
16 Developments in the racing and wagering industries

Key points

- Without mechanisms to prevent ‘free-riding’, people could take bets on the outcome of races without having to make any payment to the racing industry. This poses a risk to the longer-run viability of the racing industry and would have detrimental consequences for the communities where racing plays a key role. More importantly, such a decline would also adversely affect consumers of wagering and racing products.
- The payment of product fees based on state and territory ‘race fields legislation’ is an attractive solution to the free rider problem. However, it is not clear that the instrument is legally robust, or will be used in such a way to promote efficient market outcomes.
- Improving the consultative process through which racing bodies set product fees would strengthen the foundations of racing industry funding model.
- If it becomes apparent over time that the race fields legislation cannot facilitate a fair and competitive wagering market, then a national funding model based on federal legislation should be adopted: This would best involve:
 - a single product fee paid by wagering operators on a gross revenue basis
 - the creation of an independent national body, that would set and periodically review the product fee, in consultation with all relevant stakeholders. A key objective of this body would be to maximise the long-term interests of consumers.
- There are also grounds for a harmonised tax regime, based on a binding agreement among all jurisdictions.
- There is a good case for retaining totalisator exclusivity arrangements (i.e. the exclusive right to operate a totalisator) and for permitting tote-odds betting.
- Further research is required to determine whether credit betting should be permitted in the wagering industry. In the interim, measures should be taken to limit the growth of this practice.
- There are grounds for permitting online wagering operators to offer upfront discounts to attract customers from incumbent suppliers. But, regardless of whether the practice is permitted or prohibited, governments should adopt a consistent national approach on this issue.
- The arguments for retaining TAB retail exclusivity (i.e. the exclusive right to provide off-course retail wagering products) are not compelling.

For much of Australia's history, wagering on horse, harness and dog races has been the most popular form of gambling. The three racing codes, and in particular thoroughbred horseracing, have a cultural significance to many Australians that exists regardless of any monetary stake they may have. Nevertheless, wagering underpins most of the interest in racing, which makes these industries mutually interdependent.

Over the last 50 years, this interdependence has primarily taken the form of funding agreements between the state and territory racing authorities and the Totalisator Agency Boards operating in their jurisdictions. However, recent developments in the wagering and racing industries have seriously undermined long-standing funding arrangements, causing some to call for a national solution. This chapter examines this question. In doing so, it concentrates on the thoroughbred racing industry. Nevertheless, the same issues face harness and greyhound racing, and the analysis presented here is relevant to all three codes.

The chapter begins with a discussion of the recent developments and fundamental challenges faced by the racing and wagering industries (section 16.1) Following this, we consider the principles for a good national model (section 16.2), and their application to a workable funding arrangement (section 16.3). This is complemented with a discussion of a number of broader issues facing racing and wagering (section 16.4).

16.1 The legacy of traditional funding arrangements

The issues facing wagering and racing today resemble the debate that took place prior to the introduction of Totalisator Agency Boards (TABs) in the 1950s. The issue revolves around adequate compensation to the racing industry for wagering on its product. Whereas the current debate centres on the appropriate level of remuneration and how to enforce it, in the 1950s the industry was struggling to deal with the growth in illegal off-course bookmakers who did not pay the racing industry for the right to bet on races, and took market share from the on-course bookmakers who did.

In both cases, the problem arose because the racing industry relies chiefly on the sale of intellectual property (essentially the outcome of the race), rather than on a physical product. In the usual course of market operations, common law provides a framework for disputes over property rights, contractual obligations and other potential areas of contention. This framework allows a price to be determined through bargaining between self-interested actors who will only trade on terms that benefit all parties to the transaction. However, it appears that the underlying legal

framework does not protect the intellectual property produced by the racing industry.¹ This allows some wagering operators to ‘free-ride’ on the contributions to the racing industry made by their competitors, without paying anything themselves (box 16.1).

Box 16.1 Public goods and ‘free-riding’

The outcome of a race has the characteristics of a public good. It is non-rival (any number of bets can be placed on a given outcome) and, more importantly, it is non-excludable (it is difficult for racing authorities to prevent punters from placing bets on the races they provide). In an unregulated market, public goods can be underprovided if those benefiting from such goods do not contribute sufficiently to their creation. This is sometimes referred to as ‘free-riding’.

However, the existence of a public good does not automatically imply a market failure requiring government intervention. In many instances the provision of public goods is not adversely affected by the existence of free-riders (for example, a passerby admiring the rose garden outside a private house). Similarly, if transaction costs are low and there are relatively few users of the public good, they will have strong incentives to cooperatively resource its provision such that an efficient equilibrium is reached.

Alternatively, if there were many users of the public good, their individual decisions as to how much resources they each contribute will only have a small impact on its overall provision. They each have the incentive to avoid paying for the public good and their incentives do not change as the provision of the public good declines. This scenario is the likely outcome of an unregulated wagering and racing market.

It is possible that the intellectual property embedded in the outcome of races could be protected under existing copyright law, negating the need for any special provision to be made. Racing fields, which are routinely published by wagering operators, could be subject to copyright, potentially providing a legal basis to enforce payment. This appears to be the recent approach taken by Racing NSW, however, the legitimacy of this under Australian copyright law is unknown. The historical unwillingness of racing providers to seek payment based on copyright, and the failed attempt in the UK to base their racing funding system on copyright law, is indicative of the uncertainty as to whether fair payment can be achieved through this avenue.

Free-riding is a common phenomenon and in many instances, the adverse implications are not sufficient to warrant government intervention. However, in this case, a long term consequence of unrestricted free-riding would be serious underfunding of the racing industry, to the detriment of wagering operators and

¹ Although other products arising from racing (such as broadcasts or the atmosphere and excitement of being at the track when a race takes place) require no special provisions in order to facilitate standard market outcomes.

consumers, as well as the racing industry itself. For this reason, government policy has historically been integral to the racing and wagering industries, both in Australia and abroad.

Beginning in the 1960s, free-riding was addressed by granting exclusive licences to government-owned TABs to provide off-course retail wagering, which gave punters a legal and convenient alternative to illegal off-course bookmakers.² In addition to providing an effective means of raising taxation for government, this arrangement ensured that the racing industry was paid for the use of its product through agreements between the TABs and the local racing authorities.

Excepting Western Australia, Tasmania and the ACT, TABs have been privatised over the last 15 years. While privatisation was accompanied by new contractual arrangements (Tabcorp, sub. DR372, p. 9), the essential structure of the funding model has remained the same, despite the ongoing changes and technological advancement that occurred in the wagering and racing industries over the last 50 years.

During this period, Australia has developed substantial thoroughbred, harness and greyhound racing industries.

- In 2007-2008 there were 379 thoroughbred racing clubs, which held 17 211 thoroughbred races and offered over \$355 million in prize money (Australian Racing Board 2009).
- In 2006-07 there were 114 harness racing clubs, which held 15 588 races and offered over \$90 million in prize money (Harness Racing Australia sub 231, p. 1).
- In 2007-08 there were 76 greyhound racing clubs, and 292 000 greyhounds competed in 40 000 races for around \$61 million in prize money (Greyhounds Australasia, sub 248, p. 5).
- The racing and wagering industries also provide employment for Australians in a wide range of occupations including: bookmakers, trainers, jockeys, racing stewards and breeders. Beyond this, these industries provide employment for the range of administrative and supporting staff required to run TAB retail outlets, internet and phone bookmaking operators, racing clubs and racing authorities. Industry sponsored research estimates the total number of full time equivalent (FTE) jobs to be over 48 680. In contrast, the South Australian Centre for Economic Studies independently examined a range of surveys and

² The first TABs were licensed in Victoria and Western Australia in 1961. By 1985, TABs were present in every state and territory in Australia.

methodologies and arrived at a lower (but still considerable) estimate of between 12 500 and 15 000 FTE jobs.³

However, just as the emergence of off-course bookmakers threatened to undermine racing industry funding during the 1950s,⁴ new entrants to the wagering market in the early 1990s dramatically changed the wagering landscape, again bringing about change to the funding model. The advent of the internet, along with the liberalisation of the wagering market to allow phone betting, have facilitated the growth of corporate bookmakers and, more recently, the entrance of a betting exchange provider (box 16.2).

By operating over the telephone and internet, corporate bookmakers are able to offer cheap and innovative wagering products across Australia, 24 hours a day (and initially were not required under regulation to pay product fees to the racing industry). As a result, corporate bookmakers rapidly increased their share of the wagering market.

As corporate bookmakers increased in prominence, New South Wales, Victoria, South Australia, Queensland and Tasmania responded by enacting ‘race fields legislation’, which details the basis and level of remuneration that must be provided to the racing industry for the right to use and publish racing fields.

While, this approach is essentially an ‘add-on’ to the original model, the inclusion of these new types of wagering providers signifies a profound change in the wagering and racing industries. This change has many positive features and will do much to ameliorate the allocative inefficiencies that developed under the traditional funding model. However, many ‘legacy issues’ remain unresolved, and the race fields legislation itself faces fundamental challenges. The remainder of this section examines these and their implications for racing and wagering in Australia, focusing on:

- the impact of the traditional funding arrangements on the wagering market and on consumers
- the impact of the current ‘hybrid’ arrangements on the efficiency of the racing industry at a national, state and local level.

³ Using the same methodology on more recent data, the Productivity Commission estimates a similar range.

⁴ Up until this time the racing industry had largely been funded by spectator admission fees and fees paid by on-course bookmakers.

Box 16.2 Types of wagering operators

On-course bookmakers: individuals who are licensed by the relevant state or territory racing authority to operate at racing venues. Bookmakers offer fixed odds and tend to provide simpler wagering products such as 'win' and 'place' bets. They can operate face-to-face, as well as over the phone and internet, whilst on-course. Some jurisdictions also allow bookmakers to provide these services off-course as well.

Corporate bookmakers: fully incorporated bookmakers who operate over the telephone and internet, and are often listed companies or subsidiaries of listed companies. Corporate bookmakers tend to have fewer restrictions than on-course bookmakers (for example they can operate 24 hours a day) and offer a wider range of betting products. The major corporate bookmakers in Australia include: Sportsbet, Betchoice, Betezy, Betstar, Centrebet, Centreracing, Luxbet, Overtheodds, Sportingbet Australia and Sports Alive.

Totalisators: operated by TABs, totalisators do not offer fixed odds bets. All bets are placed in a pool, with the winning bets sharing this pool (minus a percentage taken by the operator). For this reason, the final dividend is continuously updated prior to the race as betting takes place and is not finalised until betting closes. Totalisator betting is sometimes referred to as pari-mutuel betting.

TABs: in common usage, the term 'TAB' refers to the bodies in each state and territory that are exclusively licensed to operate totalisators and to offer off-course retail wagering services (as well as non-exclusive on-course, phone and internet wagering services). This definition is adopted by the Commission in this chapter, in reference to wagering on racing. However, modern TABs provide (either directly or indirectly) a range of other wagering products: For example

- most TABs participate in the sports betting market
- in Victoria, Tabcorp can offer fixed odds betting on races from its retail outlets
- Tabcorp owns the Northern Territory licensed corporate bookmaker Luxbet.

Care has been taken to provide clarification in the instances where the Commission's adoption of the common usage of the term 'TAB' has the potential to cause confusion.

Betting exchanges: similar to a stock exchange, a betting exchange is essentially a market place for punters to trade wagers at different prices and quantities. A betting exchange matches punters who are seeking to bet that a particular outcome will occur (i.e horse X will win) with others who are seeking to place opposing wagers (i.e horse X will not win).

Source: Australian Racing Board (sub 213) and Belfair Pty Ltd (sub. 181).

The concentration of market power has reduced consumer welfare

The presence of on-course bookmakers has generated more variety and competition than most other international wagering markets. Australian consumers have also

benefited from the increase in competition resulting from the privatisation of the TABs and the entrants of online and telephone based corporate bookmakers. That said, protective barriers in the retail wagering market continue to stifle the consumer benefits of greater competition. In particular, the off-course retail monopoly held by the TABs means that consumers have worse odds than those that a competitive market would deliver.

In the case of totalisators betting offered by TABs, the odds are determined by the ‘take-out’ rate — the amount removed from the total pool available to punters to win. TABs typically have take-out rates of between 14.5 and 25 per cent (the rate varies by state, and by product), which equates to an expected rate of return to punters of between 75 and 85.5 per cent per wager. This represents a substantially lower rate of return (and thus a higher price) than most other wagering and gaming products offered in Australia.⁵ Corporate bookmakers, for example, deliver a rate of return of around 94 per cent, whereas EGMs usually return above 90 per cent and casino games such as blackjack can offer up to 99 per cent.

The higher prices charged by TABs on their totalisator products are not solely a result of their retail monopoly. Some of the price differences between corporate bookmakers and TABs simply reflects the additional cost of the retail provision of goods and the operational costs of the totalisator itself. Nevertheless, the ability of TABs to use their market power to extract monopoly rents underpins their willingness to voluntarily enter into taxation and racing industry funding agreements that far exceed what has been asked of other wagering providers. Conversely, the higher level of taxation and racing industry payments structurally reinforces the pricing regime (i.e offering odds that are consistently above the level of a competitive market) and inhibits the ability of the TABs to compete with the low priced online providers who are gradually eroding their market power.

Comparing the Australian wagering market to the relatively competitive UK market, also suggests that the market power yielded by TABs has resulted in higher prices for consumers (Box 16.3). There are potentially many causes of this, such as the differences in the regulatory environment and consumer preferences for different types of wagering products. Nevertheless, the increased level of competition in the retail wagering market is almost certainly a major factor driving the lower takeout rate in the UK (on average).

While a minority of participants appear to challenge the view that TABs’ retail exclusivity constitutes market power and allows them to extract monopoly rents (Tabcorp, sub. DR372; p. 32, Racing Industry Consultation Group, sub. DR347,

⁵ Lotteries and Keno are the main exceptions to this.

p. 6), most racing and wagering industry bodies accept that this is the case to some extent. For example, Greyhounds Australasia writes:

GA accepts that takeout rates are substantially higher through the TAB and potentially may need to be amended somewhere closer to the market. But there no doubt that a reasonable premium is still required to meet the financial obligations of the parties involved. (sub. DR362, p. 6)

Similarly the Australian Racing Board state that:

While retail exclusivity by definition confers a significant degree of market power on TABs, it does not hermetically seal them away from the wagering market as a whole. (sub. DR343, p. 9)

Box 16.3 Average take-out rates for wagering in Australia and Great Britain

The take-out rate can be estimated through the ratio of the aggregated gross revenue (or total punter expenditure) to total turnover (the money value of all bets taken). Due to differences in definition and methodology, different data sources provide different estimates of the take-out rates in Australia and the Great Britain. However, all data sources examined here tend to suggest the average take-out rate in Australia is significantly higher than in Great Britain.

<i>Country</i>	<i>Year</i>	<i>Gross revenue</i>	<i>Turnover</i>	<i>Implied take-out</i>	<i>source</i>
Australia (wagering on all racing)	2005	\$2.37 b (consumer expenditure)	\$17.39 b	13.6	Queensland Government, Office of Economic & Statistical Research
Australia (thoroughbred only)	2008	\$1.63 (Turnover – return to bettor)	\$12.64 b	12.9	International Federation of Horse Racing Authorities
Great Britain (thoroughbred only)	2008	£1.05 b (gross win)	£12.13 b	8.7	Economic Impact of British Racing 2009
Great Britain (thoroughbred only)	2008	£1.08 b (Turnover – return to bettor)	£10.55	10.2	International Federation of Horse Racing Authorities

In addition to reducing the value-for-money offered to punters, the TAB dominated funding model is unlikely to serve the long-term interests of the racing industry either. While giving TABs the sole rights to provide off-course retail wagering largely solved the free-rider problem, the resulting higher price of wagering on racing increased the incentive of punters to seek out better returns in other forms of

gambling, or to switch to other types of entertainment altogether. This type of substitution is further encouraged by the other problems associated with monopolies (such as less efficient, innovative or responsive provision of services), which reduces the potential for growth in the wagering market and dampens interest in racing generally.

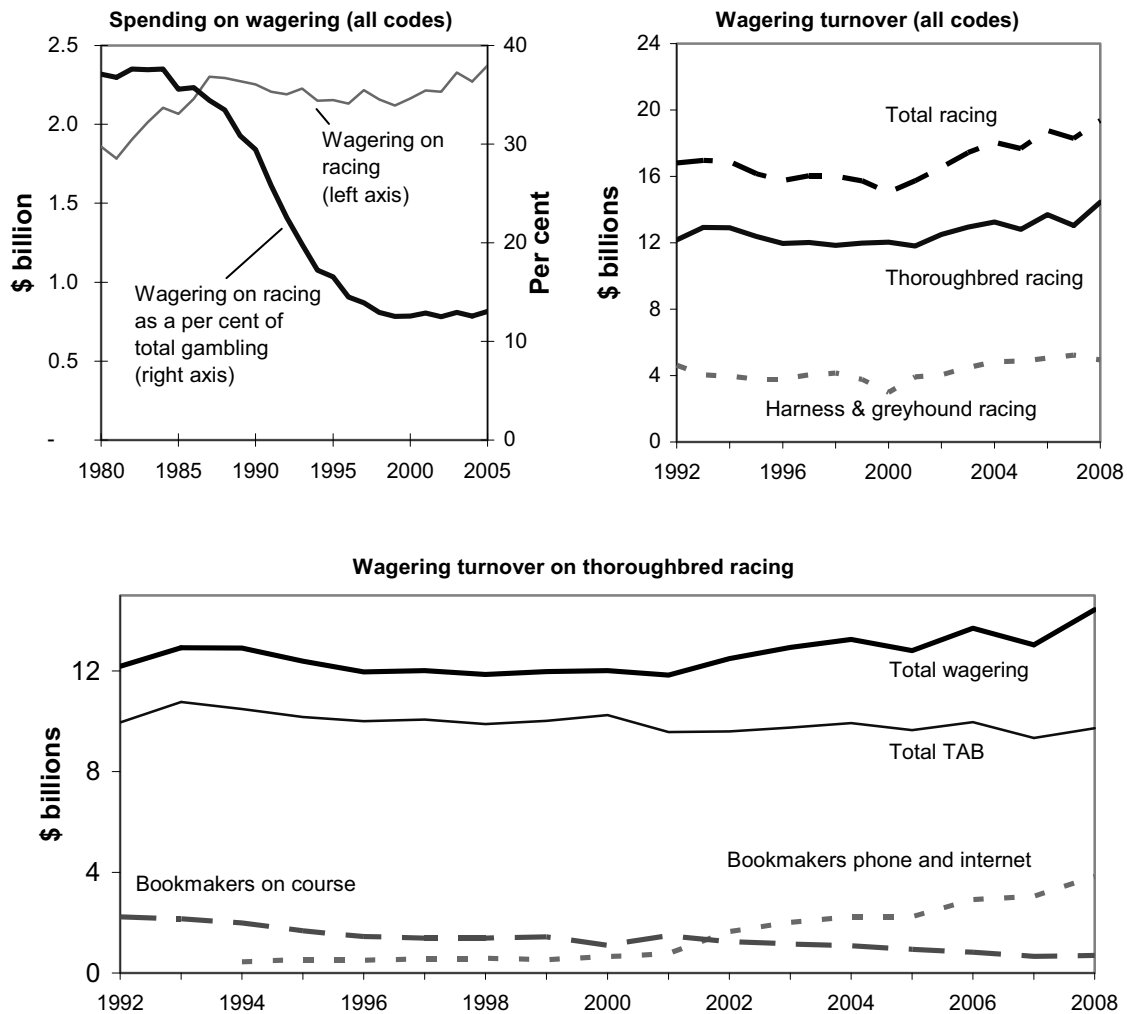
The financial ramifications of this are more severe for the racing industries than they are for the TABs. Whereas funding to the racing industry depends critically on the health of the wagering industry, the TABs are partially insulated by their stakes in competing gambling products. This is because some consumers will substitute wagering on races for other types of gambling also provided by TABs. For example, Unitab (which operates the TABs in South Australia, Northern Territory and Queensland) is owned by Tatts Group Limited, who offer a range of gambling products across Australia, including ‘scratchies’, lotteries, EGMs and EGM monitoring services. Similarly, Tabcorp (which operates TABs in New South Wales and Victoria) owns Star City Hotel and Casino in NSW and EGMs in over 260 pubs and clubs in Victoria.

Market trends substantiate a decline in the relative importance of wagering on racing during the 1990s, with turnover plateauing over this period (figure 16.1). At the same time, household income and aggregate gambling were growing rapidly, resulting in a sharp decline in expenditure on wagering when measured as a proportion of total gambling or total household expenditure.

Since 2000, phone and internet based bookmaking operators have led to increased growth in the wagering market. Whilst still a relatively small part of the wagering market (representing around 25 per cent of turnover), corporate bookmakers have grown rapidly since their inception, increasing their turnover by almost 500 per cent since 2000. In contrast, wagering turnover with TABs on thoroughbred racing was slightly lower in 2008 than it was in 1992, after inflation has been taken into account.⁶ The real turnover of on-course bookmakers has declined more markedly. These trends suggest that some of the growth in corporate bookmaking is due to punters switching from one wagering product to another. However, the growth in corporate bookmaking has more than offset these declines, causing the wagering market to grow overall, in terms of both turnover (the total value of the wagers taken) and spending (the total value of punters’ losses).

⁶ Several participants (Tabcorp, sub. 372, Betchoice, sub. DR396, p. 1) have pointed to a significant jump in TAB turnover in the 2008-09 financial year. However, this ‘jump’ is largely a correction for drop in turnover in the 2007-08 financial year caused by the equine influenza virus.

Figure 16.1 Real wagering turnover on racing
2008–09 prices



^aTotal TAB includes totalisator betting through on and off-course retail outlets, totalisator betting through phone and internet, and fixed odds betting. The vast majority of this turnover is on totalisator betting.

Data source: Australian Racing Board Fact Book, Office of Economic and Statistical Research, Queensland Treasury.

The retail monopoly held by TABs was not entirely responsible for the stagnation of the wagering industry (prior to the entrance of corporate bookmakers). Other factors that may have contributed include:

- the maturation of the wagering industry, limiting the prospects for further growth
- increased accessibility of alternative gambling products, particularly casinos, EGMs and sports betting
- changing consumer preferences.

Nevertheless, a number of industry participants and commentators have referred to serious problems that emerged due to the past dominance of the TABs (box 16.4). These detrimental effects have been lessened by increased competition in recent years. Whilst the rise of internet and phone-based wagering operators represent a fundamental and potentially risky change to the way the industry is funded, reinstating the past dependence on TAB distributions would be more problematic. Subject to an adequate way of funding the racing industry, the interests of consumers, and thereby the racing industry, are best served by a diverse and competitive wagering market.

What about the welfare of owners?

While TABs' market power in the past has reduced the welfare of punters, some participants have argued that it is necessary to ensure the welfare of an equally important group – owners. With this group in mind, the National Horse Racing Alliance suggests the need to 'reinforce the role of pari-mutuel wagering' (National Horse Racing Alliance, sub. DR411, p. 13). This is echoed by Racing NSW who argue that the key measure of the welfare of this group is the degree to which the cost of owning a race horse is recouped (on average) through prize money winnings:

The most important internationally recognised measure of success of racing jurisdiction is to compare the return to owners as a group with the cost that group of owners incurred to have their horses compete (Racing NSW, sub. DR318, p. 5)

This model (totalisator based funding) served the (racing) industry well and allowed the industry to return up to 60 per cent of the training and racing costs to owners in the form of prize money compared to a maximum of 30 per cent of cost returned to owners in Ireland, Germany and Great Britain where the wagering landscape is dominated by bookmakers and betting exchanges conducting low margin operations. (Racing NSW, sub. 228, p. 2)

Box 16.4 The traditional model has been detrimental to racing and wagering in Australia

Hunter Coast Marketing describes the situation as following:

... the relative absence of competition amongst TABs (except for facilities used by a small number of professional punters), coupled with the introverted, amateur style management of race clubs and race authorities, retarded the industry through the 1990s (turnover was flat prior to the arrival of newcomers). Product suppliers dominated, customers had to take what was offered. (sub. 57, p. 6)

A similar view is put forward by Harness Racing Australia and the Racing Industry Consultation Group:

...I believe that it is customer service that has been the biggest cause of the growth of corporate bookmakers. The racing industry has neglected some of its consumers in the past couple of decades, I have no doubt about that. I'm not talking about the present administration... certainly there was a problem, going back some years in terms of paying due attention to the rights of their customers. I certainly believe that the TABs have been guilty of being lazy and not taking care of their customers as they perhaps should have done. That doesn't mean they should be tossed out of the equation here, it means simply that they need to get their act together, and I think they are gradually doing that. (Harness Racing Australia, trans., p. 696)

The RICG recognises that competition and efficiency in the provision of racing and gaming services in the past may have been deficient. RICG also believes that the industry is very much aware that it cannot stand still and that its is under challenge from competitive forces. (Racing Industry Consultation Group, sub. DR347, p. 6)

The importance of greater competition is also stressed by the Australian Bookmakers' Association:

Wagering and racing in Australia has long been treated by policy makers as a "special" industry that should ignore consumer welfare priorities and will best prosper via anti-competitive arrangements. Unfortunately the industry's current struggle for market share and relevance to younger generations is a product of this misguided approach. (sub. DR320, p. 4)

Industry commentator Patrick Smith writes:

Racing used to be bankrolled by the TABs. A significant share of money bet went to racing. It came at a heavy price, a big slice taken out of the punters' winnings. ... Wagering on thoroughbreds is a shrinking market because money is being spent on gambling types other than horse racing. (2009, p. 1)

Allens Consulting Group also suggest that market share has been lost to other forms of gambling that operate at lower margins:

Competition from other wagering operators has been used to explain declining TAB revenues. However, this view ignores substitution with other forms of gambling, including sports wagering, casinos and pokers machines and online gaming with illegal offshore operators. (2008a, p. V)

The Commission considers that, in the absence of evidence pointing to a market failure in terms of the rate of return to owners, there is no justification for targeting

this metric. Owning a race horse is both an investment and a recreational activity. In either case there is no clear basis for regulation aimed at guaranteeing that a set proportion of the cost of horse ownership is returned to owners:

- *Investment aspect:* Government generally does not seek to guarantee any level of return for individuals or firms who voluntarily decide to invest in a new business, project, on the stock market etc
- *Recreation aspect:* It is usually the case that entertainment and recreational activities are entirely paid for by those who voluntarily engage in them. In specific circumstances governments do intervene to reduce the cost of certain recreational activities (for example youth participation in sport to promote health and well being). However, it is dubious that returning a predetermined percentage cost of racehorse or greyhound serves any wider societal purpose. For example, people who own a horse merely for the joy of riding (outside of competitions), do not receive such a subsidy.

Moreover, the rate of return to owners is a dubious metric for government or industry to target, or to use to measure one country's racing industry against another's. The return to owner is partially driven by prize money and partially driven by the factors that influence the costs of ownership and the number of people willing to enter the market. For example, should prize money rise significantly, presumably more owners would enter the market, reducing their expected winnings and generating upwards price pressure on the goods and services that owners require (breeders, trainers etc). For these reasons, there is no guarantee that higher prize money would increase the return to owners on average, or vice-versa.

Funding arrangements have distorted the racing industry

The three racing codes in Australia have historically been administered at a jurisdictional level. States and territories have their own laws and regulations, as well as their own governing bodies that:

- receive product fees from TABs and on-course bookmakers (and more recently corporate bookmakers and betting exchanges)
- oversee the distribution of funds to racing clubs across the state or territory
- manage the local industry.⁷

⁷ In some areas, there has been considerable coordination between these bodies over the years to ensure common practices, standards, racing rules and racing integrity. This has occurred through national bodies such as the Australian Racing Board, Harness Racing Australia and Greyhounds Australasia. Nevertheless, state and territory industry racing bodies retain control over the commercial operation of the racing industry in their own jurisdictions.

Whilst advantageous in some regards, these arrangements have led to the inefficient allocation of resources for racing at a national, state and club level.

Distortion at the national level

The higher prices paid by consumers, due to the protected retail segment of the wagering market, means that their consumption patterns will be different to what would have occurred in a competitive market. As punters' consumption patterns determine prize levels, this distortion will echo down the racing industry supply chain, influencing the use of the resources (such as labour and capital) available to Australian economy.

While TABs still yield a significant degree of market power, this is being gradually eroded by the growing competition from corporate bookmakers, in turn reducing the magnitude of the market distortion.⁸ This has generated considerable concern that as corporate bookmakers gain market share at the expense of TABs, revenue to the racing industry in Australia will decline overall. However, as noted in the 1999 inquiry, there is no guarantee that the traditional arrangements have delivered the 'right' level of funding to the industry in the past (PC 1999). Nevertheless, anticipating the likely effect of the shift from high margin to low margin providers is of relevance to the racing authorities and the broader industry, in order to manage this transition.

The majority of racing's funding still comes from the 'monopoly rents' extracted by the TABs from consumers, with higher margins and lower volumes than would otherwise have been the case. A more competitive market would imply lower margins to wagering operators, which would necessarily reduce the proportion of each bet that could feasibly be levied by the racing industry (and taxed by government). This could cause a contraction of the racing industry. On the other hand, lower margins also imply better prices for punters, increasing the quantity of bets they place. Similarly, the existence of low margin operators may 'bring in punters who might otherwise prefer other gambling options' (Betchoice, sub. DR395, p. 4). If punters are sufficiently sensitive to better odds, it is possible that the racing industry could expand as low margin corporate bookmakers increase their share of the racing market. One bookmaker characterises this shift as follows:

You are better off taking a small slice of a very big and rapidly expanding fresh pie than trying to take a huge slice out of a stale and contracting party pie. (Eskander 2009)

In contrast, Tabcorp has argued that most punters are unresponsive to odds, and that price is not a determining factor for most segments of the market (sub. DR372,

⁸ Conditional on the new entrants being charged an appropriate product fee.

p. 29). This contradicts earlier findings by Windross (2008) on the responsiveness of TAB customers in New South Wales and Victoria to changes in the take out rates of win and place pools. It also appears to be inconsistent with the rapid growth in corporate bookmaking, as well as Tabcorp's own concerns about 'leakage' to Northern Territory based operators (sub. 229, p. 21). Nevertheless, if it were accepted that the majority of punters are indifferent to prices, then it would follow that any further movement of customers from TABs to corporate bookmakers would be minor and the effect on racing industry funding minimal (unless corporate bookmakers are intrinsically more attractive or convenient).

In its submission, the Australian Racing Board also presents analysis conducted by Allens Consulting that found that the growth of corporate bookmakers and betting exchanges would cause a decline in racing industry funding (sub. 213, pp. 30-33). However, this result did not factor in the product fees derived from the recent race fields legislations that have since come into effect in most jurisdictions. Taking this into account in a report for Betfair, Allens (2008a) found that increased competition in the wagering industry would be revenue neutral to the racing industry.

The Australian Racing Board (sub. 213, pp. 35-44) points to similar modelling by the Boston Consulting Group (NSW) and Racing Victoria Limited (Victoria). The first of these studies finds a positive funding effect arising from the race fields legislation and a negative effect arising from the growth of bookmakers. However the combined effect of the growth in corporate bookmaking and the race fields legislation is not presented. The Racing Victoria Limited study suggests that racing funding should increase, so long as product fees are enforceable.

These analyses aside, there are indications that Australia's thoroughbred racing industry, in particular, is unusually large by international standards. For example, Australia has the greatest number of thoroughbred racing clubs in the world (379) and is amongst the top three countries in terms of the number of races held, prize money and foals born. However, international differences in the size of the racing industry will be driven by a number of factors, including: the level of competition in the wagering market, the nature of the racing industry funding system, the regulatory environment, the relative abundance of resources, consumers preferences and other historical factors. As such, it is difficult to draw firm conclusions from international comparisons.

Some participants and commentators have clearly interpreted the size of the Australian thoroughbred racing industry as reflecting a fundamental imbalance:

The evidence of waste is everywhere in the industry: too many races, horses, tracks and dependant employees to say nothing of the superstructure of associated contributors hanging off this inefficient industry (Peter Mair sub. 39, p. 6)

We have too much racing. The participants are jaded and the punters bored. Less could well mean more in terms of attendances and turnover if we have fewer meetings of a better standard. (Steve Moran 2009, p. 1)

It can be concluded that there are too many racecourse across the State (NSW) and the standards of safety and amenity could be raised generally if some were permanently closed (Balmoral Consultancy Services, sub. DR295, p 10)

Others have rejected this notion:

There is no evidence to support the contention that Australia has too much racing.... Tabcorp's data indicates that demand for racing product is increasing, rather than decreasing...(sub. DR372, p. 38)

To suggest that there is an overabundance of quality racing product beggars belief. For Racing to compete with other forms of gambling it needs more, not less quality product. (Victoria Racing Club Ltd, sub. DR310, p. 7)

It is not possible to accurately predict the long term effects of increased competition from corporate bookmakers and betting exchanges on the size of Australia's racing industries. Importantly, the change is likely to be gradual, easing the transition cost as the industry expands, or contracts. In the short term, the direction of this trend is likely be masked by the more immediate effects of the unwinding of past inter-state distortions (discussed in the next section).

In any event, an industry ultimately exists to meet the demands of consumers and for the interests of the community generally, not for its own sake (see box 16.5). The 'correct' industry size is that which most closely represents consumers' preferences for the number, frequency and quality of races, and the prices they are willing to pay for them (in terms of the odds they receive). Accordingly, if punters prefer better odds (even at the expense of fewer domestic races), then a leaner racing industry that delivers this is preferable to a larger industry that does not. And, while a move to a bigger or smaller industry may involve transitional costs (such as bottlenecks or unemployment), these costs do not justify preserving a system based on the market power of the incumbents.

Box 16.5 Who is the racing industry ‘for’?

Some participants have argued that the racing industry does not merely exist to meet the demands of consumers (punters) and provide them with the services they want at the lowest feasible prices — as generally accepted in other industries — but rather to:

- provide employment
- serve the needs of a broader group, which includes industry stakeholders themselves.

The first point only has validity to the extent that those employed in the racing industry would be unemployable anywhere else in the economy. Ideally, labour is allocated between industries according to the relative value that society places on their output. Deviating from this in order to artificially increase the size of a chosen industry only has a net employment effect if there are workers whose productive capacity would otherwise be entirely lost to the economy. But the vast majority of workers in the racing industry are not intrinsically unemployable. As such, the most important effect of a market distortion that resulted in a racing industry that is too big or too small, is the loss of consumer welfare (due to its under-provision, or its over-provision at the expense of the production of other goods and services — see also chapter 6).

The second point is more complicated. While the racing industry is set apart from many others due to the passionate interest it evokes, most participants in it are appropriately categorised as producers (e.g. breeders, racing club administrators etc). While there needs to be a mechanism in place to prevent free riding, as producers, their industry size should reflect their ability to compete with the variety of other goods and services available to consumers.

However, horse owners are at least partly ‘consumers’. That is, many engage with racing for their own recreational reasons, in addition to providing a key input into the production of racing product. They are different from most consumers, however, in that racehorse ownership receives a subsidy (through prize money), and can even enrich them. This has allowed the ‘consumption’ of this product to be larger than would have been the case without wagering, (in which case owners would have to meet the full cost of participating in horse racing).

Attempting to advance the consumer interests of owners, at the expense of punters, is counter productive. It essentially penalises the subsidy provider, who in the long run will reduce betting, with negative implications for prize money and the costs of ‘consumption’ for race horse owners.

Distortions across states

Australians have long enjoyed betting on interstate races, particularly the prestigious thoroughbred races such as the Melbourne Cup. Today, betting commonly occurs with internet or phone operators, who can be located in any jurisdiction in Australia. However, in the past, betting on interstate racing was

primarily done through local TABs and on-course bookmakers. Prior to the enactment of the recent race fields legislation, there was no requirement for wagering operators to pay interstate racing authorities for the use of their product. Rather, there was a so-called Gentlemen's Agreement in which:

- betting and racing information could be freely exchanged between the states and territories throughout Australia
- TABs and bookmakers could accept wagers on interstate racing without paying for the privilege (rather payment was made to the local racing industry)
- TABs refrained from competing for customers outside the state or territory they were located in.⁹

The Gentlemen's Agreement initially allowed each state to maximise the revenue to their racing industry.¹⁰ However, over time it meant that the growth of a jurisdiction's racing industry was proportional to the amount of wagering undertaken in that jurisdiction on races all over Australia, rather than to the amount of wagering on races actually held in that jurisdiction. This means that resources were shifted from racing industries in jurisdictions that generated the most interest to Australian punters and transferred to states providing less desired racing products. In effect, this acted like a tax on excellence, contrasting with the usual function of markets to reward firms that best serve the demand of consumers (as noted by Peter Mair, sub. 39, p. 7).

While the Gentlemen's Agreement is likely to have affected all codes of racing, the national profile of thoroughbred racing (in particular a small number of widely published thoroughbred racing events) has generated the largest distortions. In certain states, this effect has been large, with New South Wales, Tasmania and Queensland being major beneficiaries. For example, while New South Wales residents account for around 41 per cent of wagering in Australia, less than 31 per cent of total Australian wagering is on races held in New South Wales (table 16.1). It is estimated that this translated into a \$20 million subsidy per year (Allens 2008a).

⁹ For example, Brown (2009) suggests that 'when telephone betting was introduced by State TAB's it was agreed that there would be no action taken by them to attract customers from other jurisdictions.' However, this has been progressively undermined by the increased competition between TABs following their privatisation.

¹⁰ As expressed by Brown (2009, p. 1): 'When the Gentlemen's Agreement was reached it had no practical downsides... all betting was conducted on a face to face basis and was therefore confined within the boundaries of the various jurisdictions.'

Table 16.1 Wagering on thoroughbred horse racing in Australia
September 2008 to August 2009^a

	<i>Wagering by residents</i>	<i>Wagering on jurisdiction racing</i>	<i>Implied transfer</i>
	% of Australian wagering	% of Australian wagering	% of Australian wagering
New South Wales	41.5	31.0	10.5
Victoria	26.6	33.8	-7.2
Queensland	19.0	17.2	1.7
South Australia	4.6	7.9	-3.3
Western Australia	2.0	7.8	-5.9
Tasmania	5.2	1.6	3.6
Northern Territory	0.6	0.1	0.5
ACT	0.7	0.6	0.1

Source: Updated data provided by Betfair using the approach described in Allens (2008a).

While the introduction of fixed odds phone betting in 1994, and subsequently internet betting, improved the competitiveness of the wagering market, it also exacerbated the distortions generated by the Gentlemen’s Agreement. The attractiveness and convenience of these platforms encouraged punters to place bets with interstate wagering operators, often licensed in jurisdictions other than those where the races were held. In particular, the lower rate of taxation and more permissive regulatory regime in the Northern Territory dramatically increased the size of their wagering industry, resulting in funding being diverted away from the states that actually provided the racing product (prior to the implementation of the various race fields legislations — see below). In 2008, Tabcorp estimates that:

- \$987 million of turnover leaked from New South Wales to the Northern Territory
- \$592 million of turnover leaked from Victoria to the Northern Territory (sub. 229, p. 21).

The High Court’s decision on Betfair consolidated the rapid increase in the interstate trade of wagering service (box 16.6). The High Court ruled that restricting the supply of online wagering from other jurisdictions breached the constitutional requirement for unencumbered interstate trade. The High Court decision ostensibly related to prohibiting the use of betting exchanges and the power of racing authorities to deny access to racing fields. In practise, the decision has been interpreted more broadly as undermining states’ ability to use any form of discriminatory legislation or practice (including advertising restrictions) in order to maintain protected wagering markets.

Box 16.6 **Betfair Pty Limited v Western Australia**

In 2006 several amendments were made to the Betting Control Act 1954 (WA), which were subsequently challenged by Betfair. These were:

- S 24(1aa): A person who bets through the use of a betting exchange commits an offense.
- S 27 D(1): A person to whom this section applies who, in this state or elsewhere, publishes or otherwise makes available a WA race field in the course of business commits an offence unless the person:
 - (a) is authorised to do so by an approval and
 - (b) complies with any condition to which the approval is subject.

The court considered these amendments to be unconstitutional on the grounds they represented a “discriminatory burden of a protectionist kind” (s 92 of the constitution).

While s 92 is concerned with duties on interstate trade, since *Cole v Whitfield*, the object of the law has been interpreted as the elimination of protection.

Race fields legislation

These developments meant that jurisdictions could no longer maintain the Gentlemen’s Agreement. In July 2008, the New South Wales Government enacted race fields legislation, signalling the end to that agreement. Victoria, South Australia, Queensland, Western Australia the ACT and Tasmania have since enacted similar legislation (table 16.2). These empower the relevant racing authority in each state, and for each code, to set the product fee for the use of racing fields information by wagering operators across Australia. This was a fundamental shift in the racing industry’s funding model — from dependence on the size of the local wagering market (betting on both local and interstate races) to dependence on the wagering that occurs nationally, based on *their* product.

The race fields legislation partly remedied the distortions associated with the Gentlemen’s Agreement. In addition to ensuring payment from all users of racing product, the legislation reduced the extent to which states that are net importers of racing product are subsidised at the expense of states that are net exporters. However, a serious drawback of this approach is that race field legislation is state driven, and is thus based on a segmentation in the market that no longer exists. This has led to inconsistent product fees between the states and territories, which increases the regulatory burden facing wagering operators. For example, Tabcorp says that it has to comply with up to 72 domestic race fields agreements — ‘each with different charging methods, compliance and reporting requirements’ (sub. 229, p. 16).

Table 16.2 Industry agreements with TABs and product fees under race fields legislation

	<i>TAB and racing industry funding arrangements</i>	<i>Product fee under race fields legislation for all wagering operators</i>		
		Thoroughbreds	Harness	Greyhounds
NSW	22% of net revenue 25% of net profit An annual lump sum of \$12 million (indexed by CPI)	1.5% of turnover 3% of turnover for 'copyright fee' ^a	1.5% of turnover	10% of gross revenue
Vic	18.8% of net revenue 25% of net profit A further marketing and program of \$85.2m in 2008/09	10% of gross revenue (15% in gross revenue in Sept and Oct) Tab Limited product fee calculated as 1.5% turnover	1.5% turnover Betfair product fee calculated as 0.66% of net customer winnings	10% of gross revenue Tab Limited product fee calculated as 1.5% turnover
SA	42% of gross wagering revenue	10% of gross revenue	10% of gross revenue	10% of gross revenue
Qld	39% of gross revenue	1.5% of turnover	1.5% of turnover	1.5% of turnover
WA		Choice between a) 1.5% of turnover or b) The greater of 20% of gross revenue or 0.2% of turnover	Choice between a) 1.5% of turnover or b) The greater of 20% of gross revenue or 0.2% of turnover	Choice between a) 1.5% of turnover or b) The greater of 20% of gross revenue or 0.2% of turnover
Tas		Have indicated a gross revenue basis	Have indicated a gross revenue basis	Have indicated a gross revenue basis
ACT ^b	4.5% of turnover	10% of gross revenue	10% of gross revenue	10% of gross revenue

^a It is not clear which operators, if any, are currently subject to this fee.

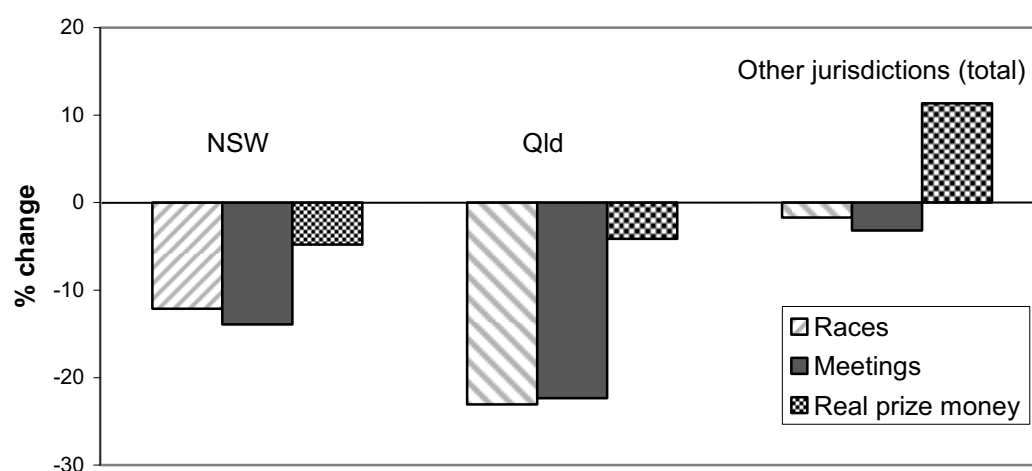
^b ACT race legislation will come into effect on 1st March 2010.

Source: Betchoice (sub. 395, p. 6), Tabcorp (sub. 372, p. 49), Harness Racing Commission (sub. 351, p. 1) and correspondence with various racing bodies.

More controversially, the state-focused regulatory approach potentially allows racing authorities to structure the product fees to defend the status quo funding arrangements with TABs, or to prevent structural adjustment. New South Wales and

Queensland have enacted the highest product fees in Australia.^{11 12} If these fees are legally sustainable (see below), they would have the effect of deterring entry by low margin wagering operators, protecting incumbent TABs and preserving the existing symbiotic arrangements of those incumbents with the racing industry. That might temporarily halt or slow the recent decline of the racing industries in those states (figure 16.2). But, as noted earlier, preserving a given size of industry is not justified for its own sake.

Figure 16.2 The racing industries have declined in NSW and Queensland^a
Between 1999-2000 and 2008-2009



^a Prize money has been adjusted for the effects of general price inflation.

Data source: Australian Racing Board Fact Book.

Given its potentially anti-competitive effects, several wagering operators have challenged the legislation (or Racing NSW's implementation of it) on constitutional grounds. While the courts have not yet ruled on the application of the law to these cases, the economics is relatively straightforward. Protectionist measures risk supporting and entrenching existing inefficiencies, in addition to contributing to ongoing uncertainty and litigation in the wagering industry. In that context, the Australian Internet Bookmakers Association argued that:

The fundamental problem with the race fields legislation is that it is State-based legislation that is designed to protect State interests, but that is trying to regulate a national market. Each State is looking at itself and its racing industry as a separate

¹¹ For example, Betfair suggests that 1.5 per cent of turnover is equivalent to 60 per cent of their gross revenue. This is six times higher than the product fees set in Victoria, SA and Tasmania.

¹² The product fees by the set by Greyhounds New South Wales are an exception to this and are comparable to those set in other states.

“economic unit” to the rest of the country. This protectionist motive inevitably leads to legal difficulties (sub. 221, p. 46).

Beyond this, funding misallocation and a variety of other distortions are likely to persist at the state level, for several reasons:

- *The new funding model has been superimposed on the old.* In some jurisdictions, the new product fees have replaced the old fees and charges on interstate bookmakers (such as in South Australia), whereas in others the new fees are additional to existing ones (such as in New South Wales) (Australian Internet Bookmakers Association, sub. 221, p. 48). Moreover, standing agreements still require TABs to pay local racing authorities based on the wagers they accept on interstate races. This is likely to:
 - reduce the competitiveness of TABs
 - reduce the welfare of consumers who bet with the TAB on interstate races who may ultimately have to accept even higher prices
 - maintain a wedge between the level of punter interest in certain races, and the level of funding those races receive.
- *The size of the racing industry in some states partially reflects cross-subsidisation from other gambling products.* For example, the Victorian racing industry receives 25 per cent of its profits from gaming machines and keno. (This arrangement will expire in 2012.)
- *TABs in Western Australia, Tasmania and the ACT are still government-owned, and the racing industry is still mainly government financed.* This may shield the TABs from the commercial pressures faced by privately owned companies as well as reduce the extent to which racing industry funding is driven by its value to Australian consumers. For example, in the ACT, it appears as if only part of the income from the proposed race fields legislation will be delivered to the racing industry, with the remainder being used as general revenue by government (*Canberra Times*, Saturday 30 January 2010). Rather than unwinding a past interstate market distortion, race fields legislation in this case is merely being used as new form of territory government taxation.

Despite their uneven application, the various race fields legislations will improve the interstate allocation of resources to the racing industry. However, the ongoing issues with the race fields legislations, and their incongruous juxtaposition with pre-existing regulations and contractual arrangements at the state and territory level, have been at the core of calls for a more national framework. To this end, the Australian Racing Board argued that:

This regulatory framework must also be national in nature ... The current changes represent an irreversible disintegration of the capacity of State and Territory

governments to individually regulate wagering (Australian Racing Board, sub. 213, p. 4).

Distortion within jurisdictions

There are two fundamental issues in allocating payments made by wagering operators to the providers of racing product:

- dividing payments between the three racing codes
- allocating funds within each code to the racing clubs that hold the race meetings.

Inter-code agreements

Whereas product fees from corporate bookmakers and other interstate wagering operators are paid directly to each code's racing authority, TABs allocate funding according to inter-code agreements. The funds are split according to specific funding formulae, which are periodically reviewed. Ideally, the share of TAB payments should correspond to the proportion of wagering turnover derived from each code of racing. However, in between review periods, these inter-code agreements can lead to an inappropriate allocation of funding if the share of wagering that takes place on one code of racing changes, relative to the other two (or if agreements are entered into that do not properly reflect market share in the first place). For example, greyhound racing accounts for 17 per cent of wagering turnover, but the industry receives only 13 per cent of the total payments made by the New South Wales TAB to the three racing codes. The greyhound racing industry estimates that:

... over the past 11 years because of the inequities of this arrangement, they have subsidised thoroughbred and harness racing in New South Wales by the tune of \$92 million. (sub. 248, p. 7)

Brasch (2006) points to a similar situation in Queensland, where the contribution of greyhound racing to wagering turnover significantly exceeds its entitlements to TAB distributions. It is estimated that this has cost the greyhound industry nearly \$18 million over five years.

Funding agreements that are unresponsive to changes in market share between the racing codes have several adverse implications:

- *Competition between the racing codes is stifled.* The incentive to offer high quality and innovative racing product or marketing campaigns is diluted because some of the rewards from such efforts will be diverted to competing racing codes. For example, if an advertising campaign by Greyhound NSW generated

\$100 of additional wagering turnover at the TAB, the largest benefactor would be thoroughbred racing industry (receiving an additional \$3.60) followed by the harness racing industry (receiving an additional 75 cents).¹³ Likewise, the funding agreements shield poorly performing codes from adverse financial effects. This distortion is greater the more the market share of a code deviates from the allocation of total wagering turnover under the inter-code agreement.

- *The power of consumers to ‘vote with their dollars’ is diminished.* In a competitive market, the success of industries (and firms) depends on the extent to which the products they provide satisfy the preferences of consumers. The inter-code agreements dilute this mechanism.

These criticisms aside, as the agreements are multifaceted and involve numerous other types of concession, it is difficult to evaluate conclusively their overall appropriateness. For example, in the case of greyhound racing in NSW, Peter V’landys has argued that favourable scheduling agreements, such as a ‘blackout’ of thoroughbred racing on Saturday nights, offsets the lower share of TAB distributions (Magnay 2009). Given some of these uncertainties and the difficulties for governments in interceding in what are effectively private negotiations, there are weak grounds for policy intervention. However, arrangements that provided more industry funding to racing codes that performed well would be preferable to the current arrangements. (Increases in competition in wagering and the consequent erosion of the legacy arrangements for sharing revenue may provide a commercial impetus for such change.)

Allocation of funds within racing codes

Allocation of funding within racing codes serves multiple, sometimes conflicting, objectives. In particular, funding can:

- support the social function of racing in communities, particularly rural ones
- provide development opportunities for up-and-coming horses. In that context, racing authorities may seek to maintain some ostensibly unprofitable race meetings on the grounds that these produce long-term benefits by increasing the quality of the breeding stock
- provide a financial incentive for parties within the industry to develop their particular races so that they are attractive to punters. In this case, allocation of funding would be proportionate to the level of wagering on events.

¹³ Based on TAB distribution of 5 per cent of turnover, being split among thoroughbred (72 per cent), harness (15 per cent) and greyhound racing (13 per cent).

Allocation of funding among these competing interests remains a controversial issue, as claims by one party for a bigger slice of the funding must inevitably reduce the slice for others. The key question is not whether the different objectives have legitimacy, so much as how much of the funding slice should be allocated to each function of the racing industry.

Overall, given the importance of providing strong incentives for the industry to hold races with high value content that attract greater consumer interest, the Commission is concerned that the funding arrangements have not given sufficient weight to the third objective. This is a view in line with some other commentators. For instance, Peter Mair contends:

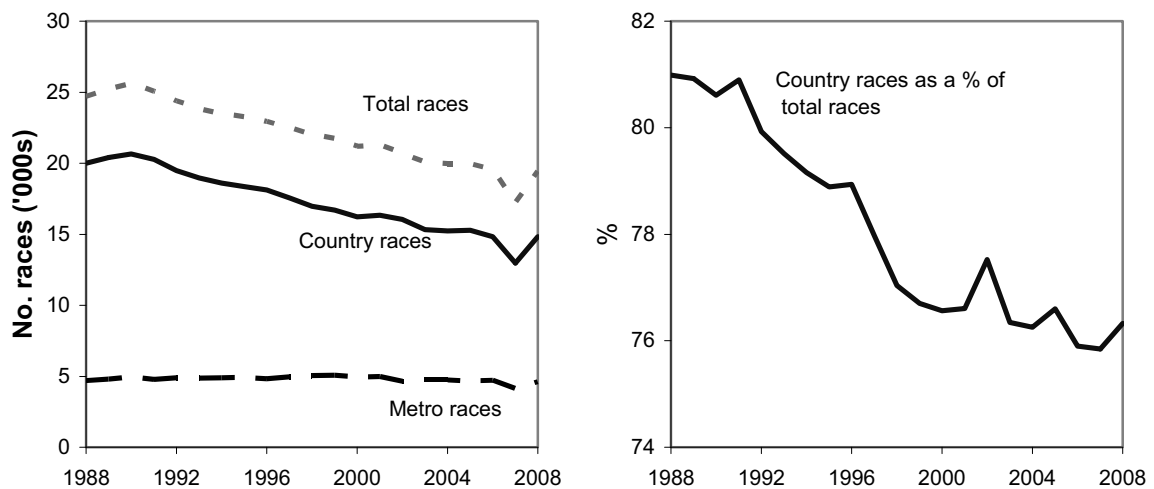
It will almost invariably be the case that ‘waste’ will characterize a substantial part of any discretionary disbursement of an automatic entitlement, money will be spent on beneficiary business operations that have no self-sustaining commercial merit ... Promoting racing that no one (apart from the beneficiaries) really wants, wastes much of the money across the states. ‘Waste’ means low grade races, largely unwanted, attracting insufficient TAB turnover to recover prize-money and associated production costs contributed by state authorities. (sub. 39, p. 1)

In part, the industry itself has recognised that the balance between these competing objectives has shifted, with new commercial imperatives and changing interests by consumers. Most conspicuously, there have been mergers between major metropolitan clubs, such as the Queensland Turf Club and the Brisbane Turf Club, as well as public debate about mergers between major clubs in Sydney and Melbourne. However, the longer term trend has been for consolidation to largely occur in rural areas, resulting in country races declining as a proportion of total races (figure 16.3).

The tensions between the various objectives described above have become starker with consolidation. Some commentators have lamented the transition, pointing to the consequences for rural communities and development of the industry. Robert Waterhouse writes:

The deliberate reduction of country racing has been unfortunate for country folk and racing. Saturday race meetings were the social centre of bush life. Country racing used to be racing’s nursery. Saturday country meetings have been transferred to mid-week ghost meetings, where no one goes. They have destroyed a great fan base and weakened our racehorse nursery. (2008, p. 3)

Figure 16.3 Changes in country and metropolitan racing



Data source: Australian Racing Board Fact Book.

However, it is unlikely that the important social or development functions of racing will be lost with a greater focus on consumers' interests:

- in the short-run, contractual obligations under inter-code agreements with TABs means that some commercially unviable races will be run
- the racing industry (and wagering) relies on a steady set of events throughout the week, with events with lower public interest being held on weekdays and ones attracting substantial interest on weekends. Accordingly, commercial imperatives may, in some cases, mean displacing less popular race meetings to different times, not eliminating them altogether. That can still serve some of the important social and development aspects of the industry
- the industry as a whole recognises that a sustainable industry requires a diverse breeding stock, which provides a constraint on excessive consolidation. With over 100 country racing clubs in New South Wales alone, the benefits arising from development opportunities may still persist if consolidations are correctly targeted
- as in other areas of society where there are community benefits from an activity — for example, sporting organisations, public swimming pools and libraries — there may be a case for local or state government funding. However, racing should be evaluated against the multitude of competing community claims for government funds (at a state or local level), with the same transparency and accountability.

The bottom line

The racing and wagering industry has undergone profound changes in the last 20 years:

- the wagering industry has been subjected to greater commercial pressure due to the privatisation of the previously state and territory owned TABs
- liberalisation and technological growth have generated a range of innovative wagering products, in addition to facilitating interstate competition between wagering providers
- traditional arrangements have been supplanted by these developments, leading to an ongoing effort to redefine the funding mechanism through which racing and wagering are inextricably linked.

Race fields legislation has partly remedied the distortions in the national racing industries associated with the Gentlemen's Agreement. However, as yet, race fields legislation has not delivered a functioning national funding model. Due to their uneven application across the Australian states, as well as amongst the codes of racing and different types of wagering operators, several legal vulnerabilities have emerged, resulting in numerous ongoing court cases. These relate to the discriminatory burden the legislations may represent, or their legitimacy given pre-existing contractual arrangements.

In light of this, there have been widespread calls for a national solution from a range of wagering operators, racing bodies and commentators (box 16.7). However, what is meant by a 'national model' differs significantly between participants. For some, a national model essentially means a strengthened race fields scheme that enshrines racing authorities' power to set their own price. For others, a national model means competitively neutral access to racing product, and reducing the complexity of dealing with a wide range of different fees from racing authorities in different jurisdictions. There is a clear tension as to what constitutes a 'good' funding model. This issue is taken up in the following section.

FINDING 16.1

In the absence of regulation, free-riding by wagering providers would undermine the racing industry and harm consumers of wagering and racing products. The current state-based race fields legislation overcomes this problem. But it poses significant risks for effective competition in wagering, potentially affecting the long-term future of racing and wagering and, more importantly, the punters who ultimately finance both of these industries.

Box 16.7 **Calls for a national funding framework**

It is recommended that the Productivity Commission support the implementation of a national approach to the application of Race Fields Legislation, particularly in respect of ensuring the constitutionality surrounding race field fees ... (Racing NSW, sub. 228, p. 1)

... the long term sustainability of greyhound racing and the wagering industry must be supported by federal intervention...National uniformity will build consistency with wagering and potentially better market share for greyhound racing. (Greyhounds Australasia, sub. 248, pp. 13 -14)

HRA encourage leadership from the Commonwealth Government to act collectively with State and Territory governments to ensure a workable, harmonised race fields model. (Harness Racing Australia, sub. 231, p. 3)

It seems sensible that the national Australian wagering market should be regulated on a national basis. In other words there should be a national model for the payment of product fees to the racing industry. (Internet Bookmakers Association, sub. 221, p. 57)

Tabcorp recommends the development of a single set of charges for the use of the racing industry's product by wagering operators. These charges would replace the current arrangements including race fields fees, profit share and other funding arrangements applying to totalisators and bookmakers. (Tabcorp, sub. 229, p. 27)

Tatts Group supports the notion that it's time to elevate the responsibility for wagering regulation and funding to a national level. (Tatts Group Limited, sub. 240, p. 3)

16.2 Principles of a good funding model

The central difficulty in constructing an effective funding model is resolving the tension between addressing the issue of free-riding, and the potential for such an intervention to stifle competition. Whilst there is no model that can accomplish this perfectly, a good balance is more likely if it is based upon transparent, generally supported principles. The principles proposed here emerge directly from the specific challenges facing the racing industry, but are aimed at promoting consumer welfare and allowing greater competition.

The funding model should serve consumer interests

The fundamental question when analysing any change to the racing industry funding model is: *will it result in better outcomes for consumers?*

It is clear that ensuring the long-term viability of the racing industry is highly important to consumers of racing and wagering products. However, for much of the second half of the 20th century, the issue of free-riding was addressed by

protectionist legislation that ensured that single operators dominated the wagering market in each state and territory. While delivering benefits to the racing industry, the lack of retail competition resulted in relatively poor outcomes for consumers. This may not have been perceived as being particularly problematic from a policy point of view as, in the earlier years of this funding regime, many saw gambling as being ‘socially undesirable’ anyway. Today however, gambling is widely viewed as legitimate source of recreation, notwithstanding its adverse impacts for some. For that reason, like any other commercial enterprise, the primary objective of racing and wagering must be to satisfy the demands of their customers (including the ‘safe’ provision of services) if these industries are to maintain the iconic status they have historically enjoyed.

The best funding model then, is one that emulates the outcomes that would be observed in a more competitive market. This involves generating the mix of value, quantity, quality and variety of races and wagering product most desired by consumers. In particular, the future health of racing and wagering is dependent on a funding model that can accommodate lower margin operators. Much of the wagering industry is characterised by operators whose prices (take-out rates) substantially exceed that of other forms of gambling. In the long term, the racing and wagering industries will be better served by a funding model that allows wagering operators to offer comparable prices to the alternative gambling products they are in competition with.

The funding model should have some degree of flexibility

The funding model needs to be designed such that wagering and racing providers are not inhibited from adapting to changes in consumer preferences over time. To the extent possible, product fees should also be designed to be neutral between different types of racing or wagering products, as well as being able to accommodate technological change and the development of new product types. The need for this kind of flexibility may influence the decision about the basis on which product fees are paid, as well as the process through which product fees are determined and how often they are reassessed.

Remuneration should reflect value

The level of remuneration that the racing codes, as well as the individual clubs, receive should be determined by the amount of betting that takes place on the races they provide. That is, a funding system that rewards racing providers proportionately to the value that consumers place on their product is preferable to

one that subsidises commercially unviable clubs. Remuneration based on the level of the racing public's interest gives racing codes and racing clubs the proper commercial incentive to:

- undertake marketing campaigns
- take on the risks associated with experimentation and innovativeness
- provide quality content that reflects consumer preferences.

The product fee structure should promote competition

The basis upon which product fees are paid needs to be compatible with the business models of existing wagering operators, including totalisators, on-course bookmakers, corporate bookmakers and betting exchanges. A fee structure that significantly disadvantages certain types of operators risks eliminating the consumer benefits that arise from a vibrant, competitive wagering market, such as:

- a wide variety of wagering products
- the pressure to provide consumers with value for money.

Product fees should be simple and uniformly applied

There is benefit in simplifying existing fees and charges, which currently differ by jurisdiction, code and type of operator. A single 'price' model, that replaced the existing arrangements, would:

- reduce administrative cost of the system
- reduce compliance cost for racing and wagering operators
- be more likely to deliver competitive neutrality.

However, whilst simplicity is a useful guiding principal, it needs to be pursued with regard to the potential to undermine the other objectives of a national funding system. For example, only allowing one type of wagering provider to operate might dramatically simplify the funding system, but at an unjustified cost to consumers.

16.3 A national funding model for racing and wagering in Australia

The lack of clearly enforceable property rights suggests that instituting an unregulated free-market would be an inappropriate solution to the issue of funding

the racing industry. A national funding model should seek to approximate the function of a more competitive market through legislation and regulatory oversight. In practical terms, this involves addressing two key questions:

- what price should wagering operators be charged for the use of their product?
- how should the system be administered?

The basis and quantum of product fees to the racing industry

Turnover or gross revenue?

The appropriate base upon which product fees are charged has been fiercely contested, both in terms of the existing race fields legislation and any national funding model. The debate centres on two potential bases for payment:

- *Turnover* — this generally refers to the total amount of sales. In a wagering context this translates into the total value of the bets placed on the backer's side.
- *Gross revenue* — this generally refers to the total amount of sales, minus the cost of the goods sold (but does not factor in other costs such as overheads, payroll, taxation or interest payments). In a wagering context this translates into total amount wagered, minus the amount paid out to punters as winnings (in other words, total player losses). Gross revenue is often referred to as gross profit.¹⁴

The two potential bases have a proportionate relationship, bound by the take-out rate of each operator.¹⁵ As take-out rates vary, the base that is chosen for the product fee changes the relative financial impact across different types of wagering operators. The challenge is to choose a base and a quantum that are 'fair' to all wagering operators.

- Gross revenue is the preferred base of Tatts Group (sub. DR302, p. 16) Clubs Australia (sub. DR359, p. 98), the Australian Internet Bookmakers Association (sub. 373, p. 8) as well online wagering operators such as Betfair (2009) and Betchoice (sub. DR258, p. 2). It has been adopted (or is planned to be adopted) by all greyhound racing bodies except Queensland and Victoria and all thoroughbred racing bodies except New South Wales and Queensland.¹⁶

¹⁴ Product fees based on both turnover and gross revenue are typically adjusted for back-betting (bets placed by bookmakers in order to reduce their exposure) under current race fields legislation. Similar provisions would be required in a national funding model.

¹⁵ That is $GR = T\beta$ where GR = gross revenue, T = turnover and β = the take out rate

¹⁶ In Western Australia, wagering operators can choose between product fees based on turnover, or on gross revenue. Tab limited mounted a successful legal challenge against Racing Victoria

- Turnover is the preferred base for product fees for totalisator operator Tabcorp (sub. 229, p. 27), Harness Racing Australia (sub. 231, p. 3), and a number of NSW based racing industry organisations (National Horse Racing Alliance sub. DR411, NSW Racehorse Owners Association sub. DR317, p. 2, Racing Industry Consultation Group sub. DR347, p. 11). It has been adopted by all racing codes in Queensland and Western Australia, thoroughbred and harness racing bodies in NSW and Harness Racing Victoria.¹⁷

Appreciating the difference between these two bases is complicated by conceptual idiosyncrasies of their application in a wagering context (box 16.8). Fundamentally, determining which is best revolves around several contested issues.

Box 16.8 Turnover and gross revenue in the wagering industry

Usually the term ‘turnover’ relates to the payment that is made in exchange for a good or service. However, in the wagering industry the good being exchanged is money itself (contingent on the outcome of an event). For this reason, what is commonly called ‘turnover’ in the wagering context is conceptually closer to what would be considered ‘units sold’ in the broader economy.

Similarly, what is commonly called ‘gross revenue’ in the wagering industry represents the total income received from the sale of wagering products, before any expenses such as wages, overheads etc are deducted. In the broader economy, this is conceptually closer to what is commonly known as turnover.

The idea of a price, also contains some complexity in the wagering context. The price that any individual punter will be concerned about is the odds offered on a given outcome (i.e that horse X will win). However, as a group, the price that punters pay, on average, per unit of consumption (i.e per \$1 wagered) will be determined by the proportion of each bet that is ‘taken out’ of the amount available to be won back by punters either via the odds structure (in the case of bookmakers) or by the predetermined ‘take-out’ rate (in the case of the totalisator).

Traditional Concept	Wagering industry
Unit sold	Turnover
Price	Take-out rate
Turnover (= price × unit sold)	Gross revenue (take-out rate × turnover)

Limited and Greyhound Racing Victoria. Following this challenge, Racing Victoria Limited has calculated TAB Limited’s product fees on a turnover basis. Greyhound Racing Victoria has adopted the turnover based product fee.

¹⁷ Harness Racing Victoria charges Betfair a separate fee based on customer winnings.

Industry support

It is sometimes claimed that only turnover-based product fees can support the current size of the racing industry (Tabcorp, sub. 229, p. 27, National Horse Racing Alliance, sub. DR411). In particular, it is argued that turnover-based product fees prevent a shift from higher margin operators towards lower margin operators that would otherwise undermine funding to the racing industry (Racing NSW, sub. 228, p. 7). However, as discussed earlier, the preservation (or growth) of the current size of the industry in each state would only be appropriate if it coincided with consumer preferences — which is doubtful.

As such, the alleged potential for a turnover base to support (or grow) the existing industry is not a good criterion for choosing between the competing models. Moreover, it is not clear that buttressing high margin operators through turnover-based measures would actually result in a larger racing industry in the long run. Product fee basis that can also accommodate lower margin operators (in addition to higher margin retail operators) may enable the wagering industry as a whole to compete more effectively against other forms of gambling or recreation.

Also, corporate bookmakers increase betting turnover through price competition and through their advertising efforts. This represents an increase in the consumption of racing product and it enhances interest in racing more generally. In turn, this raises the value of secondary assets — such as attendance fees, sponsorship and other advertising opportunities, use of race track facilities such as conference rooms or venue hire, etc — allowing the industry to reduce the risks of revenue volatility by diversifying across revenue sources.

Dealing with uncertainty

The gross margins achieved by bookmakers can change from race to race depending on how well they balance their book, whether a favourite or an outsider wins, the quality of information available on the runners in the race and the number of other operators accepting wagers on that particular event. Over the longer term, margins will also be driven by broader trends in competition, cost pressures and technological advancement.

Both the immediate and the longer term influences on bookmaker gross margin have led some to express concern about the level of uncertainty associated with product fees based on gross revenue (HunterCoast Marketing, sub. DR270, p. 7; National Horse Racing Alliance, sub. DR411, p. 10; Racing NSW, sub. DR318, p. 10). These participants argue that only turnover based product fees can guarantee that the race industry is paid for the use of its product.

With gross revenue based product fees, it is the case that a bookmaker who fails to make a margin on a given race avoids payment to the racing industry. Equally, should the bookmaker be lucky or skilful enough to make a large margin, then a gross revenue based product fee would require a larger than usual payment to the racing industry. If the former scenario was found to be more common, then the race-to-race volatility of gross revenue based fees would be problematic for the racing industry. However, wagering providers who could not secure a margin, on average, would be operating at a considerable loss (after all other expenses are deducted) and could not be expected to have a long term presence in the wagering market. Indeed, publicly listed companies offering wagering products would be expected not just to make a margin on their book, but rather a level of profit that delivered a commercial rate of return.

These commercial pressures imply that that an average industry margin (which may be different for different types of operators) should be relatively stable around the market equilibrium, and the race-to-race volatility in product fees should not be especially problematic. This appears to be the case in the jurisdiction that have adopted a gross revenue basis for their product fees (such as Victoria and South Australia).

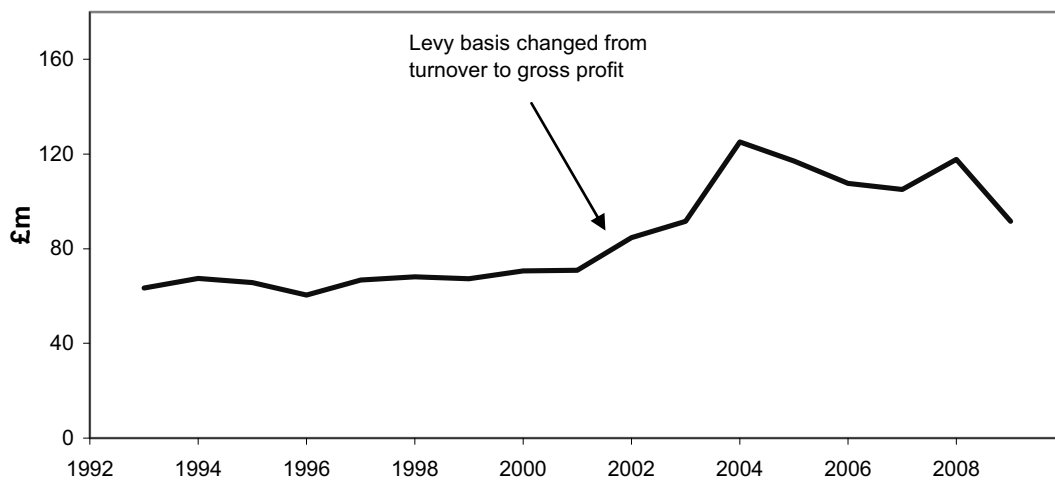
Longer term structural changes in the market will still impact the average margins that can be maintained, with repercussion for product fees based on gross revenue. However, it is unlikely that the racing industry can gain much in the long term by attempting to avoid this kind of uncertainty. The inherent interdependence between racing and wagering means that shocks to one market will always affect the other, regardless of the product fee model. This is both inevitable and desirable. For example, neither basis for payment will completely shield the racing industry from changes in the wagering market that adversely impact on overall turnover.

Furthermore, it is commonplace for the fate of producers of intermediary goods (such as horse races or car parts) to be intertwined with downstream users (such as wagering operators or car manufacturers). Indeed, from the point of view of consumers, racing and wagering are two components of a single product. Allowing signals of consumer preferences to be transmitted through both wagering and racing increases the incentive for both of these industries to jointly respond. Thus, the long term viability of racing and wagering is *bolstered* by linking their financial fortunes, not weakened. This also appears to have been the experience in the UK:

The irony is that the most significant increase in Levy income (one could argue that it has been the only one) was achieved when... the basis of General Betting Duty was changed from turnover to gross profits, which was mirrored in the Levy. This eventually led to Levy income increasing by two thirds, with little effort on the part of either racing or the Levy Board (Horseshoe Betting Levy Board 2009).

Data on the UK levy appears to support this, with a sharp rise in the levy yield (in real terms) following the change in the levy basis in 2002 (figure 16.4). However trends in the levy yield have also been heavily influenced by movement between countries (both to and from Great Britain) of online bookmakers, as well as the dramatic changes in economic climate that has occurred over the last decade.

Figure 16.4 British levy yield
Real 2009 prices



Data source: Horse Race Betting Levy Board. CPI from Office For National Statistics, United Kingdom.

Administrative ease

Tabcorp and Racing NSW (sub. 229, p. 27; sub. 228, p. 6-7) argue that turnover is easier to define, administer and assess, and is already the industry norm. Certainly, the recent Victorian Supreme Court decision demonstrates some of the difficulties associated with the use of gross revenue. This decision invalidated the product fees put into place by Racing Victoria and Greyhounds Victoria due to:

- the inconsistency of the arrangements with the underlying race fields legislation. In particular, the race fields legislation requires fees to be a fixed amount, not based on a formula.
- the ambiguity of calculating certain elements of gross revenue under the formula specified by the racing administrators. That is, certain items (such as free bets and unclaimed dividends) were not adequately defined.

The first of these findings is more of an issue with the race fields legislation than the product fee itself.¹⁸ The second demonstrates the need for the careful definition of what constitutes ‘gross revenue’ and highlights the value of dialogue between racing and wagering bodies when formulating product fees. The potential for wagering providers to adopt strategies that minimise their payments also need to be taken into account when construction product fee agreements using gross revenue. These definitional issues represent an additional cost to the use of gross revenue.

However, the widespread adoption of gross revenue suggests that any problems associated with its use are not insurmountable. While Tab limited objected to Racing Victoria Limited’s particular formulation of gross revenue, it has accepted this product fee basis in regards to the racing distribution agreement it has with the New South Wales racing industries. The majority of other wagering operators have expressed support for gross revenue based fees, despite bearing the majority of the compliance cost of this basis for payment. Finally, many jurisdictions already have experience that would be useful in developing a standard workable definition. Contrary to the views of some participants, the proportion of gross revenue (with some subtle differences) is the basis of payment for:

- agreements between the racing industry and TAB operations in Victoria, New South Wales, Queensland and South Australia
- product fees under various race fields legislation in Victoria,¹⁹ South Australia, Western Australia, the ACT
- taxation arrangements in the majority of Australian jurisdictions, across all types of wagering operators
- product fees paid to a number of sporting authorities for the right to bet on sporting events in Australia, including: the Australian Football League, Cricket Australia, the National Rugby League, Professional Golfers’ Association of Australia and Tennis Australia (Betchoice, sub. DR395, p. 9)
- wagering operators in several other countries such as the UK and Hong Kong.

The ‘uneven playing field’ argument

While turnover is often used as a financial indicator in wagering industry, gross revenue is more directly related to profitability. This is because, in the wagering

¹⁸ As some have pointed out (Saunders 2009, Racing Victoria Limited 2009), it appears that this ruling would equally apply to product fees based on turnover.

¹⁹ Racing Victoria has approached the Victorian government in order to amend the race fields legislation such that formulae based fees are allowed, which will allow gross revenue to serve as the basis for payment.

context, turnover equates to ‘sales’ (i.e. the number of units sold). On the other hand, gross revenue describes the margin or income that is actually derived from the sale (that is the price of the good minus its costs). All other things equal, the higher the proportion of gross revenue that is associated with a given product fee (regardless of the basis of payment), the less likely it is that the firm will be able to trade profitably.

The financial impost of turnover-based product fees varies greatly by type of wagering operator. As the take-out rate declines, the proportion of gross revenue that a given turnover based product fee accounts for increases. For example, if a product fee of 1.5 per cent of turnover was imposed on all wagering operators, this would result in an equivalent product fee of:²⁰

- 9.4 per cent of gross revenue for totalisators operated by TABs (based on an average take out rate of 16 per cent)
- 25 per cent of gross revenue for corporate bookmakers (based on an average take out rate of 6 per cent)
- 33.3 per cent of gross revenue for Betfair (based on an average take out rate of 4.5 per cent).

This puts lower margin operators — which offer the best prices to consumers — at a relative disadvantage. Whether they are made unviable (as some have claimed) by turnover-based fees depends on the level of the fee and the capacity of different types of operators to raise their prices. There is some indication that the capacity for corporate bookmakers to trade at higher prices is limited:

Our conclusion is that corporate bookmakers are actually tapping into a market that only exists at the low take-out rates of 4-6% and would not exist at >16% take-out pricing of totalisators. (Credit Suisse Equity research report, quoted in Australian Internet Bookmakers, sub. 221 p. 50)

The differential impact of turnover-based fees has led Betfair and Sportsbet to legally challenge their validity. These cases, which are before the courts in New South Wales, are ongoing. Irrespective of the legal outcome, it is evident that turnover-based fees will tend to either drive low margin operators out of business, or compel them to change their business models and increase their prices to punters. In short, turnover-based fees (if universally applied) discourage price competition between firms.

²⁰ A product fee based on turnover can be represented as $P = T\alpha$ where P = total product fee paid and α = proportion of turnover paid as a product fee. The proportion of gross revenue that such a product fee represents can then be expressed as: $GR = \frac{\beta}{\alpha}P$ where β = the take-out rate.

In contrast, product fees based on gross revenue are consistent with a variety of business models and are more likely to promote competition in the wagering industry. While there may be some concern that wagering operators may artificially reduce the gross revenue (for example, through free bets or offering too low prices) in order to reduce the product fee they have to pay, this is balanced against the incentive to maximise profit (which is the remainder after wages, overheads, advertising and other expenses are deducted from gross revenue).

Summing up on gross revenue vs. turnover

Overall, gross revenue appears to be the more appropriate basis upon which product fees should be charged. Gross revenue is already widely used as a basis for payment to racing and sporting authorities in Australia and internationally, and can be applied universally without disproportionately burdening certain types of wagering operators. This means that gross revenue based product fees:

- have greater flexibility in that they can support diverse business models
- are conducive to price competition between wagering operators.

These features are more likely to deliver better value to consumers and a wider range of wagering products. Similarly, to the extent that gross revenue based product fees facilitate a closer alignment of financial interest between racing and wagering, these industries will have a greater incentive to respond to consumers' preferences. In both cases, consumer interests are better served by product fees based on gross revenue. This in turn, will enhance the prospects for both racing and wagering to remain relevant and vital industries in Australia.

What price?

While this chapter is primarily focused on how the price of racing product is set, there are some indications as to what an appropriate price range might be:

- proponents typically suggest that between 10 and 20 per cent of gross revenue be paid as a product fee to the racing industry
- of those who use gross revenue as the basis for payment under their race fields legislation, most racing authorities in Australia also charge within a 10 to 20 per cent range.

In principle, wagering operators should be charged only by the racing authority whose race they accept bets on, and the fee should not differ by the type of operator. However, if it is anticipated that the TABs will continue to enjoy a significant degree of market power, it may be appropriate that they should pay a premium for

that retail privilege on top of the standard product fee. This premium should apply to retail sales of wagering products, not to non-exclusive internet and phone sales.

Setting the standard product fee dramatically above the 10 to 20 per cent range considered here risks online wagering providers evading the fee by moving their business operations off-shore. That said, several major UK online bookmakers have recently moved off-shore to avoid paying the levy there, which, at 10 per cent of gross revenue, is at the bottom end of the range considered here. As there will always be international jurisdictions willing to accommodate businesses seeking to free-ride, maintaining corporate bookmakers presence in Australia should not be the main consideration in setting the rate of the product fee.

Nor should the rate of the product fee be the sole instrument used to ensure payment for the use of racing product. As demonstrated in the UK, ensuring payment amongst internationally footloose wagering providers will progressively become a key feature of any national funding model. Both the right to hold an Australian wagering licence, as well as the right to advertise in Australia should be contingent on paying product fees to the relevant racing authority. Should the proposed federal online gambling regulator be empowered to block the ISPs of online firms who do not comply with the required harm minimisation and probity measures, similar powers could be used in regard to payment of product fees (see chapter 14).

In the absence of formal regulations, there would also be value in racing authorities entering into an agreement whereby the clubs in their jurisdictions would not accept sponsorship from wagering providers who do not pay product fees.

The administration of a national funding model

Despite widespread calls for a national funding model, there has been relatively little discussion of how such a system would actually work. The race fields legislation has conferred the necessary powers on the state and territory racing authorities to price and ensure payment for racing product in a national wagering market. However, the use of these powers has led to immediate legal dispute, undermining the practical function of a cohesive national market. There are three fundamental issues that will underpin how ‘well’ the national funding model performs:

- the process through which product fees are determined (and reviewed)
- whether the basic unit of administration is a national or a state body
- how product fees are distributed to racing clubs

The process for setting product fees

Some participants have argued that producers of racing product should have the right to set prices at their discretion, as would any other firm (Racing NSW, sub. DR318, p. 13). This is true to an extent. But, in setting a state-wide price, racing authorities are burdened with having to comply with the requirements of the Australian Constitution. Similarly, they must also be capable of setting product fees that comply with the Trade Practices Act.

In some cases, meeting the legal responsibilities of racing authorities' price setting powers will be complicated by the need to accommodate the divergent views and interests of the racing clubs they represent. Racing authorities may also be vulnerable to the influence of groups whose interests are better served by anticompetitive arrangements. In short, price setting by state and territory racing authorities is different to price setting by individual businesses. The power to set the price for the industry of an entire state, inevitably means that prices are the result of complex negotiations, be that with market participants directly, or indirectly through courts of law. Should price setting powers be elevated to a national level, a similar type of negotiation would necessarily take place.

In either case, there are several ways to increase the chances that such negotiations will result in a productive outcome:

- the price setting authority needs to engage in a public consultation with both racing and wagering stakeholders
- this consultation process should be transparent (rather than 'behind closed doors')
- the price setting authority should have clearly defined principles and objectives, which need to be known and accepted by stakeholders
- the decisions made by price setting authorities should be accompanied by publicly released documentation of the underlying arguments and evidence.

The basic unit of administration

In theory, product fees could be set by racing clubs individually. In this case, all that would be required to ensure an efficient market outcome, would be a legal framework that enforced their intellectual property rights. However, such a scenario would involve an immense transition cost from the current arrangements, and would be unlikely to achieve a stable market in any case. In order to reduce the cost of negotiation, most clubs would have a strong incentive to negotiate jointly through a representative organisation. This underpins the state and territory

arrangements in effect today. The question then, is whether an efficient national market is more likely under the current state-based arrangements, or through elevating price setting to the national level.

The funding model under state-based race fields legislation

As pointed out by several participants (Racing Industry Consultation Group, sub. DR347, p. 11; Australian Racing Board, sub. DR343, p. 4), one major advantage of the state based system is that it allows price competition. In a sense, racing authorities represent state-wide firms who must compete in a national market, with wagering providers as their customers. This can allow different jurisdictions and codes to select business strategy most suited to them. For example, some jurisdictions may choose to compete based on price, whilst others aim to provide premium content (at higher prices). This model also allows for trial and error, and for state and territories to learn from each other's experiences. The Australian Racing Board describes the racing product market in the following way:

...the view the ACCC has taken of racing to this point – within each code, it consists of at least eight competitors ... Every producer has the capacity to set its price. The market will then determine whether it's the right price or not. (hearings pg. 380-381)

Similarly, the Racing Industry Consultation Group argue:

...if the race fields is set too high, that will render an event unattractive to punters and will attract lower wagering returns and hence lower prizemoney for producers. This would make the event less attractive to producers, resulting in fewer starters. Conversely, if the race fields are set too low, they will render an event attractive to consumers but at the expense of horse owners who may have to accept lower prizemoney in order for the race clubs to recover costs. (RICG trans., p. 151)

Over time this process may lead to a market equilibrium price or a 'convergence of fees charged to wagering operators for the same product' (Australian Racing Board, sub. DR343, p. 4). Alternatively, the Racing Industry Consultation Group points out that a competitive market may deliver a range of different pricing arrangements (sub. DR347, p. 9).

Despite these advantages, there are a number of major concerns with the current state-based national funding model. Most obviously, race fields legislation may be inherently vulnerable to legal challenge. That is, wagering operators seeking a better deal may be able to successfully challenge race fields legislation, regardless of the basis or level of product fees. Even in this dire scenario, the race fields legislation may still be able to support a national funding model. Racing authorities can reduce wagering providers' incentive to legally challenge the legislation through the negotiation of a fee that all parties can accept. In some jurisdictions the lack of

dialogue has led to a clear sense of mutual bewilderment between racing authorities and wagering providers. An open consultative process, prior to determining product fees, would do much to bridge this gap.

For their part, wagering providers have reason to be reluctant to challenge the Race Fields Legislation due to the costs and uncertainty that inevitably accompany legal proceedings. Additionally, it is not in the interests of wagering providers to demolish the funding mechanism that generates the racing product that their business is built around.

The second potential danger is that the race fields legislations are legally robust, but result in anticompetitive outcomes in the wagering market. This could occur in two ways — racing authorities may purposefully advantage a certain type of wagering operator at the expense of all others, or they may collude to raise the price of racing. Competition between jurisdictions would tend to undermine this as described above. However, the majority of racing is produced by three states (New South Wales, Victoria and Queensland). Should these states coordinate their activities, anticompetitive arrangements could become persistent. This would harm consumers and, in the long run, harm the racing industry itself.

Finally, even if race fields legislation ultimately results in an efficient market outcome, the transition cost required to achieve this may be unacceptably high. Race Fields Legislations' short history has been characterised by legal action and the fear of legal action. This looks likely to continue in the immediate future. As one participant has described it:

The second option is litigation. The present case is focused on a constitutional challenge. There are clearly other avenues open for legal challenge including action under trade practices law. There is also a high likelihood of lengthy and expensive appeals. Under this option, millions of dollars is spent on wasteful litigation leading to years of uncertainty. Under this option, racing's destiny is shaped by the courts. (Australian Internet Bookmakers Association, sub. DR373, p. 12)

The funding model under a national price setting body

Elevating price setting to a national level would require a specially constituted body.²¹ The power to set product fees could be underpinned through the states and territories enacting template legislation (though the prospects for this are poor) or through a unilateral exercise of power by the Commonwealth. Commonwealth

²¹ The Commission's draft report canvassed the idea of the national racing representative bodies fulfilling a price setting role. The Commission's reservation about both the feasibility and desirability of such an arrangement was reiterated by the participants in this inquiry (for example Australian Racing Board, trans., p. 386, HunterCoast Marketing, sub. DR270, p. 23)

action could probably be based on its constitutional right to make laws with respect to taxation (s 51(ii)), though there are other potential heads of power.

A newly constituted body could be specifically designed to incorporate the principals discussed in section 16.2. It could also be required to follow a broader and more transparent consultative process than is likely to occur under the current arrangements. As raised in the draft report, the Independent Pricing and Regulatory Tribunal of New South Wales (IPART) is a useful institutional model.

As the ‘impartial umpire’, the price setting body would attempt to jump to the ‘equilibrium’ price that would emerge in a competitive market. There are several advantages of this approach:

- it would avoid the legal costs and uncertainties of the current arrangements
- it could better target consumer interest, and make broader use of the views of market participants
- it would reduce the scope for deliberate anti-competitive behaviour
- with a nation wide unified fee structure, administrative costs to both racing authorities and wagering providers would be lowered
- a national price setting body may be able to improve the prospects of exporting racing product. Such a body could negotiate with the racing and wagering authorities in other countries, and reduce transaction costs between the domestic racing industry and overseas wagering providers.

However, while the main problems of the current model would disappear under a national price setter, new ones may well replace them. While it is not possible to anticipate all of the dangers of implementing a dramatically new funding system, several key risks can be identified.

Firstly, the national price setter might ‘get it wrong’. In setting product fees at a national level, the price signals and market information that determine economic activity in the racing and wagering industries may be diluted. Whilst a national price setter could easily access information of the costs of producing racing product, it would need to make an assessment of its *value*, which is considerably more difficult.

Due to the heavily regulated nature of the racing industry, it is not clear that market information on the value of racing product is currently the driving force in determining product fees. The difference is that, under the current arrangements, if a particular racing authority incorrectly prices its product, the adverse consequences are largely limited to the racing industry in its own jurisdiction (as well as wagering providers and punters who bet on its product across Australia). However, if a

national price setter makes a similar error, all racing and wagering participants in Australia are affected until the a new price is implemented by the national authority.

Secondly, effective management of the national price setting body would require a high level of independence as well as knowledge of the racing and wagering industry. Too much of the latter (derived from personnel with direct industry experience) may undermine the institution's capacity for impartiality. There is also the danger that the selection of the board or panel that oversees the national price setting body could become highly politicised. The extent to which these risks are managed would crucially impact upon the body's legitimacy and its capacity to function effectively.

The option value of a deferred response

While the national levy scheme proposed in the draft report attracted some support (Tatts Group Limited, sub. DR302, p. 16; Australian Bookmakers Association, sub. DR320, p. 3; Greyhounds Australasia, sub. DR362, p. 2), the Commission has come to the view that it would be premature at this point to discard the existing approach based on race fields legislation. This is because, it is not yet clear whether the issues currently arising under the race fields legislation represent intractable problems, or merely the transitional costs of a dramatic shift in the racing industries' funding model. Given this uncertainty, and the many positive features of the current arrangements, there is value in deferring any further government action. In particular, the relative prosperity of the states whose product fees accommodate greater competition may prove to be a powerful motivating force for similar moves in other states, ultimately resulting in a more cohesive national system.

The costs incurred in transit to this state are likely to be severe, and concentrated on the racing industries of New South Wales and Queensland. However the costs of regulatory failure of a national pricing system could potentially fall much more broadly — impacting on states and territories who otherwise would have pursued competitive market outcomes without the need for federal intervention.

For this reason, the Commission has decided to recommend a 'wait and see' approach to race fields legislation. Such an approach has the advantage of allowing further modelling and discussion between racing authorities, wagering providers and governments as to the feasibility and attractiveness of a national approach to price setting. Should the existing legal avenues be unable to bring about an acceptable resolution, or if the costs of a litigation based solution are judged to be too high, then the national price setting model described by the Commission should be pursued.

Such an assessment inevitably contains an element of subjectivity. However, there are a number of outcomes that, if observed over the next 3 years, would indicate a move to a national price setting model is needed.

- Agreement over product fees cannot be reached and litigation is ongoing.
- Wagering providers are able to avoid paying product fees and the free-rider problem re-emerges.
- Inequitable treatment of certain types of wagering operators is obvious when comparing major racing jurisdictions to each other. In particular, if it appears that low margin operators are being forced out of New South Wales and Queensland, but are operating in Victoria, South Australia and Western Australia.

Should the third outcome eventuate in isolation of the other two, further analysis of the competitive implications of race fields legislation may be needed to motivate movement by the Australian Government towards a national body. This could be conducted by the ACCC, or through a specially constituted independent review (as with the Cameron review).

FINDING 16.2

The current approach to setting product fees by racing authorities in New South Wales and Queensland (excluding Greyhounds NSW) is unlikely to result in integration of their industries into a national wagering market. The costs of this will be felt most keenly by the racing industries in those jurisdictions.

RECOMMENDATION 16.1

The New South Wales and Queensland Governments should work with racing authorities in those states, as soon as possible, to replace their ‘across the board’ turnover fees with more competitively neutral and efficient product fees.

Within three years, the Australian Government should assess whether the race fields legislation frameworks are legally sustainable across all jurisdictions and give rise to competitive outcomes. If either condition is not satisfied, the Government should work with state and territory governments to replace these arrangements with a national statutory scheme, in which there would be a single product fee for each code. This fee should be:

- ***universally paid on a gross revenue basis and replace all other product fees currently paid by the wagering industry, but not other funding channels, such as sponsorship of race meetings***

set and periodically reviewed by an independent national entity with the object of maximising long-term consumer interests.

How should proceeds from product fees be distributed?

Ideally, the proceeds from product fees should be distributed directly to the racing clubs where the betting activity takes place, with the benefits described in section 16.2.

However, direct distribution may not be viable. First, the level of wagering may not always represent the true value of a racing club due to the compromises that are made when scheduling the many races occurring each week across Australia. In order to maximise wagering turnover, races are spread over the course of a week. It would obviously be undesirable from the consumer perspective if competition for the lucrative betting timeslots, such as Saturday afternoon, resulted in no or little racing at other times. It is unlikely that this degree of bunching would occur, as racing authorities, and the racing clubs themselves, would seek to schedule races based not only on the volume of wagering turnover that occurs in a given time period, but also the likelihood of their races attracting that turnover, given the competition they faced. Nevertheless, distributing product fees directly to the racing clubs based solely on the wagering turnover they generate, may not properly account for the complexities of scheduling races, and may undermine existing processes for determining race schedules.

Second, the costs of a direct distribution may be prohibitive. The administrative burden and technical feasibility of such an arrangement is unknown.

The alternative to direct distribution is for state and territory racing authorities to retain responsibility for allocating the funds amongst the racing industry. The advantage of using existing payment channels is that:

- the infrastructure for delivering payment to individual racing clubs is already in place
- state and territory racing authorities can account for scheduling considerations when allocating funds.

For these reasons, distribution through state and territory racing authorities is the Commission's preferred option. Nevertheless, there is value, in terms of competition and efficiency amongst racing clubs, in ensuring that the majority of racing clubs funding is determined by the revenue derived from wagering on the races they hold.

16.4 Other aspects of a national model

A number of participants have argued that a national racing and wagering model should have a broader regulatory scope than simply addressing funding issues. For example, Tabcorp recommended:

... a national approach to the regulation of wagering, including:

- Consistent regulation of credit betting and account opening inducements
- A single Code of Conduct dealing with responsible gambling, with which all wagering operators licensed in Australia will comply
- A single and mandatory integrity framework covering racing and sports, as well as all forms of betting and all operators. (Tabcorp, sub. 229, p. 26)

In some areas, there is obvious value to a national (rather than state and territory based) regulatory response. In particular, states have very little capacity to regulate the supply of telephone and internet wagering to people living within its jurisdiction. Online and telephone wagering, along with all other online gambling activities, should be subject to a consistent regulatory regime and overseen by a specialist body (discussed in chapter 15).

If a national price setting body is ultimately introduced, its national focus, expertise, independence and access to financial data make it an appealing option to take on probity responsibilities for the racing and wagering industries. In its absence, the incremental net benefits to further centralisation would need to be demonstrated, as existing institutions appear reasonably effective.

Competition issues arising from the broadcast of racing may also warrant a national response. Tabcorp, through its ownership of Sky Channel, is the sole television broadcaster of harness and greyhound racing, and is the dominant provider of thoroughbred racing broadcasts in pubs and clubs. As noted by the ACCC, the vertical integration of Tabcorp's wagering and broadcast businesses has potentially serious implications for competition in the wagering market.²²

As the capacity for punters to view racing events is a key factor of production for wagering operators that compete with Tabcorp, this arrangement may frustrate competitive access to racing broadcasts. Were governments to allow bookmakers to establish a retail presence, Tabcorp's ownership of Sky Channel would become even more problematic.

²² ThoroughVisioN Pty Limited & Ors - Authorisations - A91031 - A91032, 4 July 2007, ACCC
"The ACCC accepts that Tabcorp's ownership of Sky Channel provides Tabcorp with potential for a competitive advantage relative to other wagering providers that compete with Tabcorp."

Also, a number of wagering providers have claimed they are denied the opportunity to advertise on Sky Channel (Betchoice, sub. DR395, p. 15; Sportsbet, sub. DR376, p. 24). This may constitute anti-competitive conduct in breach of the boycott provisions of the Trade Practices Act 1974.²³

Whilst the Tabcorp submission appears to imply that the ACCC have given tacit approval to their ownership of Sky (sub. DR372, p. 39), no formal finding has been made on this issue. As such, the Commission considers that the Australian Government should refer this matter to the ACCC for further investigation.

RECOMMENDATION 16.2

The Australian Government should request that the Australian Competition and Consumer Commission examine and report publicly on any adverse implications for competition associated with the ownership arrangements for Sky Channel.

The urgency of a national approach and, in particular, federal intervention, is less evident for the various other specific issues facing racing and wagering. This is because state and territory governments and existing regulatory agencies already possess the authority, competency and infrastructure required to regulate racing and terrestrial wagering. Nevertheless, the Commission considers that there would be benefit in achieving greater national harmonisation of the regulation of wagering if the single price-setting model discussed above is adopted.

In the absence of federal intervention, the benefits of a unified regulatory approach to wagering should be attained through coordinated action by state and territory governments. The remainder of this section examines several key issues that these governments will need to address in the future.

Taxation

Taxation of wagering operators raises considerable revenue for state and territory governments. In 2007-08, this amounted to \$341 million, or 0.5 per cent of the total revenue raised by state and local governments (ABS 2009). The majority of this comes from TABs, although the specific taxation arrangements differ substantially between jurisdictions. At the high end of the scale are Victoria and New South Wales, which both charge off-course totalisators 19.11 per cent of gross revenue. At the low end are Tasmania and the ACT, which apply no special taxes to totalisators at all. There has a downward trend in taxation rates recently with the Northern

²³ More specifically ss 45(2)(a)(ii) and 45(2)(b)(ii)

Territory and Tasmania have recently introduced a cap of the amount of taxation the corporate bookmakers can be subject to.

Outside of sumptuary taxation (taxes aimed at reducing socially undesirable activity), governments tend to set higher taxes on goods or services whose demand and supply are relatively unresponsive to price increases. By this criterion, the changing structure of the wagering industry has made it a less attractive candidate for high taxation. Wagering on races faces increasing competition, not just from other forms of gambling, but also from other types of entertainment. This increase in potential substitutes makes wagering consumers more responsive to price increases, decreasing the efficiency of taxing this sector. The growth of online and telephone wagering providers has also reduced the capacity to raise tax revenue as these highly mobile providers have the ability to avoid paying taxes by migrating to jurisdictions with lower tax rates.

To the extent that special taxation of wagering is warranted, the remedy for tax competition is a binding agreement between all jurisdictions for a harmonised tax regime. Similarly, all wagering providers should be treated equally in terms of their GST obligations.

FINDING 16.3

There are grounds for state and territory governments to cooperate when setting taxes on wagering revenue, in order to avoid destructive tax competition. Increased levels of competition and the international mobility of corporate bookmakers will increasingly limit the capacity to tax wagering activity effectively.

‘Tote-odds’ betting

Tote-odds betting is amongst the most contentious wagering products offered by corporate bookmakers. Unlike traditional fixed-odds betting, where the bookmaker and the punter agree upon the potential payout at the time the bet is made, with tote-odds, the payout corresponds to the final dividend delivered from a nominated totalisator. This wagering product was first made available by Darwin All Sports (now known as IASBet) in 1996 and corporate bookmakers are currently permitted to offer tote-odds in all jurisdictions except for New South Wales, and Western Australia.²⁴

²⁴ This is not to say that tote-odds are strictly legal in all other jurisdictions. In some jurisdictions the practice occurs under the informal (but widely known) understanding that prosecution will not take place. Other jurisdiction have partial bans on tote-odds. For example, in Tasmania on-course bookmakers are prohibited from offering tote-odds, but other operators are free to do so.

From the perspective of consumers, tote-odds betting has two main advantages over betting directly with TABs. First, corporate bookmakers offering tote-odds provide better value than TABs. Most tote-odds providers either give the best available odds from a number of nominated TABs, or they offer to beat the final dividend paid out by a nominated TAB by a certain amount. In part, this price advantage arises from a lower cost structure. Corporate bookmakers are subject to a lower rate of taxation than TABs and tend to have lower overheads as their services are provided over the internet and telephone.

Second, tote-odds are able to provide a more attractive product to punters seeking to make substantial wagers. With totalisators, if a punter makes a large bet (relative to the size of the pool) on a given outcome, then the potential dividend available to the punter will be proportionately reduced (should that outcome occur). This effect can be dramatic in small pools, reducing the attractiveness of totalisators to those making big bets. The risk of ‘crushing’ the dividend can be reduced when placing a bet with a tote-odds bookmaker, who is likely to hold at least some of the wager. Back-bets made into a linked (by the terms of the bet) totalisator pool may still reduce the final dividend. However, the bookmaker has an incentive to minimise this by laying the bet across a number of totalisator pools and other bookmakers, as not ‘crushing’ the dividend is the basis for their comparative advantage over TABs in the first place.

Whilst being advantageous to some consumers, the practice of offering tote-odds has been strongly criticised by Tabcorp and a number of racing authorities (Racing NSW, Australian Racing Board, Australian Thoroughbred Racehorse Owners Council, and Harness Racing Australia). In addition to submissions made to this inquiry, arguments in favour of a national ban on tote-odds betting have also been raised in relation to the Cameron review (2008), as well as the Cross-Border Betting Taskforce (Department of Justice, Victoria 2003). Specifically, opponents argue that tote-odds betting products:

- have an unfair advantage as they contribute less to the racing industry and pay less tax than TABs
- increase the risks of totalisator pool manipulation by both punters and bookmakers. This may unfairly reduce the dividend that customers of TABs receive and undermine confidence in totalisator products
- steal market share from TABs, reducing their economies of scale and undermining their product by increasing the volatility of totalisator dividends
- are a de facto totalisator, offering no additional benefit to consumers, and potentially breaching the TABs’ right to exclusively provide totalisator products.

While some of these arguments illustrate genuine problems associated with tote-odds betting, these can be remedied using less extreme regulatory responses than prohibition. For example, the higher product fees paid by TABs are based largely on the market power they derive from their retail exclusivity. However, it not obvious why they should pay such a premium for their phone and internet sales, as this is a highly competitive segment of the wagering market (Tabcorp, sub. DR372, p. 31). To the extent that tote-odds betting is based on ‘jurisdiction shopping’ for the most preferable taxation requirements, tax harmonisation between states (discussed above) is preferable to denying consumers access to a product they highly value. Should corporate bookmakers still be able to ‘undercut’ TABs’ prices on an even playing field, they should be free to do so.

Similarly, there are several options for reducing the potential adverse impacts of totalisator pool manipulation without eliminating the benefits consumers receive from tote-odds products. Unlike TABs who operate on a cash basis, corporate bookmakers maintain comprehensive records of the transactions made between themselves, punters and other wagering operators. In theory, this should allow the relevant authorities to apply more stringent monitoring of corporate bookmakers offering tote-odds in order to detect any unusual behaviour. This kind of oversight would not prevent punters themselves from attempting to manipulate small totalisator pools in order to place large bets with tote-odds bookmakers on more favourable terms. However, the greatest risk of such behaviour is to the corporate bookmakers offering tote-odds, as well as to the pool manipulator themselves should the gamble backfire.

The effect of tote-odds betting on the size of the totalisator pools is a *potentially* more problematic concern. Were the pool to shrink significantly, this would make TAB dividends erratic and would poorly approximate the ‘true odds’. This would adversely affect customers of both the totalisator and tote-odds products (as well as providers of these products). Yet, it is not clear that allowing corporate bookmakers to offer tote-odds will shrink totalisator pools to a significant extent. For one thing, tote-odds providers commonly ‘back-bet’ into totalisator pools in order to reduce their risk exposure. Back-betting means that there is, in effect, an interdependent relationship between tote-odds and totalisator pools. This means that the pools will, at most, decline by only a proportion of the custom attracted away from the TABs by tote-odds providers. For example, one bookmaker participating in this inquiry indicated that around 80 per cent of their tote-odds turnover is bet back into totalisator pools (trans., p. 41).²⁵

²⁵ Confidential estimates received from Tabcorp suggest a considerably lower proportion of turnover is bet back into totalisator pools.

In addition, tote-odds betting will grow the market, attracting some new customers who would not have originally placed bets with the TABs. Given the interdependent relationship described above, this means that new customers attracted by tote-odds actually add to the totalisator pool. While the net impact of tote-odds on the totalisator pool is probably negative, the adverse scale effects are likely to be small and less important than the benefits of price competition in this segment of the market. This is supported by the observation that the increases in corporate bookmaker turnover have not been matched with commensurate declines in totalisator turnover (figure 16.1).

However, there is an important distinction between competition from tote-odds products and the competition that would ensue were governments to relax the exclusivity arrangements for the provision of totalisator betting. In the latter case, the adverse scale effects would be much more severe, as competing totalisators would quarantine wagering turnover into separate pools (rather than recirculate it through back-betting). This would risk substantially reducing consumers' access to reliable totalisator products.²⁶ For this reason, the Commission is not recommending that totalisator exclusivity arrangements be removed.

Tabcorp have argued that the Commission's support for totalisator exclusivity is not consistent with permitting tote-odds betting:

...the Commission makes two statements that in our mind are contradictory. The first says that totalisator exclusivity is a good thing because totalisators require a pool... we agree with that. The second statement is that tote odds betting by bookmakers should be allowed so they can copy the price and offer the best tote. The problem with that is the moment you allow tote odds betting, there really is no exclusivity because for the consumer you can either go to the tote and bet directly in the pool or you can bet best tote with the bookmaker. (trans., p. 13)

In contrast, the Commission considers that totalisator exclusivity retains value due to the greatly reduced risk structure of totalisator products. Totalisator providers face ordinary business risks (like other firms in the economy), but not the peculiar risk of negative revenue that bookmakers (and certain kinds of stock market firms) must contend with. This represents a significant competitive advantage. Should taxation and product fees be harmonised throughout Australia, this advantage would increase considerably. Even in the current environment, Tabcorp has described

²⁶ On the other hand, the consumer benefits of larger pools also means totalisator providers with larger customer bases would have a competitive advantage over smaller new entrants. In a completely open market, with harmonised tax and product fees the totalisator business may equally exhibit the characteristic of a 'natural monopoly'. This would effectively mean that totalisators would not need formal exclusivity to achieve sufficient scale to provide a reliable product. However, under the current arrangements, new totalisators operators from low taxing jurisdictions, could indeed generate the disruptive effects described here.

numerous examples of tote-odds providers incurring considerable losses from their operations (sub. DR372, appendix F). Betchoice describes the risks that tote-odds providers face in the following way:

The difference between the amount bet back with totalisators and the amount received from the punter represents a real risk that Betchoice, as a bookmaker takes on. It is by successfully assessing this risk and offering a better price as a result that corporate bookmakers make money on tote-odds products. (sub. DR395. p. 17)

To the extent that tote-odds providers harm totalisators through decreasing the pool size and increasing the risk of pool manipulation, an appealing remedy is to allow TABs to co-mingle with pools in other jurisdictions. This already occurs to a certain extent with the Unitab pool covering Queensland, South Australia and the Northern Territory, and the SuperTab pool covering Victoria, Western Australia, Tasmania and the ACT. As pointed out by Tabcorp, ‘this involves a level of what could be interpreted as price fixing amongst competitors’ (trans., p. 12). However, the provision of tote-odds provides a high level of direct price competition in the online and telephone segment of the market. Thus the adverse competitive implications of further co-mingling are minor. There are two considerable advantages from further increasing the size of totalisator pools in Australia:

- larger pools are much harder to manipulate, less volatile and the dividends better approximate the true odds of wagering outcomes (i.e. win, place or trifecta) actually occurring, subject to the take-out rate by the TABs
- larger pools decrease the effect of large bets on the final dividend. This increases the competitiveness of TABs relative to tote-odds providers.

FINDING 16.4

There are better ways of dealing with the risks of tote odds betting than prohibition, such as co-mingling of totalisator pools. As tote-odds providers generate a high level of direct price competition with totalisators, the grounds for preventing further co-mingling are not strong.

Credit betting

Unlike most gambling providers in Australia, bookmakers are permitted to offer credit accounts to their clients. Credit betting refers to the practice of allowing customers to place wagers on credit (that is, without the use of cash or credit cards) and settle the account at a later date. These facilities are primarily used by large bettors and offer several benefits:

-
- they provide security and convenience for on-course punters, who would otherwise need to transact, and travel to and from the race course, with large amounts of cash
 - they allow online punters to avoid fees associated with credit card use.

Balanced against these potential benefits are the risks associated with permitting this practice. Similarly to credit card betting, access to credit increases the capacity of problem gamblers to inflict financial harm on themselves and their families. These harms may be further compounded by the absence of a financial intermediary (such as a credit card company) with the proper skills or resources to accurately assess the credit worthiness of their clients.

These potential harms warrant, at a minimum, strict regulation and monitoring of credit betting. However, it is not clear that, in practise, the problems associated with credit betting are sufficient to justify its complete prohibition. As credit betting facilities are usually only extended to very large bettors, those with access will tend to be either wealthy individuals or ‘professional’ punters. For the former, losing apparently large wagers may not be indicative of harm, while access to credit offers considerable benefits in terms of convenience and security. For the latter, access to credit is simply an ordinary feature of a business relationship that is common in other sectors of the economy. In either case, the number of those with access to credit, and therefore exposed to the risks of its abuse, is small.

Moreover, bookmakers have a commercial interest in the prudential provision of credit facilities as they bear the cost of the collection of outstanding debts, as well as the risk of default. As credit tends to be offered to well-known and established clients, bookmakers’ commercial interests may be reinforced by a personal interest arising from the ongoing relationship they have with their clients. Such relationships are likely to be stronger in the face-to-face environment on-course, than they are over the internet.

The challenge for policy is to ensure that credit is directed towards those with a lower risk profile (such as professional punters), and that wagering providers who offer credit retain strong incentives for due diligence. In this vein, the Commission sought feedback in the draft report on credit betting generally, as well as:

- whether credit betting should be limited to established clients and to wagers above a certain threshold (so as to limit credit to higher income or professional punters and to increase the incentives of bookmakers to undertake due diligence)
- whether credit betting should be extended to TABs (for reasons of competitive neutrality).

A number of trends were evident in participants responses (a sample of views are included in box 16.9).

Box 16.9 Participant's view on credit betting

We are opposed to any practices that are likely to contribute to a higher incidence of problem gambling ... We believe that if credit betting is not to be prohibited then the capacity to offer it should be extended to TABs as a matter of competitive neutrality. Moreover, credit betting should only be able to be offered to large and established clients with a capacity to afford their gambling activities ... We believe that an evaluation of the impact of credit betting on problem gambling should be carried out in 2 years in conjunction with an assessment of the impact of inducements. (Australian Racing Board, sub DR343, p. 8)

There are acknowledged reasons why credit betting should be permissible for on-course bookmakers, but why, as a matter of principle, should credit betting be allowed for internet or account wagering? This argument has some force but it is change for change's sake. At this stage, we see insufficient evidence to support a change to current practice. This should be a matter for further research. (Australian Internet Bookmakers Association, sub. 373. p. 3)

The notion that credit is necessary to service 'high-end' customers is questionable. Among its account holders, UNiTAB has some of Australia's largest punters betting through its internet service. They cannot bet unless there are sufficient funds in their account. The lack of credit does not deter these customers. A quick search on 'Google' regarding the offer of credit by bookmakers suggests that this practice is not restricted to 'high-end' customers. There is clearly an effort to attract 'ordinary' recreational punters. Such activity should be reviewed. (Tatts Group, sub. DR302, p. 17)

The suggestion that online punters benefit from credit betting by avoiding credit card fees is erroneous. There are a number of ways in which punters could transfer funds without incurring fees or at least incurring minimal fees ... Because online wagering is so profitable, the bookmakers have engaged in a race to the bottom when it comes to credit assessment ... Credit is given to anyone, even pensioners and the unemployed. Financial counsellors are increasingly seeing clients being pursued through the courts by these bookmakers. Bets are placed online with Northern Territory bookmakers, so the appropriate law for collection is the law of the Northern Territory. Losing gamblers can't defend the court actions that are instituted by these bookmakers because they would have to find legal representation in the Northern Territory, a jurisdiction lacking in consumer protection laws. (Uniting Care Australian, sub. DR387, p. 21)

Providers of credit betting tended to argue that the harm minimisation measures suggested by the Commission would be ineffective and are largely unnecessary as bookmakers have strong incentives for self-regulation in this area (Australian Bookmakers Association, sub. DR320, pp. 6-7, Australian Internet Bookmakers

Association, sub. DR373, p. 3). These participants tended to support continuing the current arrangements and extending credit betting to TABs.

Racing authorities tended to support equal treatment amongst wagering operators, but expressed the need for better understanding of the effect of credit betting on problem gambling (Australian Racing Board, sub. DR343, p. 10; Greyhounds Australasia, sub. 362, p. 7; Harness Racing Australia, sub. DR335, p. 12).

Whilst the benefits of on-course credit betting were not explicitly challenged, there was concern amongst a number of participants, who challenged the view that credit betting online and over the phone offered any substantial consumer benefits (Tatts Group, sub. DR302, p. 17; Uniting Care Australian, sub. DR387, p. 21). These groups have suggested that the harms of credit betting justify its prohibition.

The Commission considers that the evidence of harm is not great enough to justify immediate prohibition. Nevertheless, the risks associated with the practice warrant further investigation. The Commission is especially concerned with the off-course provision of credit betting as:

- the benefits of this practise appear lower than on-course
- the personal interest in the client is likely to be lower over the internet or phone than it is with the (often long-term) face-to-face interactions that occur on-course
- it appears that some corporate bookmakers are beginning to advertise credit facilities on relatively small bets, This increases the chances of attracting customers with a higher risk of harm (non-professional, smaller bettors).²⁷

Either an online gambling regulatory body (described in chapter 15) or the national gambling research body (described in chapter 18) would be well placed to conduct this investigation. This research should determine whether credit betting is prohibited. In the interim, steps should be taken to limit the growth of credit betting, such as a ban on advertising. In general, the Commission considers that the provision of credit betting should be subject to regulation that limits the practice to big bettors (that is ‘high rollers’ or professional punters).

One important exception to these measure is in the provision of credit to facilitate business-business back betting, which should be allowed between licensed wagering providers in Australia.

²⁷ For example, AISbet offers credit betting on wagers as low as \$200 (9 February on <https://www.iasbet.com/whatsnew/internet-credit.aspx>)

The impact of credit betting should be examined in further detail by either the regulator overseeing the national regulatory regime (recommendation 15.1) or the national gambling research body (recommendation 18.3). In the interim, advertising credit betting facilities should be prohibited, and credit betting should not be extended to TABs.

Inducements

While the Betfair Decision was generally interpreted as invalidating advertising restrictions on out-of-state wagering providers, states retain the authority to regulate advertising within their jurisdictions (so long as the regulations are not discriminatory). As such, New South Wales, Victoria and South Australia have prohibited wagering providers from advertising promotions that include inducements — in particular, free bets — on the grounds that they may encourage problem gambling.

Whilst the overall costs of these restrictions for consumers are unlikely to be high, it is not clear why customers attracted by inducements such as free bets are more likely to develop gambling problems than customers attracted by other advertising strategies. Moreover, a large number of the customers accessing free bet promotions are likely to be simply shifting from one wagering provider to another. Indeed, as opening an internet or phone betting account with a corporate bookmaker involves some degree of effort, it is clear that the inducements are partly directed at overcoming ‘switching costs’ between providers (a practice common in a number of other industry such as telecommunications, health insurance etc.). As the wagering market is largely dominated by TABs, the prohibition on inducements risks advantaging incumbents with a significant degree of market power, at the expense of greater competition.²⁸

The inter-state discrepancy in the approach to inducements also disadvantages wagering operators based in New South Wales, Victoria and South Australia when competing for market share in jurisdictions that permit these practices. For this reason, a nationally consistent approach is preferred to the current arrangements, regardless of whether that involves banning or permitting free bets. Whichever regulatory path is chosen should be based on evidence and should balance the realistic risk of problem gambling against the possibility of unduly advantaging incumbent wagering operators.

²⁸ Tabcorp themselves have not argued in favour of a ban on inducements, rather that a consistent position is taken on the issue at a national level (sub. 229, p. 28).

Offering inducements to wager through discounted prices to new customers is not necessarily harmful, and may primarily serve to reduce switching costs between incumbent wagering operators and new entrants, enhancing competition. The risks for problem gamblers should be assessed and, regardless of whether prohibition or managed liberalisation is the appropriate action, a nationally consistent approach would be warranted.

Retail exclusivity arrangements

Fair and open competition is a fundamental principle of a market economy. As such, the retail exclusivity arrangements with TABs represents a rare privilege. As monopolies tend to deliver poorer outcomes to consumers (like higher prices and poorer service) than the competitive market, they are purposely constructed by government only when there is clear evidence of their necessity (for example, the need for patents in order to avoid the under-provision of research and development). Most of the TAB exclusivity agreements are scheduled to expire between 2012 and 2016, which raises the question as to whether there is strong enough evidence to support their renewal.²⁹

While the historical reasons for instituting exclusivity are no longer relevant (see box 16.10) many racing participants have argued that the TAB retail monopoly should be continued. Proponents argue that

- *The harms of retail exclusivity are minimal.* Specifically, TABs' market power has been either eliminated or at least limited by online and telephone wagering competitors. Moreover, many punters do not care greatly about price, limiting the harms of higher prices (to the extent that they are raised at all).
- *Retail exclusivity has offsetting consumer benefits.* That is, the proceeds from TABs' retail exclusivity allows them to maintain substantial retail networks, which benefit consumers. In addition, restricting the entry of wagering retailers is necessary for totalisator pools to be large enough to function effectively.

²⁹ Specifically, Tabcorp's licences expire in 2012 in Victoria and 2013 in New South Wales; UniTAB's licences expire in 2014 in Queensland, 2015 in Northern Territory and 2016 in South Australia.

The harms of retail exclusivity are minimal

As discussed in section 16.1, it is difficult to reconcile the notion that TABs do not have market power with

- their willingness to enter into taxation and racing industry funding agreements that far exceed that asked of other wagering providers
- price comparisons with more competitive regimes
- with the need to legislate maximum take-out rates for totalisators (which appear to be generally binding).

The argument that the harms of retail exclusivity are limited by the indifference of some punters to the resulting higher prices, is implicitly aimed at customers who bet at TAB retail outlets (as customers of corporate bookmakers and betting exchanges clearly *do* care about prices). However, the fact that many punters continue to place bets at retail TAB outlets, despite better prices being offered by corporate bookmakers, is not strong evidence that they do not care about prices. This is because:

- many retail customers may be unaware of the existence of alternative wagering providers or reluctant to try new betting products that they are not familiar with
- they may not have access to, or be comfortable with, the platforms that alternative off-course wagering providers are limited to (internet and telephone)
- they may be dissuaded by the ‘switching cost’ involved in setting up an account with online or telephone based wagering providers
- they may have a strong preference for local retail betting (though would still like a better value retail option if it was available).

In effect, retail exclusivity denies such customers the opportunity to reveal the value they place on prices. If it is truly the case that these customers do not care about prices, then the introduction of new competitors to the retail wagering markets would have little effect on take-out rates (and thus racing industry funding). Even in this case, consumer welfare would still be advanced by the greater competition in regard to the quality of service in the retail market.

Box 16.10 Historical justification for retail exclusivity

Retail exclusivity as a solution to the free-rider problem

Today this argument is essentially obsolete as retail exclusivity is no longer sufficient, nor necessary, to overcome the problem of free-riding on racing product. It is not sufficient in that, as recently demonstrated, retail exclusivity on its own could not prevent free-riding by online and telephone based wagering providers. It is not necessary in that free-riding can be more comprehensively dealt with through either the national scheme described in section 16.3 or through existing race fields legislations.

Retail exclusivity as a source of taxation revenue

This argument does not have a strong underlying rationale. Retail exclusivity does generate a significant amount of taxation revenue. However, the benefits arising from the increased tax revenue are offset to some degree by the reduced welfare of consumers who face restricted choices and increased price for wagering products.

Put differently, if raising taxation revenue is a legitimate justification for establishing a monopoly, this principle could be widely applied to the production of a variety of goods and services. In general, governments tend not to do this because of the unfavourable trade-off in consumer welfare generated by tolerating monopolies. In this light, it is not obvious why the welfare of punters should be valued less than the welfare of consumers of other forms of entertainment.

Retail exclusivity as a means to regulate the wagering industry in terms of community access, consumer protection and probity.

This argument has some merit. While there is already widespread access at TAB outlets, as well as at pubs and clubs, it is likely retail wagering would proliferate even more widely in an unrestricted market place. The increase in community access may contribute to a higher incidence of problem gambling. Moreover, it would also risk reducing the level of compliance with probity and harm minimisation measures by retail wagering providers, whilst increasing the costs of monitoring these measures.

However, maintaining control over access to retail wagering does not require monopoly provision. Similar to gaming machines, licenses for retail wagering could be capped, and the areas where they are permitted to operate prescribed by government. Venue licenses made available could be limited to the number of existing TAB outlets or even reduced if necessary. At the extreme, if the retail provision of wagering could move toward a 'destination venue' model, with fewer venues that house totalisators and multiple bookmakers (essentially replicating the betting rings found at race meetings).

Retail exclusivity benefits consumers through allowing the provision of a substantial TAB retail network and the scale required for totalisators

The argument that retail exclusivity benefits consumers by supporting an extensive retail network, has little validity. The benefits that consumers receive from TAB

shopfronts could equally arise from other wagering providers. Indeed, with greater competition, the extent to which the TAB retail network declined would be a function of the growth in bookmakers' retail presence. This shift would be entirely driven by consumer preferences. As such, it is doubtful that protecting TABs commercial interest, through restricting meaningful choice in the retail wagering market, best serves consumers.

The issues of totalisator scale is more subtle. The Australian Racing Board (sub. DR343, p. 9) indicates that the arguments in favour of totalisator exclusivity (which the Commission is not recommending any change to) could also apply to retail exclusivity for the providers of totalisator products.

As discussed above, removing totalisator exclusivity risks deteriorating the quality of totalisator products that consumers have access to. Moreover, it does not dramatically increase the choices available to consumers, in terms of wagering products.

However, the equation is different with regard to retail exclusivity. In this case consumer choice is dramatically increased by the introduction of bookmakers to the retail market. This is likely to challenge the scale of totalisator operations. However, most business, including bookmakers, benefit from scale to some degree. It is not generally appropriate for the government to arbitrarily decide one business is worthy of realising these scale benefits while others are not. If consumers' preference for retail bookmakers is so large that totalisators become an unviable business model, this suggests that the detrimental welfare effects of their continued protection are very large. That said, there is strong reason to think that totalisators would continue to play a large role in the wagering market without retail exclusivity for TABs:

- totalisator products are less risky to offer than fixed odds
- TABs already have a comprehensive network and are experienced in the retail market
- totalisators betting is the dominant wagering product in Australia. Many consumers would be expected to continue using totalisators due to their familiarity with the product

There is insufficient evidence in favour of continued retail exclusivity

The extension of the TABs' retail exclusivity agreements do not appear to be to associated with any significant, demonstrable net benefit to consumers, or to the Australian economy. The fact that retail exclusivity is the status quo in the wagering market is not, in itself, a justification for maintaining the current arrangements.

Similarly, the currently stated (and historical) arguments in favour of TABs' retail exclusivity are not compelling, and would not be accepted in other areas of the economy.

That said, moving from the current arrangements to a more competitive retail wagering market represent a major shift and is likely to involve significant transactions costs. These transaction costs can be minimised by phasing out retail exclusivity gradually over time. This should be accompanied by an ongoing assessment of the effects on consumers in regard to:

- the resulting changes in the racing and wagering industry
- the potential harms from problem gambling.

In the past, commercial activity in many racing clubs and authorities has been based around a presumption of constant revenue flow from TABS. Gradually opening the retail market to more competition will allow these bodies the time to acquire new commercial capabilities and re-orientate their organisation to a more diverse retail wagering market.

RECOMMENDATION 16.4

TAB retail exclusivity should not be renewed.