added an increase in non-gambling taxes, initially set at 1.5% rising to 2% by 2006/7. This should provide an additional $150m. Declining gaming turnover implies falling revenues for the Community Support Fund. We recommend that this be allowed to happen, thereby funding an additional $5m and eventually $25m by 2007/8. These three measures should generate approximately $325m of the $400m needed to finance the gaming tax cut. The balance could come from the Commonwealth, which might well take a leadership role and, in a spirit of partnership and the common good, agree to pay Victoria (and any other state that might follow its lead) $1 for every $4 raised through gambling tax reductions that are linked to a responsible gambling policy. The Commonwealth contribution could peak in 2007/8, and be scheduled to fall to zero as the GST revenue becomes increasingly revenue positive from that year onward.

**Table 18: Funding a gaming tax cut ($m)**

| | 2002/3 | 2003/4 | 2004/5 | 2006/7 | 2007/8 |
|---|---|---|---|---|---|
| Portion of 2001/2 unanticipated surplus | $100 | $100 | $100 | $100 | $100 |
| GST revenue contribution | | | | | $50 |
| Increase in non-gambling taxes | | | $100 | $125 | $130 |
| Decline in CSF takings | $5 | $10 | $20 | $30 | $40 |
| Sub total | $105 | $110 | $220 | $255 | $320 |
| Commonwealth contribution | $26 | $28 | $55 | $64 | $80 |
| TOTAL | $131 | $138 | $275 | $319 | $400 |

(1) Would require an increase of 1.4% in non-gambling taxes in 2004/5 and a further 0.4% in the following year.

(2) Estimated effect of falling turnover on Community Support Fund Levy.

(3) Assumes that the Commonwealth agrees to a $1 for every $4 raised by the state.

Tax cuts, however, are only part of the solution. Indeed, they should be considered to be only part of a broader reform package, without which the tax reductions should not be proceeded with. The tax cuts are a precondition for a reform package. They should not in any way be seen as the package itself.

## Cutting the industry down to size

There are some urgent reforms that are needed to the industry, independent of any decision to wind back gaming turnover. Foremost amongst these is a requirement that Tattersall's publish an annual report containing financial details of similar quality and quantity to that of TABCORP, including the names of the beneficiaries of the trust. Even though Tattersall's is a private company, its financial success and very existence is a product of government legislation. At the very least, its legislated duopoly status as a gaming operator should be sufficient justification for a requirement of this type.

Second, it is imperative that the state government improves the transparency of its gambling tax revenue data as published in the budget papers and annual financial report. The total amount of gaming and gambling revenue, with and without the GST contribution, should be fully disclosed in the interests of public accountability. Also, there is no justification for the government continuing to publish gambling tax data that does not provide a clear breakdown by venue type (hotels and clubs) and source (EGM venues, and EGMs at the casino). It should be pointed out that the budget papers currently only show

EGM revenues from non-casino sources. There is no publicly available information showing the contribution to the budget of taxes on EGMs at the casino.

In addition, the core part of a gaming reform package must be a commitment to reduce gaming turnover, and to break the strong economic incentives for the duopoly to keep increase intensity of play and machine use. We recommend that the government aim for a $400m reduction in turnover to be put into effect gradually over the next five years, rolled out roughly in proportion to the new revenue measures proposed in Table 16. The beauty of a 40% reduction like this is that it would match the proposed reduction in tax revenues. From 2007/8 onward, turnover could be allowed to increase at a rate no greater than inflation.

There are any number of ways in which a 40% reduction in gaming turnover could be effected. For the most part, it could be left up to the industry to decide how best this can be done. There are, however, a number of reforms that must be considered compulsory. Included here are:

- Legislation requiring the machine population to better reflect the international distribution of machine types, with a view to increasing the proportion that are low intensity at the expense of the existing high intensity ones.
- The elimination of 24 hour gaming in all venues.
- The imposition of a cap on maximum continuous hours of operation to 16 hours per day, with a break of 8 hours between each 16 hour period of continuous play.
- Shutting down all gaming venues located in strip shopping and shopping centres.
- Ensuring that no gaming machines are located in areas where people gather for daily activity other than entertainment, such as travel (train and bus stations) or education.

The turnover reduction could involve any number of different measures, such as:

- Machines automatically turn off for 10 minutes after 60 minutes of continuous play.
- Ban all note-taker machines.
- Reduce maximum bet for stand-alone machines to $1.
- Require a minimum wheel spin-time of 3.5 seconds and a minimum passage of time of 1.5 seconds in idle mode, during which at least one standard data block must be transmitted (slow down rate of play by 43% in New South Wales).
- Ban play-through (the facility to cut short the pay cycle by simply playing the next game) and auto-gamble.
- Redesign of button function to prevent continuous play without further button press.
- Limit the number of credits per line to four.
- Set maximum prize limits for stand-alone machines to $500.
- Only allow one double-up attempt of a single play.

- Limit accumulated credits with a win.
- Limit accumulation of credits to no more than $500.
- Eliminate free spins.
- Wins of $250 or more automatically paid out in cheque.
- Restrict loss per hour to $50.
- Remove all ATMs and EFTPOS facilities.
- Ban all advertising and incentives.
- All new machines be required to demonstrate their effect on problem gamblers.

### Public opinion and gaming policy reform

No matter how compelling the evidence for policy reform might be, governments inevitably are swayed by public opinion. The significant reforms proposed here will undoubtedly be controversial. But they will also be popular.

Over the last five years, public opinion on gaming has shifted decisively, in much the same way as have poker machine participation rates – indeed, the two trends are likely to be related. According to the VCGA's research, 84% of Victorians believe that gambling related problems have worsened in recent years (56% strongly), and 83% believe that gambling is now a serious social problem (51% strongly). 78% believe that gambling is too widely accessible in Victoria (45% strongly), and 73% believe that the number of poker machines should be reduced (51% strongly) (Roy Morgan Research, 2000, p. 85). These findings are confirmed by other recent research. In their study of 1,000 Victorians, Sharp and Romaniuk (1999),found 'an overall high level of disagreement with the statement 'increased gambling activity is good for the economy' (61%) (Table 28). They also found 64% disagreed with the statement 'there are sufficient controls and restrictions on the gambling industry' (Table 32), while 78% agreed with the statement, 'overall the costs of gambling far outweigh the benefits' (Table 30). KPMG (2000) also found widespread hostility to current poker machine policy settings, with over 90% of their respondents believing that gambling does more harm than good, and that only 10% felt that poker machines had been good for their local area (2000, p. 108). NCS Pearson found overwhelming support for measures designed to lessen intensity of play: 68% of 400 respondents agreed that poker machines should be banned from accepting notes, 71% felt that poker machine players should be forced to take regular breaks from gambling; 78% agreed that ATMs should be banned from gaming venues and 68% felt that the maximum number of lines that can be played with each push of a button should be restricted to five (*Herald Sun*, 22 June, 2001, p. 3).

# Conclusion

This report had two main aims. First, to identify the key players in the system of gaming provision, how they relate to each other, and with what effect. This formed the subject of the first part, showing that the Victorian poker machine industry is geared for turnover growth to the benefit of the gaming duopoly and the state government, and at the expense of a shrinking pool of consumers. The second main aim was to identify a package of reforms that would address any problems that had been identified. The reform package as outlined is indicative only, for there are any number of ways in which it could be put into effect. Its purpose, however, is not open to change: breaking the nexus between the economic interests of two very powerful operators and the fortunes of a minority of Victorians drawn heavily from lower income areas who, on any reasonable criteria (including their own), are spending too much on poker machines. At the heart of the package are two interlinked measures: one requiring the state to sever its dependence on gaming taxes, the other requiring the government to commit to a goal of reducing gaming machine turnover by 40% over the next five years. These are strong measures, and will require a bold government to implement them.

There is a way forward. But is there the political will?

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