
**DEPARTMENT OF TREASURY AND
FINANCE**

**NATIONAL COMPETITION POLICY :
REVIEW OF GAMING MACHINE
LEGISLATION**

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PREFACE

Under clause 5 of the Competition Principles Agreement, the Victorian Government is committed to review all legislation that restricts competition.

In July 2000, the Victorian Department of Treasury and Finance engaged Marsden Jacob Associates, consulting economists, to conduct a public review of the competitive restrictions associated with the *Gaming Machine Control Act 1999* and associated legislation and regulations that affect gaming machine operations.

A Discussion Paper was produced by the Department and submissions sought from interested parties. The review was advertised through the State's press. Interested parties could obtain copies of the Discussion Paper electronically or directly from the Department. Stakeholders and other interested parties were invited to provide submissions by 28 August. Submissions and comments were received from 14 parties. Copies of the submissions/comments are available on request from the Treasury.

This independent review has been prepared on behalf of the Review Panel by Marsden Jacob Associates, consulting economists.

This report does not represent the views of the Victorian Government.

1. INTRODUCTION

1.1. BACKGROUND

As a signatory to Competition Principles Agreement (CPA), Victoria is required to review all existing legislation, including legislation relating to gaming machine operations, in terms of its impact on competition. In recognition of meeting this and other obligations under National Competition Policy (NCP), Victoria in common with all other States will receive substantial Competition Payments, i.e., 'efficiency dividends' from the Commonwealth. For example for 1999-2000, Victoria can receive up to \$152.2 million in payments for satisfactorily advancing competition reform.¹ Gambling is to be considered by the National Competition Council (NCC) in its third tranche assessment.²

Gaming machine activities in Victoria are subject to extensive legislation and regulation, as they are in all jurisdictions. The base legislation banning all gambling (from which the gaming legislation provides an exemption) is the *Lotteries Gaming and Betting Act 1966*. Gaming machines inside the Casino are regulated by the *Casino Control Act 1991* and the *Casino (Management Agreement) Act 1993*.

Legislation regulating gaming machines outside the Casino comprises:

- *Gaming Machine Control Act 1991* which establishes licensing and conditions of licences for gaming operators, gaming venue operators, gaming machine manufacturers and suppliers, gaming machine monitoring, gaming machine servicing;³ and
- *Gaming and Betting Act 1994* provides for licensing of a gaming machine operator in conjunction with a wagering licence. The Act also provides for the racing industry to be a major beneficiary of the licence and future licensees.

¹ National Competition Council (1999) *Second Tranche Assessment of State and Territory Progress with Implementing National Competition Policy and Related Reforms*, p. 239.

² National Competition Council (1999) *Second Tranche Assessment*, p. 163.

³ Relevant regulations include:

- *Gaming Machine Control (Monitoring and Control) Regulations 1991*;
- *Gaming Machine Control (Miscellaneous) Regulations 1991*;
- *Gaming Machine Control (Special Employees and Technicians) Regulations 1992*;
- *Gaming Machine Control (Jackpots) Regulations 1996*;
- *Gaming Machine Control (Fees)(Amendment) Regulations 1997*;
- *Gaming Machine Control (Fees) (Amendment) Regulations 1998*; and
- *Gaming Machine Control (Returns by Gaming Operators) Regulations 2000*.

These Acts were recently amended by the:

- *Gambling Legislation (Responsible Gambling) Act 2000* which states the maximum number of gaming machines in the Casino, provides for regional caps and restrictions on 24 hour gaming, requires the VCGA to consider the views of municipal councils, allows regulation of advertising and provides for players to receive information.

Other relevant legislation includes the *Liquor Control Reform Act 1998* which defines the liquor licences and the conditions attached to them.

1.2. TERMS OF REFERENCE

The review of gaming machine legislation has been commissioned by the Minister for Gaming in accordance with the Victorian Government's *Timetable for the Review and Reform of Legislation that Restricts Competition*, under the Government requirements to meet its NCP obligations.

The review is required to examine the case for reform of legislative restrictions on competition contained in the *Gaming Machine Control Act 1991*, part 2 of the *Gaming and Betting Act 1994* as it relates to a gaming operator's licence and relevant regulations. The review is conducted in accordance with the Victorian Government's *Guidelines for the Review of Legislative Restrictions on Competition*.

In particular, the review will provide findings and recommendations where appropriate in its report in relation to the following:

- clarify the objectives of the legislation;
- identify the nature of the restrictions on competition;
- analyse the likely effect of the restriction on competition and on the economy in general;
- assess and balance the costs and benefits of the restriction; and
- consider alternative means of achieving the same result including non-legislative means.

The Terms of Reference and project brief confirm the Government's commitment to maintaining the numeric limit of 27,500 gaming machines outside the Melbourne casino. Similarly, proposed regional caps on gaming machine numbers represent a Government commitment in the public interest. It is therefore beyond the scope of the review's brief to develop reform options that propose lifting these machine number caps.

The review is directed to address specifically the appropriateness of the current arrangements of:

- licensing two gaming operators. The review should recognise that the Government will continue to uphold all its contractual agreements;
- gaming venue market structure. This includes the 50:50 split of gaming machines between hotels and clubs. It should also include consideration of the concentration of gaming venue ownership and the emergence of quasi-clubs;
- the allocation of at least 20 per cent of gaming machines outside the Casino to non-metropolitan Victoria;
- the numbers of gaming machines per venue; and
- betting limits on gaming machines.⁴

1.3. NATIONAL COMPETITION POLICY

The object of NCP is to “*accelerate the microeconomic reform process, recognising the benefits from sustained economic and employment growth.*”⁵

Legislation review is one of Victoria’s obligations under the Competition Principles Agreement entered into on 11 April 1995.

The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:

- (a) *the benefits of the restriction to the community as a whole outweigh the costs; and*
- (b) *the objectives of the legislation can only be achieved by restricting competition*⁶

and

*The guiding principle established under National Competition Policy places the onus of proof on governments to demonstrate a public interest case for the enactment or retention of statutory restrictions.*⁷

The guiding principles are, therefore, pro-competitive, i.e., the onus is on each government to demonstrate the case for retaining any competitive restrictions identified. On the other hand, the Competition Principles Agreement also makes it clear that

⁴ *Gaming Machine Legislation National Competition Policy Review Terms of Reference* (2000)

⁵ National Competition Council (1998) *Compendium of National Competition Policy Agreements*, 2nd edition, AGPS, Canberra, p. 11.

⁶ *Competition Principles Agreement*, Clause 5 (1). The requirement to review legislation is contained in Clause 5.

⁷ Government of Victoria (1997) *NCP Guidelines for Legislation Review*.

competition is not sought for its own sake, but rather to improve efficiency. As a result, the issue is not whether the legislation underpinning existing gambling activities restricts competition, but rather, whether those restrictions can be justified in public interest terms.

The essential question for any NCP legislation review is, can the restrictions be justified? More precisely, are there net social and economic benefits from the anti-competitive arrangements identified?

1.4. KEY NCP QUESTIONS AND APPROACH

NCP identifies five basic questions which should be addressed in review of legislation. These are:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;
- consider alternative means for achieving the same result including non-legislative approaches; and
- assess and balance the costs and benefits of the restriction.⁸

These questions can be addressed in terms of a step-by-step examination of each of the individual Acts and regulations associated with gaming machines and how gaming machines legislation fits with overall gambling restrictions. However, it is also possible to take an overview of the total framework, how it has developed over the last several decades and the challenges and changes that the framework and objectives must address.

The outline of this review paper is as follows:

- Chapter 2 provides key facts relevant to the Victorian gambling and gaming machine markets. It describes their magnitude, economic impacts, the nature of the customers and evidence on the social concern of problem gambling.
- Chapter 3 provides an overview of the objectives of gaming machine legislation and gambling legislation as a whole and the issues affecting the framework for the benefit cost tests.
- Chapters 4, 5 and 6 then examine the restrictions contained in the legislation and regulations. These restrictions are grouped into common themes and broadly ranked in terms of impact on competition. These are, respectively, the dual

⁸ *Competition Principles Agreement*, Clause 5 (9).

operator system, gaming venue market structure and the range of other restrictions.

1.5. RELEVANT MARKETS IN VICTORIA

The key restrictions in the relevant associated legislation affect participants and operation of a number of markets within Victoria and nationally. These include:

- the market for gaming provision outside the Casino;
- the market for gaming provision at any venue;
- the market for gambling services generally;
- the market for entertainment generally; and
- the wider market for the consumer's dollar.

In addition, the legislation regulates all major input markets and functions including (but not limited to):

- the manufacture and supply of machines;
- the ownership and operation of machines;
- the ownership and operation of venues;
- the conduct of monitoring and machine control; and
- the provision of machine servicing and maintenance services.

2. THE VICTORIAN GAMBLING MARKETS

2.1. OVERVIEW ON ECONOMIC CONTRIBUTION

Gaming and other gambling are significant activities in Victoria with major social and economic consequences.

Principal features of these industries are set out below.

- Total gambling expenditure (i.e., gamblers' losses) was almost \$3.5b in 1998-99 with gaming expenditure of \$3.0b comprising the bulk and wagering on racing the remaining \$0.5b. Gaming machine expenditure comprised \$1.9 billion – over one-half of gambling expenditure (Chart 2-1).⁹

CHART 2-1: SELECTED GAMBLING EXPENDITURE – 1998-99

GAMBLING FORM	NSW (\$m)	Vic (\$m)	Qld (\$m)	SA (\$m)	WA (\$m)	Tas (\$m)	ACT (\$m)	NT (\$m)	Total (\$m)
TAB	566.8	406.0	239.7	96.4	133.8	27.	18.5	11.5	1,500.3
Total Racing	644.8	454.8	271.7	106.7	155.1	29.7	20.9	20.4	1,704.1
Lottery	51.2	5.4	2.4	-	-	0.4	1.1	1.3	61.8
Lotto, Tattslotto	255.2	282.1	201.9	70.6	145.1	16.2	12.4	11.9	995.3
Pools	3.8	1.3	1.7	0.3	0.8	0.1	0.1	0.0	8.1
Minor gaming	-	-	128.5	19.3	26.1	9.9	-	-	183.8
Gaming machines	3,487.5	1,954.2	757.4	442.5	-	39.3	147.2	24.3	6,852.3
Casino	479.7	721.9	476.8	76.6	285.8	82.2	16.3	54.4	2,193.6
Instant lottery	61.9	23.8	99.0	9.3	32.0	2.3	2.1	1.4	231.9
Keno	89.6	7.2	52.4	12.6	-	16.5	-	-	178.3
Total Gaming	4,428.9	2,995.8	1,720.1	631.2	489.8	166.8	179.2	93.4	10,705.1
% of HDI	3.40%	3.21%	2.87%	2.40%	1.46%	2.19%	2.29%	2.42%	2.95%
Total Sportsbetting	2.6	5.9	0.8	0.7	1.1	0.0	0.0	8.6	19.7
Total All Gambling	5,076.3	3,456.5	1,992.6	738.6	646.0	196.5	200.1	122.3	12,428.9
% of HDI	3.89%	3.70%	3.32%	2.81%	1.93%	2.58%	2.56%	3.18%	3.43%

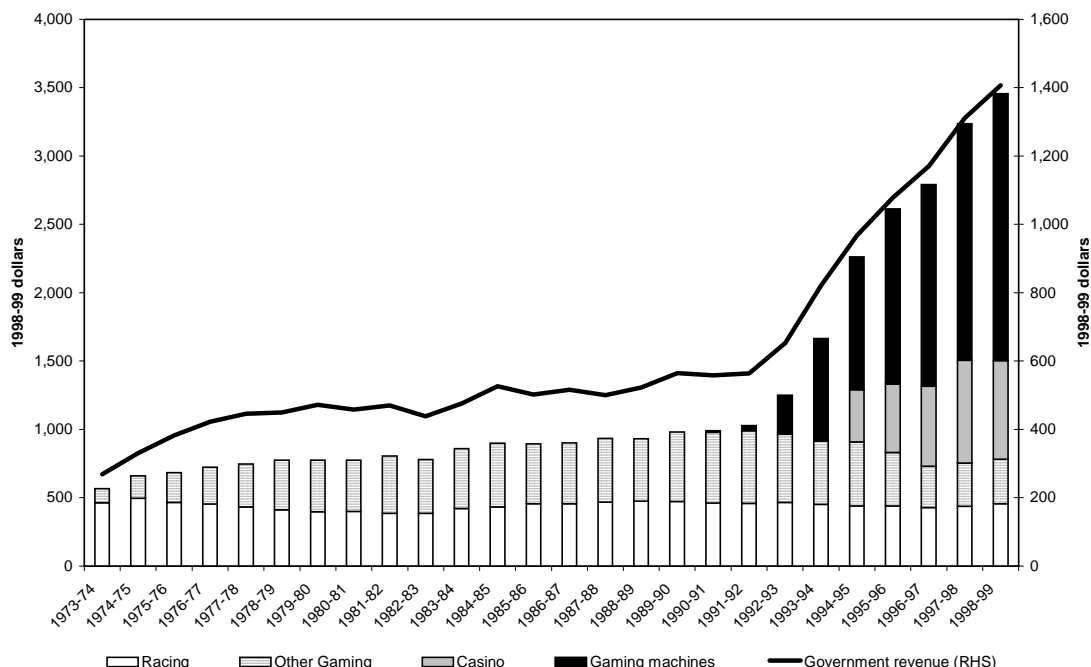
Source: Tasmanian Gaming Commission (2000) Summary Table A.

- Newer forms of gambling have dramatically increased the size of the market. However, gambling activities compete with one another for the gambling dollar and part of the new growth is at the expense of existing forms of gambling (Chart 2-2).

⁹ Tasmanian Gaming Commission and Centre for Regional Economic Analysis (2000) *Australian Gambling Statistics: 1972-73 to 1998-99*.

- Gambling expenditures have trebled since gaming machines were legalised in 1991-92.

CHART 2-2 : REAL GAMBLING EXPENDITURE AND GOVERNMENT REVENUE : VICTORIA



Source: Tasmanian Gaming Commission and Centre for Regional Economic Analysis (2000) *Australian Gambling Statistics: 1972-73 to 1998-99*.

- Traditional forms of gambling are in decline – relatively, and in some cases absolutely.
- Gaming expenditure underpins the clubs and hotel sector. Non-gaming activity in these sectors has declined.¹⁰
- An important transfer from gamblers is the splitting of profits from TABCORP (both of its own racing related gambling and from the joint venture with the Victorian Racing Industry for gaming machines) for the racing industry. The racing industry received \$65m in 1999-2000 from the joint venture representing its gaming operations.¹¹
- As new gaming opportunities have been permitted, the pattern of gaming expenditure in Victoria has become more like New South Wales (Chart 2-3).

¹⁰ After taking out the Government's share, gaming expenditure represents about one-quarter of retail turnover for the "Hospitality and services" sector; of the latter across Australia, clubs and hotels account for about two-thirds of turnover. In fact since their introduction, turnover in this sector has increased by less than gaming expenditure net of government take. ABS (Various) *Retail Turnover* and Tasmanian Gaming Commission (2000).

¹¹ VicRacing Submission to review, p. 5. The Treasurer's letter of 29 June 1994 notes that the joint venture is to be 25 per cent owned by the racing industry and 75 per cent by TABCORP.

CHART 2-3: PER CAPITA GAMING EXPENDITURE

YEAR	NSW \$	Victoria \$	Q'land \$	SA \$	WA \$	Tasmania \$	ACT \$	NT \$
1973-74	74.89	8.00	6.28	10.35	5.55	22.36	-	-
1975-76	120.20	21.54	9.58	18.88	10.42	29.81	-	-
1977-78	137.76	37.32	12.46	28.67	11.33	52.95	65.01	-
1978-79	149.56	46.10	15.27	38.13	11.53	73.17	80.95	24.06
1980-81	196.25	56.16	17.70	47.47	15.28	96.37	111.93	121.87
1981-82	205.77	68.05	27.42	55.87	19.10	114.79	128.83	182.56
1984-85	234.93	89.41	60.12	70.11	45.37	157.24	199.95	172.90
1987-88	287.16	107.87	124.09	152.23	144.39	186.80	259.61	305.05
1989-90	369.71	131.22	165.02	192.02	245.23	224.98	368.87	191.50
1990-91	418.20	141.25	226.99	209.06	280.98	235.34	398.86	404.87
1991-92	441.88	152.42	251.88	210.73	287.33	250.54	425.85	407.90
1992-93	481.98	210.53	336.93	218.24	336.06	249.29	532.36	394.39
1993-94	519.97	329.23	396.01	233.74	412.80	265.30	687.85	412.08
1994-95	582.50	507.26	423.68	340.98	450.68	295.12	743.86	444.92
1995-96	679.55	624.46	516.52	451.90	485.85	325.74	729.52	655.28
1996-97	708.88	680.12	521.80	487.92	433.23	366.22	669.53	604.10
1997-98	828.61	795.51	596.39	524.32	415.57	417.49	698.25	637.80
1998-99	931.42	852.06	673.28	558.54	362.26	478.73	784.43	713.35

Source: Tasmanian Gaming Commission (2000) Table 254.

- Gaming and other gambling activities have substantial effects on the economy through employment and investment effects in establishing the facilities required for gambling.
- Gambling generates direct and indirect employment, full and part-time. There is a significant number of others whose employment is connected with gambling through retail outlets selling lottery tickets and 'scratchies', or providing inputs to gambling activities.
- At the same time, gambling expenditure and employment are diverted from savings and other household expenditures. To the extent that gambling is being financed by dissaving, the impacts of gambling on current activity levels may be delayed.

2.2. TAX RECEIPTS AND RATES

Gambling taxes are now a major source of revenue for all State governments (Chart 2-4).

In the last five years, states have become increasingly reliant on gambling revenues to meet demands on their budgets, collecting \$3.5 billion, or 11%, of their taxes from gambling in 1996-97.¹²

and

Fiscal pressures and 'gambling wars' have been a force for expanding gambling in Australia, with a 27% fall in the real value of general revenue grants since the mid 1980s. Virtually all states have expanded gambling activity as one of their few autonomous tools of revenue policy.¹³

The Western Australian Government was very forthcoming in describing the importance of gambling revenues:

...it seems certain that the revenue motive would have played a bigger role in the more recent rapid expansion of legalised gambling in most parts of Australia (in the last 10 - 20 years), due to:

- *the States' excessive reliance on Commonwealth grants (commonly known as Vertical Fiscal Imbalance or VFI) and substantial cuts in those grants; and*
- *very limited own source revenue raising options for the States.¹⁴*

CHART 2-4: GAMBLING REVENUES AS A PERCENTAGE OF STATE TAXATION

	NSW	VIC	QLD	SA	WA	TAS	NT	ACT	ALL STATES
1975-76	12.8	9.4	6.7	5.1	6.4	6.0	na	na	9.8
1985-86	11.6	9.1	10.1	7.6	5.8	9.6	na	na	7.9
1995-96	11.0	12.6	13.1	11.5	7.4	8.8	8.4	10.1	11.4
1996-97	10.2	13.0	12.8	13.0	6.4	9.8	9.4	8.6	11.2
1997-98	10.4	15.2	12.5	13.8	5.7	10.3	9.6	8.3	11.7

Taxes include licence fees and charges.

Source: Productivity Commission (2000) *Australian Gambling Industries*, Final Report, Canberra, p. 19.7.

¹² Smith, Julie (1998) *Gambling Taxation in Australia*, Australian Tax Research Foundation, Research Study No. 32, p. 23.

¹³ Smith, Julie (1998), p.27

¹⁴ Western Australian Government (1998) *Submission to Productivity Commission Inquiry into Australia's Gambling Industries*, November

The Victorian government is more dependent upon revenue from gambling taxes than any other Australian State. Chart 2-5 shows the composition and importance of different gambling taxes to the Victorian State budget. Gambling taxes overall represent over 15 per cent of the Victorian Government's taxation revenue and over five per cent of all of the State's revenues.¹⁵

CHART 2-5: BUDGETED GAMBLING TAXATION REVENUE – 1999-2000

Taxation type:	1999-00 Revised	2000-01 Budget	
	(\$m)	(\$m)	Share of tax revenue (per cent)
Electronic Gaming Machines	940.0	780.0	9.9
Private Lotteries	298.8	279.2	3.6
Casino	145.3	80.3	1.0
Racing	137.2	93.0	1.2
Other Gambling	3.5	2.6	0.0
All Gambling	1,524.8	1,235.1	15.7
TOTAL ALL TAXATION	9,390.5	7,845.3	100.0
ALL REVENUE	21,446.0	22,180.0	

Source: Victoria Department of Treasury and Finance (2000) *Budget Estimates 2000-01: State Revenue*, p. 417

In common with other States and Territories, the Victorian Government depends heavily on gambling revenues with 15 per cent of tax revenue obtained from various gambling sources. The 2000-01 Victorian Budget forecasts receipts from gambling taxation to total \$1.2b, more than double the \$500m collected in 1990-91 before gaming machines were introduced. Of this, \$780m are expected to be derived from gaming machines (Chart 2-5). Taxes on gaming machines now represent one of the major single sources of revenue for the Government.

Although all forms of gambling are effectively taxed by the State, there is substantial variation in the tax rates levied (Chart 2-6). The rate at which gaming machines are taxed also varies across the jurisdictions.¹⁶

¹⁵ Reflecting offsets for the introduction of the GST, gambling taxation revenue is lower than in 1999-2000.

Pursuant to the Intergovernmental Agreement, the States and Territories undertook to adjust their gambling tax arrangements to take account of the impact of the GST on gambling operators. In the case of Victoria, with the exception of casino gambling, it has been decided to adjust gambling tax rates having regard to the introduction of the GST. In the case of the casino, it has been decided to institute a credit scheme whereby GST payments will be offset against casino taxes already paid to Victoria. The total tax burden of the operators will remain unchanged as a result of the imposition of the GST.

¹⁶ See for example, Department of Gaming and Racing – NSW (2000) *Interstate Gaming Tax Comparisons*, January covering both club and hotel rates.

CHART 2-6: TAXATION RATES ON DIFFERENT GAMBLING FORMS – VICTORIA

Gambling form	Taxation Rate (pre-GST adjustments)
Gaming Machines	33 1/3 per cent of Net daily balances (Amount bet less prizes) For hotels, an extra 8 1/3 per cent to Community Support Fund. Levy of \$333.33 per machine Tattersall's pays a licence fee
Lotteries	36 per cent of subscriptions 10 cent ticket levy on some lotteries
Casino	Ordinary players: 22.25 per cent Commissioned players: 10 per cent both include 1 per cent of gross gaming revenue to Community Benefit Levy
Racing	28.2 per cent of commission on totalisator bets (and of fractions) 2 per cent of bookmakers turnover in metropolitan and 1.5 per cent in country racecourses. (To be abolished with introduction of GST.)
Other	Club keno: 33 1/3 per cent of revenue Permit fees for raffles Sports betting: 20 per cent of net investments

Source: Department of Treasury and Finance (2000) *Budget Estimates 2000-01: State Revenue*, pp. 424-5.

Further, the benefits of gambling taxation may be hypothecated – the racing industry benefits significantly from gambling: the racing clubs receive revenue through wagering which not only has a lower implicit tax rate than gaming machines but racing also receives substantial return funding from the TAB and its own gaming operations.

2.3. CUSTOMERS & PROBLEM GAMBLING

Much of the concern about gambling derives from the adverse consequences on the gamblers and their families. The concerns relate primarily to heavy, excess or problem gambling.

The Productivity Commission suggests that gamblers can be disaggregated according to whether they are 'recreational' or 'problem' gamblers.¹⁷

Concern arises where the gambling becomes excessive causing serious or extreme adverse consequences, possibly taking on characteristics of an addiction. Under these circumstances, gambling expenditure may be associated with high levels of crime, need for counselling, family break-up and possibly suicide.

¹⁷ Productivity Commission (2000), p. 5.3. In the case of racing, they also distinguish professional gamblers.

Problem gambling is a special issue with faster forms of gambling such as electronic gaming machines. As noted in 1994,

*Casino, poker machine and Tabaret methods use pressure gambling because they create an environment which stimulates gambling behaviour beyond tolerable limits. They use mechanisms that make play so unbroken that patrons scarcely have time to reflect on how much they are losing, and they foster dangerous addiction by providing more frequent and regular opportunities to play than the older forms of gambling.*¹⁸

To the extent that there are clear differences between different forms of gambling in levels of problem and heavy gambling associated, then these differences may justify different levels of restriction or different regulatory approaches. As a result, NCP reviews of gambling legislation need to form a view on the nature and level of social concerns associated with different forms of gambling. The available evidence suggests that problem gambling is higher with gaming machines than it is for any other venue-based form of gambling.

Gambling Patterns in Australia and Victoria

The features and dimensions of gambling in the Australian population have been documented including the comprehensive national survey undertaken by the Productivity Commission in April 1999.

- The overwhelming majority of adult Australians (82 per cent) engaged in some form of gambling during a year, for example, a Melbourne Cup sweep.¹⁹
- Thirty-nine per cent of adult Australians played gaming machines at some time in the previous year.²⁰
- Almost two-thirds (62 per cent) of these (or 24 per cent of adult Australians) played the machines less than once a month.²¹
- The remaining 38 per cent of players (or almost 15 per cent of adult Australians) played gaming machines at least once a month.²²
- Over 13 per cent of players and (five per cent of adult Australians) played gaming machines at least once a week.
- Overall, gambling expenditure in 1998-99 averaged \$886.80 per adult and represented 3.4 per cent of household disposable incomes across Australia (Chart 2-1).²³

¹⁸ Anglican diocese of Melbourne, Submission to the Schilling Review, quoted in Schilling (1994) *Review of Electronic Gaming Machines in Victoria*, p. 43.

¹⁹ Productivity Commission (2000), p. 3.16.

²⁰ Productivity Commission (2000), p. 3.16.

²¹ Productivity Commission (2000), p. 3.16.

²² Productivity Commission (2000), p. 3.16.

- In 1998-99, expenditure on gaming machines averaged \$488.91²⁴. This latter figure represents 1.9 per cent of household disposable income.²⁵

Comparable figures for Victoria in 1999²⁶ show a similar pattern:

- Eighty-one per cent of Victorian adults gambled in the 12 months to October 1999.
- Almost one-third (30 per cent) of adults had played electronic gaming machines (EGMS) in the previous year.
- One-third of these (or 12 per cent of all Victorian adults) play EGMs 'regularly' (defined here as at least once a month).
- In 1998-99, Victorians spent an average of \$983.09 per adult on gambling, or 3.7 per cent of household disposable income.
- In 1998-99, expenditure on Victorian gaming machines was \$1,954 million or over \$550 per head, which represented 2.1 per cent of the State's household disposable income.²⁷

Problem Gambling

For most people, gambling represents a minimal proportion of their expenditures. However,

*problem gamblers ... are strongly represented among heavy gamblers ... Problem gamblers account for about 0.4 per cent of gamblers who outlay less than \$500 a year on gambling, but for around 40 per cent of those who outlay more than \$4 500 annually. Of course, this does not mean that heavy spending equates with excessive spending or with problem gambling – indeed it is still true that a majority of heavy gamblers are not problem gamblers.*²⁸

Heavy gamblers represent a major source of income for gambling providers:

²³ Tasmanian Gaming Commission (2000), Summary Table A.

²⁴ The average will be lower as Western Australia does not have gaming machines outside the casino. For States and Territories with gaming machines outside of the casino, the average expenditure is \$541.11.

²⁵ Tasmanian Gaming Commission (2000), Summary Table A.

²⁶ Victorian Casino and Gaming Authority (2000) *Seventh Survey of ...*, March, p. .

²⁷ Derived from Tasmanian Gaming Commission (2000), Summary Table A.

²⁸ Productivity Commission (2000) p. P.6.

*Numerous overseas studies ... show that around the heaviest 20-30% of gamblers account for some 80% or more of total gambling expenditure.*²⁹

The Productivity Commission's national gaming survey provides more recent and statistical evidence on the link between problem gambling and electronic gaming machines³⁰ and the relationship between heavy gambling and overall gaming expenditure. It found that:

- the 'top' 5 per cent of gamblers (by level of expenditure) account for almost two-thirds of outlays^{31,32}
- the 'top' 10 per cent of gamblers account for over three-quarters of outlay.³³
- problem gamblers accounted for around 42 per cent of gaming machine expenditure.³⁴
- of the 4 per cent of adult Australians who play gaming machines very regularly, i.e., at least once a week, 23 per cent or one-in-four scored 5 or higher on the South Oaks Gambling Screen (SOGS), the most commonly used index to measure problem gambling.³⁵

Analysis of ABS data on socio-economic disadvantage and gaming expenditure figures show:

- the less well off bear the heaviest burden. Across Victorian local government areas (LGAs) those with the lowest socio-economic indicators have the highest densities of gaming machines and losses per adult (Chart 2-7 A and B).³⁶

²⁹ Smith, J. (1998) *op.cit.*, p. 57.

³⁰ See in particular, Productivity Commission (2000), Table 6.15, and pp. 6.51-54, 8.10, 17.35-36.

³¹ The Productivity Commission report detail on the outlay (that is the gross amount of money that gamblers bring to bet) though not on expenditure or losses.

³² Productivity Commission (2000), p. P.5.

³³ Productivity Commission (2000), p. P.5.

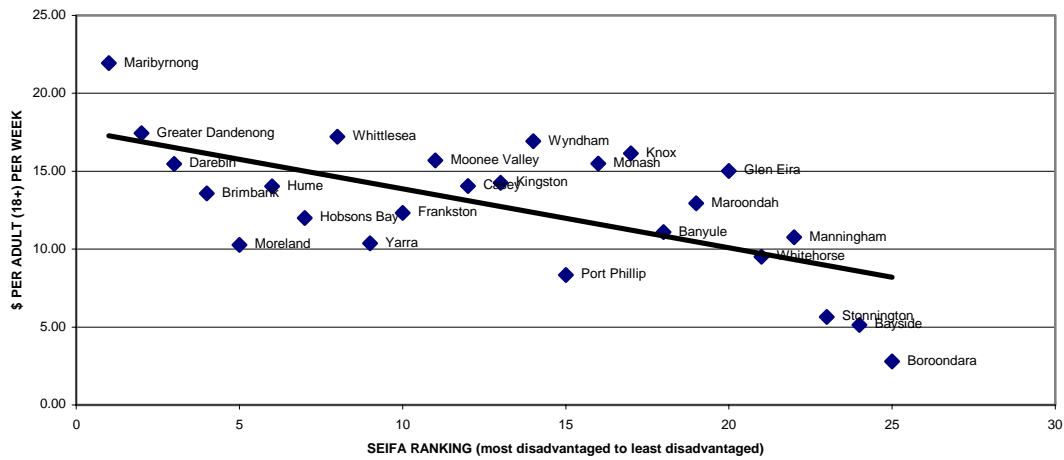
³⁴ Productivity Commission (2000) p. P.17 – the 95 per cent range of this estimate is 33 per cent to 52 per cent.

³⁵ Productivity Commission (2000), p. 6.54. The Commission's report looks at the validity of this test, pp. 6.40ff. Importantly, as previously noted by Shaffer, problem gambling is a robust phenomenon.

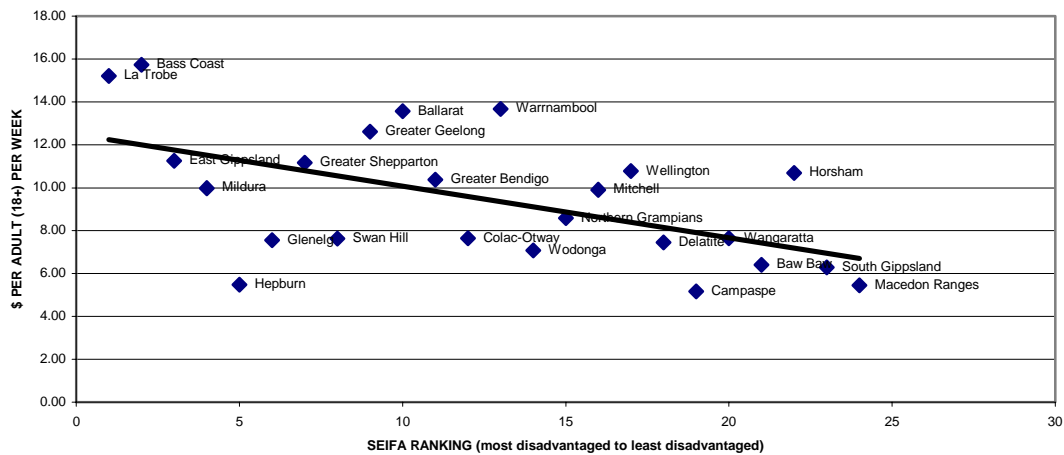
³⁶ Doughney, J., (2000) *Pokie Caps and the Disadvantaged in Victoria*, Victoria University.

CHART 2-7: POKER MACHINE LOSSES & DISADVANTAGE

A: METROPOLITAN LGAS (1998-99) RANKED BY SEIFA INDEX³⁷



B: REGIONAL LGAS (1998-99) RANKED BY SEIFA INDEX



Source: Doughney, James (2000) *Pokie Caps and the Disadvantaged in Victoria*, Victoria University

While it is convenient to segment the gaming customers into recreational and problem gamblers, the situation is not black and white. The American research highlights the problem of second level gamblers whose may not experience clinical levels of gambling problems, but nonetheless expose themselves and their families to “severe adverse consequences”.³⁸ Moreover, there is a two-way migration between the heavy and problem gambler categories.

The concerns of community and the objectives of governments in regulating gaming have swung increasingly towards harm minimisation and responsible gaming.

³⁷ Socio-Economic Index for Areas (SEIFA) is set of ABS indexes that "measure different aspects of socio-economic conditions by geographic area".

³⁸ Shaffer, Howard J, Hall, Matthew N and Vander Bilt, Joni (1997) *Estimating the Prevalence of Disordered Gambling Behavior in the United States and Canada: A Meta-analysis*, Harvard Medical School, project funded by National Center for Responsible Gaming, 15 December, p. 22

3. CLARIFICATION OF OBJECTIVES & FRAMEWORK

National Competition Policy requires clarification of the objectives of legislation. These objectives may be explicit in the legislation itself, spelt out in second reading speeches and other relevant documentation, or implicit. In reviewing legislation in terms of its objectives and impact on competition, it is important to understand the nature of the market(s) and why the Government is involved.

Gambling exhibits a number of special features that suggest a role for Government. These include:

- the attraction of crime to major cash-based activities;³⁹
- the ability to change the odds in favour of the operator and against the gambler;
- the adverse social and economic consequences of gambling; and
- the traditionally strong community and religious attitudes against gambling in large segments of the community.

In economic terms, gambling therefore causes negative externalities or spillovers. These are broadly summarised as the social costs arising from excessive levels of gambling and the potential for gambling venues to be used for criminal purposes (money laundering, cheating players, tax evasion).

Typically, governments react to negative externalities by prohibiting or constraining access to the activity, by imposing a tax to cover the costs of the negative side-effect, or by imposing minimum standards under which the activity may be conducted.

The legislative intervention in gaming markets should be seen, therefore as a response to the need to create and control (previously illegal) markets and to mitigate or control negative side effects that arise from the market activity. This perspective drives the objectives of the legislation

The gaming machine market, like all gambling markets is, therefore, heavily regulated. First, as a matter of public policy ALL gambling and conduct of gambling is prohibited, unless it is specifically exempted or legalised. In Victoria, the general control of gambling is in the *Lotteries Gaming and Betting Act 1966*. Legitimation of a form of

³⁹ The Australian Institute of Criminology (AIC) noted in 1990 that the “Woodward (New South Wales 1979), Stewart (Australia 1986), Costigan (Australia 1984) and Moffitt (New South Wales 1974) Royal Commissions, the Fitzgerald Inquiry (Queensland 1989), the New South Wales and Commonwealth Joint Task Force on Drug Trafficking (Australia 1983) ... have revealed there are strong connections between organised crime and illegal gambling in Australia” AIC (1990) “Gambling in Australia”, *Trends & Issues in Crime and Criminal Justice*, No. 24, July, pp. 3-4.

gambling is therefore carefully constrained. The legislation creates the property rights to operate or conduct gambling and in itself creates the (legitimated) gambling market.

The *Lotteries Gaming and Betting Act 1966* states:

13(1) Any person who plays or bets at any unlawful game or in any public place plays or bets by way of wagering or gaming at or with any table instrument or means of wagering or gaming at any game or pretended game of chance shall be guilty of an offence.

The central acts regulating gaming machines outside the casino are the *Gaming Machine Control Act* (GMCAct) and the *Gaming and Betting Act* (G&BAct). The explicit purposes of the *Gaming Machine Control Act 1999* are to:

...establish a system for the regulation, supervision and control of gaming machines and gaming equipment with the aims of –

- a) ensuring that gaming on gaming machines is conducted honestly;*
- b) ensuring that the management of gaming machines and equipment is free from criminal influence or exploitation;*
- c) regulating the use of gaming machines in casinos and other approved venues where liquor is sold;*
- d) regulating the activities of persons in the gaming machine industry;*
- e) promoting tourism,, employment and economic development generally in the state; and*
- f) fostering responsible gambling in order to:*
 - (i) minimise harm caused by problem gambling; and*
 - (ii) accommodate those who gamble without harming themselves or others.*

These purposes are consistent with three prime objectives, namely to:

- establish rapidly and comprehensively gaming in Victoria;
- ensure probity and freedom from organised crime; and
- ensure that gaming is now⁴⁰ undertaken responsibly in order to minimise the harm of problem gambling.

A further objective may be inferred:

- to assist the hotel and club industries.

⁴⁰ This last objective was added in 2000.

The underwriting of the Victorian racing industry is explicit in the contractual arrangements summarised in the 29 June 1994 letter from the Treasurer to TABCORP and Vic Racing (see Attachment A below).

The explicit purposes of the *Gaming and Betting Act 1994* are to “*make provision for the carrying on, under licence or permit, of:*

- *a business of wagering;*
- *a business of conducting approved betting competitions;*
- *a business of conducting gaming;*
- *a business of conducting club keno; and*
- *a business of on-course wagering.”*

In addition, other prime objectives can be inferred. These include:

- the underwriting of the Victorian racing industry;
- the addition of value to the then-to-be privatised TAB.

The underwriting of the Victorian club industry as an objective is indicated in the relevant provisions of the GMCA⁴¹ and reconfirmed in the second reading speech for the 1993 amendment act.

The policy objectives of gaming machine legislation have clearly shifted over time and changing circumstances and fit within the framework of the Victoria’s gaming legislation (Chart 3-1). Objectives such as establishment and industry development have already been achieved.

We conclude that this NCP review should be based on the Victorian community’s current prioritisation of objectives. This is seen to be to:

- minimise the harm of gambling;
- ensure probity in all aspects of gambling;
- underwrite the Victorian racing industry;
- underwrite the Victorian club and hotel industries; and
- maximise the economic benefits to the State.

⁴¹ Licences are specifically defined for clubs (s. 12A) and the capability for the Minister to give directions on machine numbers specifically refers to clubs (s. 12(1)(d)(ii)).

CHART 3-1: POLICY OBJECTIVES IN VICTORIAN GAMBLING LEGISLATION : PAST & PRESENT

- 1) Prevent uncontrolled gambling by prohibition and offering legal licensed gambling opportunities.
- 2) Provide restricted access to legalised gambling through electronic gaming machines and demonstrate that legal gambling benefits the community.
- 3) Protect consumers by:
 - guaranteeing integrity, probity and safety of legal gambling activities,
 - prevent monopoly exploitation; and
 - prevent crime and unfair contests.
- 4) Mitigate and control the extent of problem gambling and other adverse social consequences.
- 5) Enhance product e.g., increasing size of totalisator pools.
- 6) Stimulate related industries, e.g.
 - racing through TAB and gaming machine franchise;
 - tourism through casino;
 - hotels and clubs through gaming machines.
- 7) Create and maintain new sources of State revenue e.g., by successive/selective relaxations of restrictions (e.g., on-course bookmaking, lotteries, TAB, casino/gaming machines, sports betting).
- 8) Ensure that expansion of gambling activities occurs at a pace which can be monitored and controlled.

3.1. FRAMEWORK FOR BENEFIT / COST ASSESSMENTS

National Competition Policy requires that legislation reviews:

*assess and balance the costs and benefits of the restrictions.*⁴²

Any consideration of the benefits and costs of the restrictions, and of any alternative means of achieving the objectives of the legislation, requires an explicit framework and a clear understanding of the policy objectives, the nature of the markets and the State economy. The key aspects of such a framework should be clarified in advance. These include:

- what are the characteristics perceived as distinguishing gambling from other more normal markets?

⁴² CPA sub-clause 5(9).

- how should the policy objectives of gambling legislation be integrated and treated in the benefit cost assessment?
- how should the lack of hard direct evidence on many of the major questions and presumptions affecting public policy and public policy questions on gambling impact the benefit cost assessment? and
- what base case should be used as the reference against which to judge benefits and costs?

3.1.1. DISTINGUISHING CHARACTERISTICS

The business of legal gambling does not exist without regulation. Regulation of gambling is predicated on several distinct characteristics (Chart 3-2).

CHART 3-2: GAMBLING REGULATION

Gradual liberalisation	Until 1990, only wagering, lotteries and some minor forms of gaming were legal. Gradual liberalisation from this restricted base has accommodated an experimental approach to assessing the benefits and costs to stakeholders – including consumers, service providers, community welfare groups, other related industries, regional and State economies, and government as a revenue recipient
Social costs	There is social detriment accompanying gambling. It is greatest for certain ‘quick realisation’ forms of gaming (such as gaming machines), and is effectively controlled by restrictions on who can supply these gambling forms and how many can be provided.
Taxation	Gambling is a legitimate social/entertainment activity, but it can be justifiably taxed at rates exceeding those on most other goods and services with social costs justifying restrictions which conveniently provide a tax base of their own. Very different effective tax rates on individual gambling products are accommodated by this feature.
Size advantages and statutory market power	Large pool sizes for parimutuel forms of gambling – such as, lotto and totalisator betting – serve the interests of players, providers and government (revenue) alike, and help justify entry restrictions and limitations on numbers of providers. The market power effects of this require controls (for example, minimum payout ratios).
Quality of product (integrity, probity – consumer protection)	There is a useful role for government in providing this via regulation and its effectiveness is enhanced under exclusive provision. Such regulation, according to this view, makes for more efficient industry, despite the restriction on the competition.
Industry and activity support	A complex web of gambling restrictions can be justified in part by the need to support certain industries and activities (for example, racing, clubs) at the expense of rivals (for example, hotels).

Source: CIE (1997) *A Framework for National Competition Policy Reviews of Gaming Legislation*, May.

The legislative presumption in Australian jurisdictions has been that gambling is prohibited unless specifically allowed for.

As a result, the State is the monopolist and can segment and discriminate within the potential gambling market in order to maximise tax revenue and other economic benefits and to minimise adverse social consequences. Each step in the liberalisation or

contraction of gambling involves its own benefit-cost evaluation and possibly discriminatory outcomes.

3.1.2. POLICY OBJECTIVE AND ASSESSMENT CRITERIA

In any assessment of benefits and costs, it is essential to identify the explicit policy objectives and criteria against which to judge the various options. Past and present policy objectives in Victorian gambling have already been identified above and summarised:

The [net] *benefits to the State economy will be maximised where:*

- *the monopoly rents created by legislative restrictions are fully appropriated by the community whether through payments to Government or direct benefits to the community;*
- *tax rates and the price of gambling are set to maximise tax revenue from gambling by tourists and by residents; and*
- *the harm and costs of problem gambling and social disruption are minimised within the State.*

As noted, taking the starting position as one of overall restriction, the State is the monopolist. The task is to issue gambling franchises and conditions incrementally to maximise net socio-economic benefits to the Victorian community – essentially, to get the best for Victoria by reducing or avoiding harm and maximising economic benefits.

The benefits and costs must, therefore, be evaluated in more than dollar terms. Indeed, the Competition Principles Agreement explicitly acknowledges that the assessments should take account of a range of matters, such as:

- *policies relating to ecologically sustainable development;*
- *social welfare and equity considerations;*
- *economic and regional development;*
- *the interests of consumers generally or of a class of consumers;*
- *the competitiveness of Australian Businesses; and*
- *the efficient allocation of resources.*⁴³

⁴³ CPA sub-clause 1(3).

3.1.3. QUALITY OF EVIDENCE AND INFORMATION

Hard, direct evidence on the major facts and presumptions affecting public policy and public interest questions on gambling is currently lacking:

*Formulating public policy in the area of gambling depends upon estimates: estimates of the positive economic contributions of gambling industries which policy makers must weigh against estimates of the negative externalities associated with the operation of these industries.*⁴⁴

There is little or no direct evidence, for instance, on:

- the impact of different harm minimisation methods, on problem gamblers and/or on recreational gamblers;
- the impact and practicality of specific options to minimise harm (such as machine generated queries to test informed consent⁴⁵);
- the impact of different types of venues on problem gambling and the introduction and effectiveness of responsible gaming;
- the impact of higher or lower machine numbers in venues on problem gambling – although revenue per machine in Victoria is known to be higher in venues with more machines; and
- the levels of organised crime in gaming. While informed opinion suggests that levels are uniformly low, the possibility remains that organised crime exists but is simply undetected;

Lack of compelling evidence to justify existing restrictions is no defence of those restrictions in normal markets. However, the Productivity Commission and other reviewers recognise that “gambling is a special industry”.

The gambling industries, more than many others, are creatures of government activity.

*... The task for government policy towards these industries, as for many others, is to regulate them in ways which, by taking account of their special characteristics, will help to bring the greatest benefits to society.*⁴⁶

Similarly,

gambling is different from other industries, primarily because of the negative externalities [of problem gambling and crime] that can occur.

⁴⁴ Volberg, R.A. Moore, W. L., Christiansen, E. M., Cummings, W. E. and Banks, S. M. (1998) “Unaffordable Losses: Estimating the Proportion of Gambling Revenues Derived from Problem Gamblers”, *Gaming Law Review*, Vol. 2 No. 4.

⁴⁵ See Dickerson, M. (1999) *EGM Players and Responsible Gaming*, Paper presented at the National Association for Gambling Studies Conference for practitioners, Adelaide, November, submission to Responsible Gaming Consultation.

⁴⁶ Productivity Commission (2000) pp. 14-15.

These adverse effects reduce the economic and social contributions of gambling to the state.⁴⁷

The nature and magnitude of these negative impacts are of central relevance to the questions addressed by this NCP review.

Community concerns over the adverse consequences of gambling underpin the policies of restriction and regulation of gambling opportunities and activities (Chart 3-3). The question arises therefore as to whether the onus of proof on matters relating to the spread and level of gambling and levels of problem gambling ought not to be reversed and the precautionary principle applied.

In its generalised form, the precautionary principle states that where the costs of inaction are high and likely irreversible, then the lack of conclusive technical evidence is not a reason for doing nothing.⁴⁸

We conclude that the precautionary principle should be applied to gambling policy and this legislative review.⁴⁹

⁴⁷ Professor Jan McMillen (1999), comment on MJA discussion paper on South Australian Racing & Wagering Legislation NCP Review, December.

⁴⁸ For example, the guiding principles for Economically Sustainable Development include:
“where there are threats of serious or irreversible environmental damage, lack of full scientific certainty should not be used as a reason for postponing measures to prevent environmental degradation “ Government of Australia (1992) *National Strategy for Ecologically Sustainable Development*, December.

⁴⁹ For an alternative view, see Tattersall’s submission to this review, p. 5.

CHART 3-3: VICTORIAN ATTITUDES TO GAMBLING

One of the roles of the Victorian Casino and Gaming Authority (VCGA) is to undertake research into the social aspects of gaming.

In its Seventh Survey of Community Gambling Patterns and Perceptions in 1999, the VCGA found “*more respondents who **strongly** agreed with negative attitudinal statements and **strongly** disagreed with positive attitudinal statements about gambling than had been reported in the 1998 survey. Although results were less negative than those for the 1997 and 1996 surveys, in general, it appears that the overall flavour of opinion concerning gambling in Victoria is receding from its most positive point in this survey to date (1998).*”

Of note “*more than half of respondents strongly agreed that the number of poker machines operating in Victoria should be reduced.*” Other indicators were less dramatic and some suggested a pragmatic approach to gambling.

The KPMG longitudinal survey found that 81 per cent of the community **disagreed** with the statement that “gambling does more good for the community than harm”. This survey also found that 82 per cent agreed that “gambling is a serious social problem”.

Sources: VCGA (1997) *Summary of Research Findings 1996-97*, VCGA (2000) *Seventh Survey of Community Gambling Patterns and Perceptions*, KPMG (2000) *Report of the Longitudinal Community Impact Survey*

3.1.4. CRITERIA FOR ALTERNATIVES

While gambling legislation is predicated on numerous strongly held beliefs for which there is currently little firm research evidence, it would be risky and imprudent to drop existing restrictions in favour of less restrictive but largely experimental alternatives.

This raises the further question as to how alternatives should be defined. Does Clause (5) of the Competition Principles Agreement refer to any alternative which might in concept be practical in the future, or does it refer to alternatives which on the basis of experience or a body of research can be judged to be practical now?

This question is in fact a common issue in public policy determinations, for instance, in regulatory reviews to determine efficient costs based on best available technologies. In general, alternative or benchmark options need to be practical, rather than conjectural.

In examining the alternatives to Victoria’s unique dual operator system, the arrangements in other States provide direct examples of such alternatives.

However, alternatives to the cap on machine numbers in individual venues or the split between club and hotel venues are more conjectural.

3.1.5. THE BASE CASE

The benefits and costs of the current restrictions, and of any alternative means of provision, must be assessed against a base case. Three options are reviewed below:

- **without legislation:** under this approach the current restrictions and alternatives would be assessed against the situation which would exist without legislation. This approach has proved helpful, in legislative reviews such as of the Barley Act where there are restrictive marketing arrangements in place, and it is possible to construct a free market model, as the base case. This approach is not sensible in the case of gaming, i.e., we see no model of the markets for gaming and gambling in the absence of any legislative or regulatory intervention;
- **a single alternative vision:** under this approach the current restrictions would be assessed against a coherent alternative structure. This approach is preferred where it is possible to construct a comprehensive vision of an alternative to the status quo, yet retaining legislation. For instance in gaming, some parts of an integrated, and coherent, alternative industry structure are reasonably observable in other States and jurisdictions;
- **the status quo:** finally, the status quo, itself, could be used as the base case, and the benefits and costs of alternatives assessed against it. This approach is useful where there is a suite of different alternative elements which require assessment rather than a single integrated vision. This approach provides not only a judgement of the relative benefits of the alternatives but also, by reflection, an assessment of the benefits of the status quo.

3.2. RESTRICTIONS TO COMPETITION

The Competition Principles Agreement requires that all legislation be reviewed to identify restrictions to competition. As noted, legalised gambling industries and markets are permitted where specific legislation has liberalised the general prohibition on gambling. As a result, these markets are typified by multiple restrictions.

The multiple restrictions applying to the Victorian gaming industry are listed in Chart 3-4. These restrictions can be split into three categories, that is:

- restrictions relating to industry structure;
- restrictions relating to the distribution of machines; and
- other restrictions generally relating to licensing and probity issues.

These restrictions are examined in the following chapters.

CHART 3-4: LISTING OF RESTRICTIONS IN VICTORIAN GAMING MARKETS

Restriction
Gambling is prohibited by the Lotteries Gaming and Betting Act.
The gaming machine market is exempted and is solely defined through the rules in the <i>Gaming Machine Control Act 1991</i> and <i>Gaming and Betting Act 1994</i> and the two casino acts.
Manufacturers, machine technicians, venue operators and the venues separately, venue staff, gaming operators, machine-servicing providers are licensed with probity hurdles.
Separation of venue operation from machine ownership (the gaming operator).
Purchase from manufacturer limited to gaming operator.
Monitoring of system linked to ownership of machine.
Gaming operators licensed – limited to two operators until 2012.
Gaming operator licences to be reviewed after 15 years to determine if extended.
Each operator guaranteed half of machine numbers.
Each operator guaranteed one-third of gaming income (originally to be reviewed by November 1996).
Monitoring is required to be continuous real-time on-line.
Operators pay clubs one-third of income (after GST), hotels 25 per cent after GST.
The operators pay 8 1/3 per cent to Consolidated Revenue for hotel venues. This is then to be paid into the Community Support Fund (less \$25m per year until 2003), and a further 24.24 per cent for all venues.
The minimum return to player is 87 per cent.
The total number of machines outside of the casino must not exceed 27,500. (Ministerial Direction)
Until 2006, there may not be more than 45,000 machines in Victoria.
Where new venues are to be licensed or where there is an application to expand machine numbers, the local municipality may make a submission on the social and economic impact of the proposal on the municipality (and also surrounding areas). This proposal must be considered by the Authority.
Venues owned by the same person may not be located within 100m of each other unless shown to be independently operated.
Contracts (broadly defined) between gaming operators and venue operators must be approved by VCGA.
Unless authorised, the maximum continuous hours of operation in a day are 20 hours.
Within the Melbourne Statistical Division, twenty-four hours a day trading for specified days may be approved. The application must contain a submission on the net social and economic impact on the local municipality and the impact on surrounding municipalities.
20 per cent of machines must be located outside of the Melbourne Statistical Division. (Ministerial Direction)
There must be equal number of machines in clubs and hotels. (Ministerial Direction)
No venue may have more than 105 machines. (Ministerial Direction)
No venue within 100km of the casino may have more than 105 machines until 2006.
The Minister may set regional limits.

4. RESTRICTIONS ON INDUSTRY STRUCTURE

The Terms of Reference for this review direct attention to a number of specific issues. The first is the licensing of two gaming operators, i.e., “the dual operator system”.⁵⁰ This system is based on both legislative and contractual agreements and the licences. In this regard the review is required to recognise that the Government will continue to uphold all its contractual agreements.

The Premier has announced in relation to the dual operator system that the Government will honour all existing contractual arrangements. Tattersall's and Tabcorp are licensed to 2012. Any recommendations in relation to the market structure that arise in the review will relate to options for change available to Government beyond 2012.

The dual operator arrangements with Tattersall's and TABCORP constitute the underpinnings for the current industry structure. As such these key restrictions are examined first and in depth.

In reviewing the dual operator structure we have examined:

- the relevant parts of the *Gaming Machine Control Act (1991)* and the *Gaming and Betting Act (1994)*;
- the letter dated 129 June 1994 from the Treasurer to TABCORP Holdings and VicRacing;
- the *Gaming Operator's Licence issued under the Gaming Machine Control Act 1991 (Vic)*; and
- the *Ministerial Directions Under The Gaming Machine Control Act 1991* dated 4 April 1997.

These documents are all in public domain. They may not, however, constitute a full description of the contractual arrangements and understandings. Consequently, we have only partially clarified which components of the dual operator system are capable of change within the period of the current contracts. Nonetheless, on the basis of the available documents, we conclude that the level and form of the payments to the operator are able to be reviewed during the course of the contracts/licences. However, this view would need to be confirmed by an examination of the unsighted 1996 review documents, amongst others.

⁵⁰ The NCC has also drawn attention to the fact that the duopoly on the ownership of gaming machines (excluding casino gaming machines) is a legislative restriction on competition under the terms of the CPA. It needs to be reviewed under NCP, and if it is to be retained, it must be shown to be in the public benefit. Similarly, alternatives must be examined to evaluate ways of achieving objectives. NCC (2000) *draft internal working paper*.

When examining the dual operator structure we have also found it useful to draw upon the 1994 Review of Electronic Gaming Machines in Victoria, otherwise known as the Schilling Review. This review was undertaken very shortly after gaming machines were introduced and, therefore, has immediate and fresh insights into objectives and understandings which are no longer apparent from the public documents.

4.1. INTERLOCKING RESTRICTIONS

The dual operator system is based on a core set of interlocking restrictions. These include:

- i. the separation of machine purchasing and ownership from venue ownership and operation.

Separate sections of the GMCAct authorise the licensed gaming operator to purchase machines from an authorised supplier, and for the ownership of machines (s. 14) and for a licensed venue operator to manage the operation of the machines (s. 13). A licensed gaming operator may not be a licensed venue operator (s. 19A). The operator licensed under the G&BAct acts as if under the GMCAct (s. 7(c));

- ii. the linking of the monitoring and control functions with the function of machine ownership.

Again, the licensee under the G&BAct must conform to the requirements of the GMCAct. As noted above only gaming operators may own machines. A condition of the operator's licence is "*the Authority must be satisfied that the proposed licensee will have in place an adequate electronic monitoring system for detecting significant events associated with each gaming machine, including a system for continuous on-line real time recording, monitoring and control of significant game play transactions*" (s. 34);

- iii. for the initial period to 2012, the limitation to two licensees only to undertake the combined functions of machine ownership and monitoring and control of machines.

Operator licences may be issued under the G&BAct or the GMCAct.

The licence issued under the G&BAct is a sole licence (s. 8(b)). This initial licence is for 18 years (s. 12(2)(a)). It expires in 2012.

The initial licence under the GMCAct was agreed to expire in 2012. No new licences may be granted under this Act until this first licence expires or is terminated (s. 33(2)).

Subsequent licences under the G&BAct will again be sole licences (s. 8(b)) and of at least 18 years duration (s. 20(4)). Subsequent licences under the GMCAct are not limited in number (there is no number specified) or duration (s. 35).

In the cases of both licence holders, they may receive compensation if they do not receive a renewal of their licence (GMCAct s. 35A and G&BAct s. 21). However, compensation need not be payable for loss of **exclusive** licence;

- iv. the 50/50 split in machine numbers between the two operators (Ministerial Direction under s. 12 of GMCAct); and
- v. the specification that licensees will retain one-third of daily spend (s. 136(3B)) and pay set amounts to the government and venue operators (Authority under GMC Act, s. 136(3) and s. 159 and again G&BAct s. 7(c), the amounts specified are in the *Gaming Machine Control (Returns by Gaming Operators) Regulations 2000* s. 6).

The Gaming Operator's Licence (para. 8) states that “A review of rates of return payable by the [machine operator] under section 136 of the Act shall be conducted by the Minister in consultation with the [machine operator] and other relevant parties before 1 November, 1996.”

In addition, there are associated but separable restrictions including the requirement for TAB (and any future holder of the gaming operator's licence under the G&BAct) to enter into arrangements with Racing Victoria and the requirement that monitoring and control be undertaken in real time. These associated, but separable restrictions, are examined in the final sections of this chapter.

The arrangements in the two Acts specifying the current structure and the arrangements with Racing Victoria represent Agreement Acts

“Agreement Acts broadly provide legislative backing to contractual agreements entered into by Government with the private sector.

By their nature these Acts often restrict entry to particular markets for the period of the agreements. As such, they will involve a legislative restriction on competition which falls within the requirement for review under the Competition Principles Agreement.

To balance the requirement for review against the limitation imposed by existing private rights and obligations, reviews will initially need to identify the scope for change while preserving existing private rights and obligations and, where there is scope for change, proceed within those parameters.”⁵¹

Consistent with these guidelines, we examine below what restrictions should be removed at the expiration of the current contracts and what restrictions may be able to be changed within the period of these contracts.

⁵¹ *Victorian Government Timetable for Review of Legislative Restrictions on Competition* (1996) June, s. 10.

4.2. OBJECTIVES

The prime objective of the dual operator system is indicated in the Second Reading Speech:

*A major safeguard against the use of undue influence in the industry is provided by the establishment of two gaming operators*⁵²

However, there were clearly other purposes. The Schilling Review's summary was that:

Government's intention in having gaming operators was four-fold. They were to provide:

- *a "buffer" against potential criminal activity arising from the direct purchase of gaming machines by venues from manufacturers;*
- *gambling industry expertise to help ensure orderly start-up;*
- *the security of known Victorian "brands" and public confidence;*
- *capital injection to support industry start-up.*⁵³

With the industry now having reached substantial maturity only the first and prime objective remains relevant – although the dual operator restrictions will impact other legislative objectives.

4.3. EFFECTS OF RESTRICTIONS

The effects of the (two operator) restrictions are to:

- prevent club and hotel venues from owning and operating machines – which is allowed in other Australian States;
- set profit sharing arrangements – as distinct from approved maximum fees – for the operator/monitoring functions. This unique profit sharing:
 - generates payments to the operators very substantially above the fee levels received for the same functions when undertaken in other States;
 - shifts the decision rule for machine allocation from maximising revenue and welfare at the venue to maximising net revenue per machine for the operators.

The shift in decision rule occurs because the two operators are given a share of the profits as distinct from approved maximum fees. This shift is of fundamental importance in its wider impact on the Victorian industry;

⁵² Second Reading Speech, Gaming Machine Control Bill, 5 June 1991 Assembly

⁵³ Schilling, pp. 55-56.

- prevent independent firms which do not wish to own machines from undertaking the monitoring and control functions;
- limit competition to between two operators only; and
- prevent competition between these two operators in terms of price and change in share of machines (but allows competition for customer numbers and high spending customers).

The cumulative effect of the individual restrictions is that:

- *Victoria in its structure and approach is unique, having the most complicated structure and a high degree of regulation when compared with other jurisdictions*⁵⁴;
- the electronic gaming industry in Victoria is run by the two machine operators. Clubs and hotels are potentially at a severe disadvantage in terms of relative power in contract negotiation;
- there is a driving focus on maximising income per machine;
- machines are located where they maximise revenue per machine rather than where they maximise venue income or satisfaction;
- the two operators are given “amazing” monopoly rents.

Clearly the two-operator system is strongly anti-competitive.

However, among the several restrictions making up Victoria’s dual operator system, the critical restriction and major driver is section 136 which awards the operators a share of the profits.

Interaction with Caps

These effects would occur in the absence of the cap on machine numbers, but are exacerbated by the total cap, the 50 : 50 split between the two operators and the 50 : 50 split between hotels and clubs. Even when the total cap has not been binding, the number of machines available for the more successful operator to place into the more profitable hotel venues, has been constrained by the number of machine able to be taken up by the clubs and/or the number of machines able to be taken up by the other duopolist.

The effective result is that operators have tended to face an individually binding cap at all stages and have behaved accordingly.

⁵⁴ Schilling, (1994) p. 7

In the absence of any form of cap, the operators would reallocate machines only where they failed to cover costs.

With caps, the operators reallocate machines from low turnover venues to high turnover venues.

Because the two machine operators are strongly profit focussed and have had total discretion over the allocation of machines, machines have been reallocated to maximise performance per machine and profits to the two operators. Regular league tables comparing credits or turnover per machine have been part of this incentive structure which has led to machines being shifted to those venues which generate the highest machine revenue.⁵⁵

...In March 1994, we contracted with TABCORP for 5 EGMs

...[which returned] over the 4-5 years ... \$425,000.

...In August 1999, our 5 machines were removed by TABCORP as they were not returning their target revenue.⁵⁶

and

...the imposition of regional caps is, to some extent, a reaction to the excesses of the two operator system which allowed the gaming operators to systematically remove the machines from areas of relatively low turnover and to concentrate the numbers in areas of higher turnover. If the operators were not at liberty to remove machines from venues, the venues in lower turnover areas would not have relinquished machines.⁵⁷

In a situation of caps but venues able to own their own machines, there would be legitimate pressure to allow trade in machine entitlements but each venue operator would make its decisions on machine numbers on the basis of the venue as an entity rather than on the basis of maximising revenue per machine.

These concerns are not new and were noted in the Schilling Review.⁵⁸

The impact of giving the machine operators a profit share is to maximise machine revenue across the State for any given number of machines. In turn this shift in decision rule is exacerbated by the combination of the total cap of 27,500 on the number of machines and the two 50 : 50 splits. Together with these caps, the two-operator system drives the sharply different performance of the Victorian industry compared with the other States (Chart 4-1).

⁵⁵ Both Tattersall's and TABCORP produce 'league tables' showing the relative per machine income position of each of the clubs and hotel using that operator's machines.

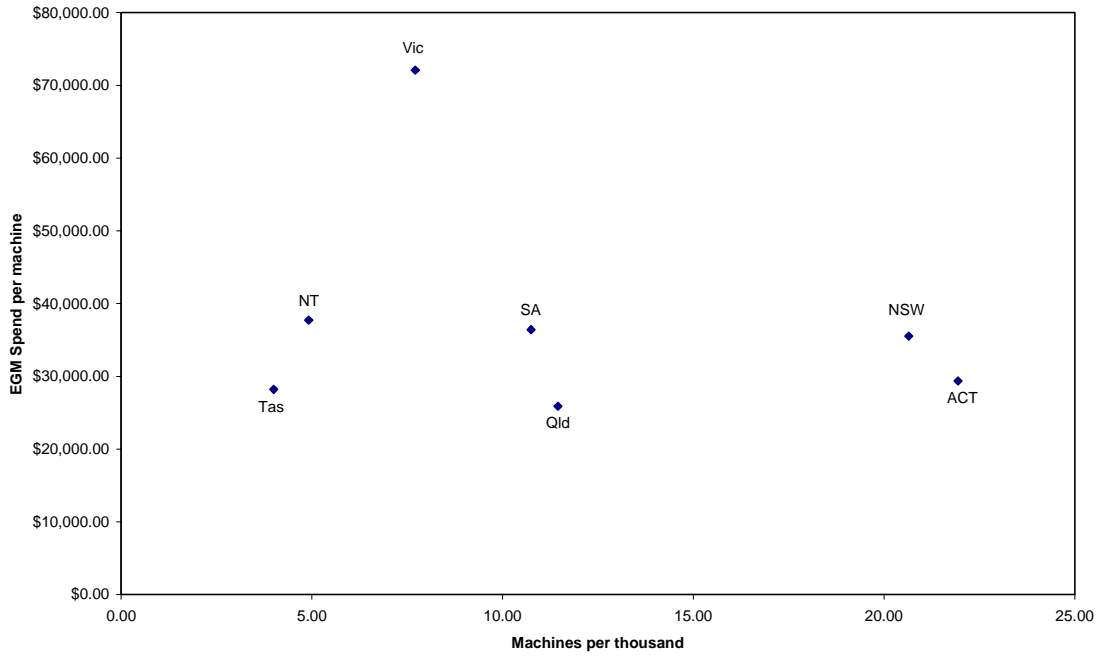
⁵⁶ Brighton Bowling and Tennis Club Submission to review

⁵⁷ Clubs Victoria submission to review, p. 24.

⁵⁸ Schilling Review (1994) p. 122.

CHART 4-1:

A. AVERAGE MACHINE REVENUE AND MACHINE PENETRATION



B: MACHINE PENETRATION AND PER CAPITA SPEND

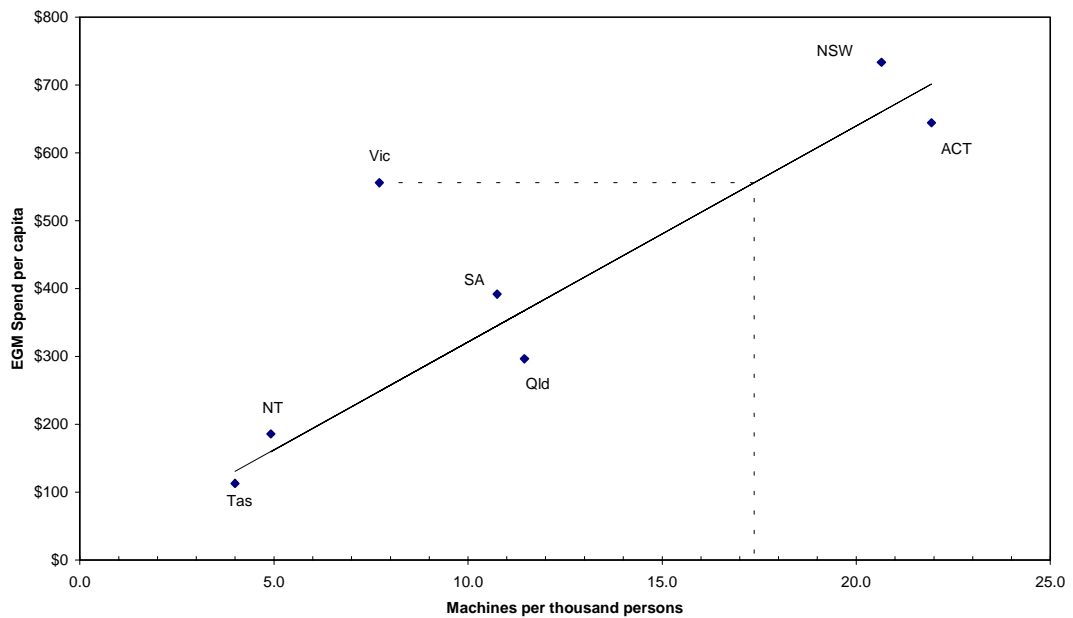
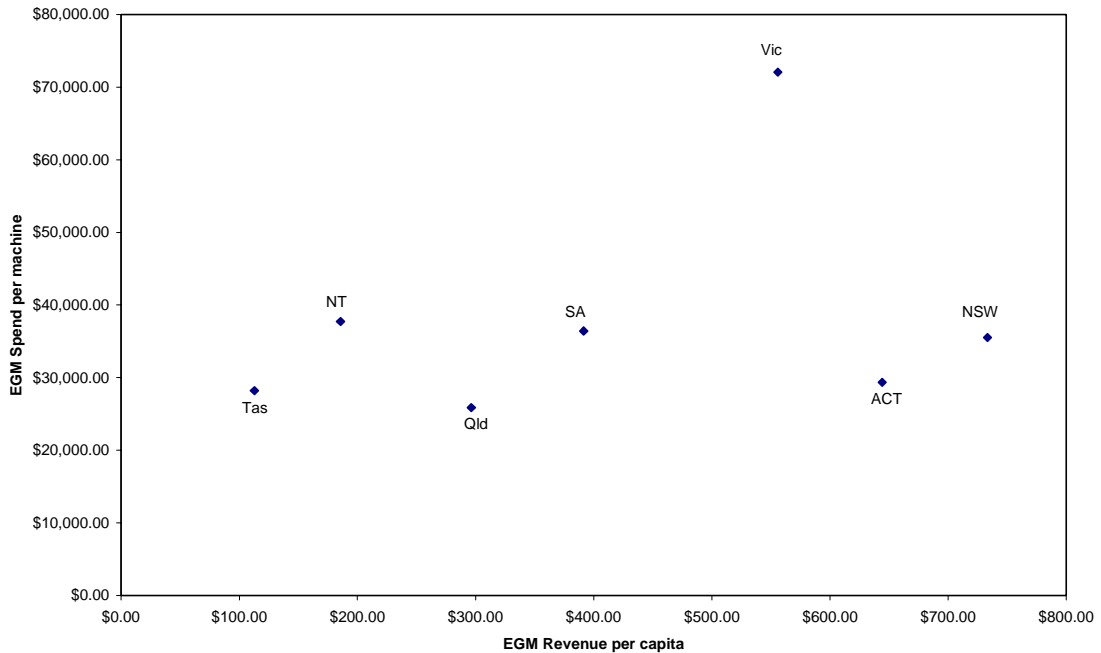
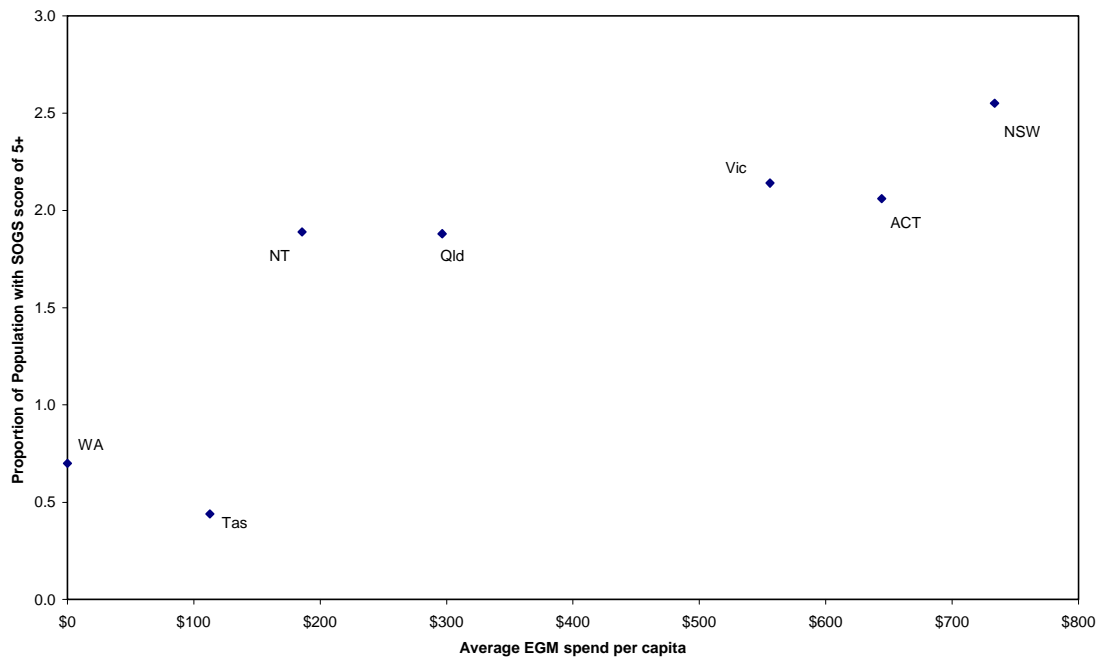


CHART 4.1 (CONT'D)

C: PER CAPITA SPEND AND PER MACHINE REVENUE



D: PER CAPITA SPEND AND PROBLEM GAMBLING



Note: Gaming expenditure, household disposable income, adult population for 1998-99 from Tasmanian Gaming Commission; machine numbers for end-September 1999 and SOGS from April 1999 from Productivity Commission,

Sources: Tasmanian Gaming Commission (2000), Productivity Commission (2000).

These effects may be mitigated by the new requirement that the contracts between the machine operators and the venues are inspectable by the VCGA to reduce unconscionable behaviour and removal of machines without the agreement of venue operators. However, this mitigation measure deals with the symptoms and not the underlying source of the exceptionally strong and peculiar incentives operating in Victoria.

4.4. ASSESSMENT OF BENEFITS & COSTS AGAINST ALTERNATIVES

As noted, the Competition Principles Agreement requires that the benefits and costs of identified restrictions be assessed. It is not meaningful to base the benefit/cost assessment on a situation of no restriction. This is so because of the special features of gambling, which mean that most governments and communities do not allow gambling without some regulation or restriction.

Consequently, the assessment of the benefits and costs of the identified restrictions must be assessed against the base of alternative methods of achieving the relevant policy objectives. Moreover, the identification of alternative methods of achieving the relevant policy objectives is a formal requirement of any NCP legislation review.

Alternative methods and arrangements for ensuring probity in gaming and undertaking the function of monitoring and control of machines are readily observable in other Australian States.

The common features of the arrangements in the three mainland States are:

- the dual functions of machine ownership and operation, and venue ownership are not split by legislation;
- the functions of machine operation and monitoring and control are not linked by legislation. On the contrary, in these other States the monitoring and control function is separated from all other functions; and
- profit sharing by contractors and suppliers to the venues are not permitted.

Inspection of the differing restrictions on industry structure in Queensland and NSW indicates that these two States are converging in their approach and that the Queensland restrictions may represent current best practice. Chart 4-2 summarises the current Queensland model.

Tasmania's gaming legislation and industry structure has some similarities with Victoria but differs in one critical respect.

**CHART 4-2: BENCHMARK REGULATORY RESTRICTIONS FOR GAMING IN AUSTRALIA
(QUEENSLAND MODEL)**

- i. Machine manufacturers should be licensed and precluded from any other activity in the industry.
- ii. Venues may not purchase/obtain machines directly from manufacturers.
While the venues decide what machines to purchase (albeit often at the recommendation of their Licensed Monitoring Operator (LMO) or the manufacturer), they cannot buy directly from the manufacturer. The order must be placed through their LMO and approved by the gaming authority.
- iii. Monitoring and control should be separated from all other functions, other than machine purchase.
LMOs can provide ancillary monitoring services such as jackpot systems, promotions, training, financing for purchase of machines, process orders for machine purchases etc. Monitoring operators should not be involved in the operation of the sites/venues themselves.
- iv. Monitoring and control regulation should not specify the form of monitoring – but rather the performance standards.
- v. Venues must hold a liquor licence and a separate gaming licence. The liquor licence should not automatically qualify the venue for a gaming licence.
- vi. Licensed venues should be permitted to own or lease gaming machines.
- vii. Testing, servicing and staffing functions should each be individually licensed, desirably on a person-by-person basis
(Queensland currently does its testing in-house but is moving to approved privately provided testing but without licensing).
- viii. Profit sharing arrangements should be prohibited. Exceptions are allowed for linked jackpots. All contracts should be inspectable.
- ix. competitively set fees for monitoring and rental (Qld)
Approved fees (NSW/Tas)

Source: Derived from *Gaming Machine Act 1991* (Qld) and discussions with officers in Queensland Office of Gaming Regulation (QOGR).

As in Victoria, the venues do not own the machines and the single machine operator also has the monitoring responsibility. However, the monopoly machine operator is paid an approved fee per machine plus an administrative fee per venue, unrelated to machine turnover or profit.

Chart 4-3 summarises the Tasmanian arrangements.

The common feature of gaming legislation in all other Australian States is that no party, other than the venues and the government, have a legitimate share of gaming profits

(with the minor exceptions of linked jackpots and the foreshadowed ability of TabLtd to assist small undercapitalised NSW clubs). In this respect, Victoria is unique.

The Queensland restrictions affecting industry structure are less restrictive than the Tasmanian model. As a result, we have taken Queensland as the benchmark for the benefit cost analysis of the Victorian restrictions.

CHART 4-3: REGULATORY RESTRICTIONS FOR GAMING IN TASMANIA

Gaming Machines in hotels and clubs

...

Two types of machines are approved for use in hotels and clubs, the Aristocrat MkV and the Olympic OA2. The machines are continuously monitored by a computer located at the venue, and data relating to security and game play is retrieved daily by the Olympic Sentinel Central Monitoring and Control System located at the Operations Centre in Sandy Bay. Reports and statistical information are generated daily from the system.

It is a legislative requirement that gaming machines return a minimum of 85% to players. Gaming machines in hotels and clubs generally return in excess of 87%.

Hoteliers and clubs rent machines from the gaming operator, which provides training and marketing services to the venues and coordinates machine maintenance by Wang Australia. The approved monthly rental fee per machine is $\$196.54 + (\$347.44/x)$ where x equals the number of approved machines for the particular venue. The approved monthly maintenance fee is \$32 per machine.

Until 30 June 2000 the maximum number of machines permitted in a hotel or club is limited to 15 and 25 respectively. Thereafter the limit increases yearly ... This limit will be reviewed in January 2003.

From 1 January 1999, the limit for a single bet on a gaming machine was removed in accordance with the Deed of 25 October 1993 between the Federal Group and the Government. Prior to 1 January 1999, the maximum bet that could be made in any one play on a gaming machine was 30 cents. The maximum bet in a single play is now \$10 as set by the operator, Australian National Hotels Pty Ltd.

Taxation on gaming machines is calculated on gross profit, that is, turnover less winnings paid. The tax rates are based on a sliding scale from 25% to 35% depending on the combined gross profit from all gaming machines in hotels, clubs and casinos (excluding Admirals).

Source: extract from Tasmanian Gaming Commission (1999) *Annual Report 1998-99*

4.5. BENEFIT COST EVALUATION

In terms of the differential benefits and costs of the restrictions making up the Victorian dual operator system, it is necessary to examine the evidence on the:

- probity;
- harm minimisation and responsible gaming;
- efficiency and equity; and
- competition.

The benefit cost assessment is undertaken on the basis of the totality of the restrictions and on the key individual restriction, i.e., profit sharing.

4.5.1. PROBITY

Strong concerns were expressed in the eighties and early nineties on the danger of organised crime in gaming.

With the benefit of hindsight, these concerns are now seen by gaming regulators to reflect the pre-computerisation, pre-electronic monitoring and control situation.

To gain an impression of the situation regarding crime in gaming in the three Eastern States, regulators in each State were contacted. The comments were:

- in Victoria: *“no evidence of organised crime in venues, gaming operators, customers ... no evidence of criminal infiltration.”*⁵⁹
The VCGA annual reports list extensive, albeit minor, staff crime.⁶⁰
- in New South Wales: *“ignoring the casino, crime is very low, almost negligible, More so with the tool of central monitoring. Some crime and siphoning with venue staff which is soon uncovered. Systematic organised crime barely exists.”*⁶¹
- in Queensland: *“in terms of gaming machines in Queensland, there is minimal potential for organised crime because the machines are monitored. Criminal activities by staff and any others are rapidly identified through the regular audit inspections and accounting systems.”*⁶²

⁵⁹ pers. comm. Bill Lahey, Director Gaming & Betting, VCGA [VCGA may wish to confirm]

⁶⁰ VCGA Annual Reports

⁶¹ pers. comm. Dominic Herschel, Manager, Policy Branch, NSW Department of Gaming & Racing, 21 September 2000.

⁶² pers. comm. Linda Woo, Director, Licensing and Gaming Services, QOGR, 21 September 2000.

Despite the different restrictions and structures and the legislative specification of “real time monitoring” for Victoria, there appears to be little or no difference in the levels or threat of infiltration of organised crime between the three States.

We would note that in its assessment of the VCGA, the Auditor-General found:

*...Audit has stressed that until the new procedures have been formally endorsed and are fully operational, the members of the Authority cannot be completely satisfied that all licensing decisions are soundly based and consistent with the organisation’s statutory aim of ensuring the gambling industry is free from criminal influence and exploitation.*⁶³

but

*The overall conclusion reached by audit was that the standards developed by the Authority are comprehensive in coverage and have been instrumental in assisting the Authority in the establishment of technical integrity in the conduct of gambling activities.*⁶⁴

Overall

*... the Parliament, Government and community can be confident that an effective regulator is continually overseeing the day-to-day workings of the State’s major gaming industry.*⁶⁵

This specific issue identified by the Auditor-General was refuted by the Authority which replied:

The Authority is satisfied that all licensing decisions are soundly based and consistent with its statutory obligations.

*After more than 5 years of gaming in which participants have been licensed, there has not been one substantiated case of criminal influence or exploitation having entered the gaming industry.*⁶⁶

We conclude, therefore, that in terms of probity the strongly anti-competitive features of the Victorian dual operator system, and the unique profit sharing in particular, appear to offer either no or no significant additional benefits.

⁶³ Auditor-General of Victoria (1998) *Victoria’s Gaming Industry: An insight into the role of the regulator*, Special Report No. 54, March, para. 1.1.6.

⁶⁴ Auditor-General of Victoria (1998). para. 1.1.9.

⁶⁵ Auditor-General of Victoria (1998). para. 1.1.17.

⁶⁶ Auditor-General of Victoria (1998). pp. 6-7.

4.5.2. HARM MINIMISATION

In Victoria, the duopoly operators submitted to this review that their centralised structure offers the best method of ensuring responsible gaming. Tattersall's submitted:

From the time of its introduction to the present, the Operator System has delivered responsible gaming during the establishment phase of the industry in Victoria. The mandated separation of operators and venues has meant that Government requirements for responsible gambling have been implemented in a cost-effective, certain and timely fashion.

... Moreover, as the gaming industry moves into a mature phase of its development Tattersall's considers that the Operator System will continue to deliver net benefits to the community.⁶⁷

and TABCORP:

Compared to the NSW industry, the Victorian industry, due directly to the dual operator system:

...has a higher level of uniform standards for responsible delivery of gaming

and

The two operators are well positioned to apply uniform standards across all venues in terms of venue presentation, and in particular, responsible service of gaming.⁶⁸

However, the Productivity Commission tended to the alternative view.

The Victorian duopoly has the advantage that two operators may be able to police a self-regulation approach more effectively than under more dispersed ownership of gaming machines. But it is questionable whether self-regulation is the best approach to dealing with problem gambling.

...

The Commission sees no significant advantages for harm minimisation arising from exclusivity arrangements as such. A preferred approach is to focus on improving the efficacy of harm minimisation programs in a range of venues.⁶⁹

More direct evidence on the comparative merits of different structures in achieving responsible gaming may be inferred from the other States. At a time when all States are co-operating under the auspices of the Council of Australian Governments (COAG) to foster responsible gambling and harm reduction, none of the other States which have significantly different structures and contacted as part of this review see their structure and regulatory restrictions as a weakness in furthering responsible gaming.

⁶⁷ Tattersall's Submission to review, pp. 31-32.

⁶⁸ TABCORP Submission to review, pp. 10, 16.

⁶⁹ Productivity Commission (2000) p. 14.21.

In addition, implementation and practical operation of emerging suggestions to apply the principle of informed consent as a basis for responsible gaming (and involving intelligent machine protocols to question the gambler on her informed intent), do not appear to require a highly monopolised industry structure.^{70, 71}

We conclude that the dual operator system is neither necessary nor sufficient for the effective introduction of responsible gaming.

Indeed, retention of the unique profit-sharing arrangements with the dual operator system would appear to create strong incentives to continue to push for maximum gaming levels if not growth. Certainly, it cannot be concluded that the responsible gaming objectives of the legislation can only be achieved by restricting competition in this unique way.

4.5.3. EFFICIENCY & EQUITY

There can be no dispute that:

- the dual operator structure was highly effective in rapidly establishing and expanding gaming in clubs and hotels in Victoria. A key driver of the expansion was the profit-sharing arrangement. This may have been appropriate for the speedy establishment of the industry; and
- that machine turnover in Victoria is substantially higher than it is in other States, so that gaming activity as a percentage of household disposable income is broadly similar to New South Wales, despite having only a quarter of the number of machines. In NSW, EGM expenditure was the equivalent of 2.7 per cent of household disposable income in 1998-99; the comparable figure for Victoria was 2.1 per cent.⁷²

Efficiency has other dimensions including the appropriateness and allocation of incentives and risk. For instance:

- In all other jurisdictions where venues normally own the machines, venue operators make a decision on machine numbers on the basis of the total venue revenue. However in Victoria, machine operators make decisions purely on the basis of the return from each machine. The league tables and removal of machines in low performing venues are well documented (see above);

⁷⁰ Dickerson, M. (1999)

⁷¹ *pers. comm.* Mark Dickerson, 28 September 2000. Consultations with Professor Mark Dickerson, Tattersalls Chair of Gambling, University of Western Sydney, suggest that intelligent machine protocols can be installed in all states subject to political will and carry through.

⁷² Derived from Tasmanian Gaming Commission (2000), Summary Table A.

- there is
*... little real competition between the two because of the compulsory Ministerial Direction for segmentation of the market at 50% of electronic gaming machines per gaming operator. This situation was frequently summed up in submissions to the Review as a duopoly situation, and the behaviour compared to Australia's previous two-airline policy.*⁷³

Our review has found no evidence to modify this finding from the 1994 Schilling Review;

- the machine operators receive excessively generous payments.
*Contrasting the capital investment required for the gaming operators to establish their gaming businesses, and the returns on that investment, the terms of the licences (20 years and no up-front licence fee) are excessively generous and this is likely to lead to sub-optimal outcomes for the Government and therefore the community.*⁷⁴

Again, our review has found no evidence to modify this finding from the 1994 Schilling Review. We present updated evidence below; and

- the excessive returns to the gaming machine operators are obtained at the expense of the Government and, in particular, the venue operators.

This means that gaming has not been as profitable for Victorian clubs and hotels as it has been in other jurisdictions and has created pressure for Government to make other concessions. In some cases these other concessions are undesirable. For instance, the creation of the authorised gaming visitor has allowed clubs access to a wider clientele but has undermined the unique status of clubs and encouraged the formation of “quasi-clubs”.

Excessive Monopoly Rents

The magnitude of monopoly rents provided by Government to the two operators may be illustrated by benchmarking against the typical range of costs in any of the Queensland, New South Wales, Tasmanian and South Australian situations. The choice of which State is used makes little difference to the qualitative conclusion, i.e., that the Victorian legislation is unique in providing very substantial monopoly rents to the gaming operators. As noted, this arises because only in Victoria are there machine operators who receive a share of the profit.

The costs faced by the Victorian dual operators include the costs of monitoring, servicing and lease costs for the machines. These costs are directly observable in other States (and estimates are available of the differentially higher costs of the on-line

⁷³ Schilling (1994), p. 56

⁷⁴ Schilling (1994), p. 8.

real-time monitoring). In each of the other States, the total payments for these functions are a fraction of the guaranteed return provided to the two Victorian monopolists.

The legislated monopoly powers provide a very substantial monopoly rent, i.e., a level of payment well above that required to ensure provision of the service. Indicative calculations suggest that the guaranteed payment to the two machine operators is around four times larger than the payments for the equivalent functions in other States (Chart 4-4).

That is, under the alternative structure of restrictions identified above, either there would be a much greater return to the venues or to government.

The indicative estimates of the monopoly are shown on a per machine per month basis. In annual terms, the rent is of the order of \$4-500 million. Even if costs of operating the system were double⁷⁵ our primarily market-based figures, this would still imply a rent in excess of a \$200 million each year.

⁷⁵ Double machine costs for example, would require **all** machines to be the equivalent of Aristocrat's Premium Service which includes banks of hyperlinked machines. Aristocrat have advised that the standard example shown in Chart 4-4, is broadly representative of most of the machines they supply into the market. *pers. comm.* Kim Watt, Aristocrat Technologies, 12 October, 2000.

CHART 4-4: INDICATIVE COSTS & MONOPOLY RENT IN VICTORIAN GAMING MACHINE OPERATION: 1999

Gaming expenditure outside Casino		\$1,954 b	
Number of machines		27,500	
Income per machine per annum		\$71,062	
Income to operator (1/3) per machine, per annum		\$23,687	
Licence fee per annum ¹		\$1,658	
		<i>Minimum return</i>	<i>Maximum return</i>
Income to operator per machine, per month		\$1,836	\$1,836
Less	<i>Cost ranges</i>		
Purchase cost/rental per machine, per month	\$267 ² - \$550 ³	\$550	\$267
Monitoring cost per machine, per month ⁴	20 ⁵ – 55 ⁶	\$55	\$20
Servicing costs per machine, per month ⁷	25-40	\$40	\$25
	\$525 – \$645	\$645	\$525
Rent to Monopoly Operators per machine per month		\$1,191	\$1,524
Annual equivalent		\$393m	\$503m

Notes:

1. Tattersall's pays an annual licence fee equivalent to 7 per cent of income received. We have allocated this across both operators to reflect TABCORP's up-front licence fee for the same right.
2. Lower bound based on approved Tasmanian rental of \$196.54 and the administrative fee of \$347 allocated across five machines.
3. Upper bound represents estimated machine cost derived from Aristocrat Revenue Profiles⁷⁶ based on purchase price of hardware of \$10,100, minimal residual values of \$0 for the hardware, financed over four years at 10 per cent pa. Assuming software is replaced every year, annual software and technical support costs are set at \$3,500.
4. Note, the IPART determined rate for monitoring in NSW is \$27.50 per machine, per month.
5. Market rate for dial-up monitoring in Queensland.
6. Current set fee for dial-up monitoring in South Australia.
7. Likely range for monitoring costs under most contractual arrangements. Does not include zero cost that may be offered by some manufacturers to promote sales.

Mechanisms allowing monopoly rents

The Schilling Review sets out in part the mechanisms which allowed the excessive returns.

The Review has been informed that returns were considered reasonable for their proposed contribution. Information provided to the Review indicated that the arrangement for the distribution of profits also took into account a principle of equal sharing of profits. p. 58

In view of the particular contributions expected from gaming operators, namely assistance in ensuring public confidence in the probity of the industry and capital for industry set up, the then Government considered [a]n investment [return] of around 27% appropriate. This figure was confirmed by financial analysis using an internal rate of return methodology. p. 71

The original estimates by the Office of Gaming assumed a turnover/EGM/day of \$520 based on the New South Wales experience in a

⁷⁶ Aristocrat (2000) *The Way Forward*, Investor Presentation, slide 18.

mature market. The fact that this figure was used underlines the conservatism of the estimates. Actual average daily turnover per electronic gaming machine in 1992/93 was \$1426... p. 72

Average daily turnover for electronic gaming machines in 1999/2000 was \$2,751 for hotels and \$1,376 for clubs.⁷⁷

Since the two operators were estimated to receive an internal rate of return of 27 per cent based on a daily turnover around 25 per cent only of levels currently being observed, it follows that the two operators are presently receiving returns dramatically larger than the 27 per cent internal rate of return agreed with the Government in the early nineties.

The Schilling Review further observed that:

The gaming operators' share of returns – 33.1/3% of daily net cash balance until 1996 – was meant to ensure adequate returns to operators during the start-up period of the industry, but allow a review of returns beyond this period to ensure adequate but not excessive returns. page 58

As noted, the provision for such a review is contained in the Gaming Operator's Licence para 8:

“A review of rates of return payable by the [machine operator] under section 136 of the Act shall be conducted by the Minister in consultation with the [machine operator] and other relevant parties before 1 November, 1996.”

We are informed that an internal review was undertaken with the Treasury in that year. No change was made to the shares between the stakeholders. The Schilling recommendations to reduce payments to operators were not adopted in either spirit or detail. The payment arrangements remained unchanged until modified by regulation in 2000 to reflect the impact of the Goods and Services Tax (GST).

Our conclusion is that this market operates as an unregulated (legislated) monopoly. **We recommend that the Victorian Government use the discretion provided by clause 8 of the Gaming Operator's Licence to:**

- i) remove the monopoly profits above the level of payments necessary to ensure competitive or regulated provision of monitoring, servicing and machine rental;**
- ii) provide the operators with a flat cost-based fee for these services to venues.**

Unlike the 1996 review, any future review should be public and transparent.

⁷⁷ Indicative estimate by Marsden Jacob based on venue revenue, machine numbers and average pay-out ratios from TABCORP submission to inquiry, p. 13.

The discretion of the Victorian Government to undertake a subsequent review is unclear. Clause 8 of the Operator's Licence does not, in itself, preclude a subsequent review. However, the wording of the conclusions of the 1996 review and the phrasing of the decision conveyed to the operators may have closed out the possibility. We have not been able to review any papers relating to the 1996 review, the possibility of a subsequent review or the conditions under which a subsequent review might proceed.

On these issues, the Government will need to review the 1996 documents and take specific legal advice on the discretion and options.

4.5.4. DOES THE CAP NECESSITATE DUAL OPERATORS?

An important restriction outside the ambit of this review is the cap of 27,500 on the number of gaming machines. A popular view with the Victorian industry is that this cap necessitates and justifies the dual operator structure. This is quite incorrect.

The availability of key resources are capped in many other industries where governments have intervened to limit the market. For instance, governments limit:

- the number of taxi plates;
- the volume of water available for irrigation; and
- the tonnage of fish that may be taken.

In none of these cases does the relevant cap necessitate a monopoly or duopoly structure. Nonetheless, the interaction of the cap with the dual operator restrictions dramatically exacerbates the impacts of each individual restriction.

Rather than the cap necessitating the dual operator structure, reflecting the analysis in Section 4.3 above, the alternative conclusion is that (to avoid the sharply adverse interaction effects), the use of caps necessitates a move away from the dual operator structure as soon as contractually possible.

4.5.5. LINKING RACING TO LICENCE UNDER G&BACT

As noted in Chapter 2, expansion of gambling through new products typically occurs at the expense of existing gambling forms. Recognising this relationship, the racing industry and the government undertook to broaden the revenue base. A condition of the sole licence available under G&BAct is that the holder must come to an arrangement with the racing industry to establish

20. Grant of licence

...

(2) The Governor in Council must not grant the licences unless the Minister, after consultation with the Authority--

(a) is satisfied--

(i) that the arrangements between the current licensee and VicRacing or Racing Products have been or, before the licences commence, will be, concluded to the reasonable satisfaction of the parties; or

(ii) that a reasonable opportunity has been given for such a conclusion of those arrangements; and

(b) is satisfied that the applicant has entered into, or made a binding offer to enter into, arrangements with VicRacing and arrangements with Racing Products that, in the opinion of the Minister, after consultation with the Authority, are no less favourable to VicRacing and Racing Products than those last in force between a licensee (other than a licensee appointed under section 34) and VicRacing or Racing Products, as the case requires.

The racing industry is a direct beneficiary of the on-going efficient extraction of revenues from gaming machines as venue operators and as joint venturers with TABCORP. There is little doubt this arrangement has contributed to the health of the Victorian racing industry. To give an indication of the importance of this contribution

In 1999/2000 the Victorian Racing Industry paid out a total of almost \$150 million in prize money and other benefits to owners ...

[and]

*In the year ended 30 June 2000, revenues to the Victorian Racing Industry from the conduct of gaming by TABCORP totalled \$65 million ...*⁷⁸

The retention of the duopoly in gaming machines⁷⁹ is not necessary to achieve the legislative objective of supporting the racing industry. Uncoupling the link will ensure that the subsidy to the industry is not dependent on the health of one operator in the gaming machine market. Under more competitive conditions for machine operators and/or reduced earnings, the racing industry is likely to receive substantially lower returns. Other means of directing money to the racing industry would be more effective and sustainable.

Alternatively, the subsidy to the racing industry could be coupled to total gaming industry revenue.

We recommend that the Government and the racing industry take the early opportunity to renegotiate the current open-ended Agreement Act to ensure on-going support independent of the existing duopoly and financing arrangements,

⁷⁸ Racing Victoria Submission to review, p. 5.

⁷⁹ We do not comment in this review on the exclusive wagering licence in Victoria held by TABCORP which also contributes to the viability of the local racing industry.

so that agreed new arrangements can be in place when the existing contracts/licences expire in 2012.

4.5.6. LINKING REAL-TIME ON-LINE MONITORING TO OPERATOR'S LICENCE

One component of the original GMCAct (and a major consideration in the original debate on introducing gaming machines)⁸⁰ was the requirement for real-time on-line monitoring of gaming machine operations. This is a condition of the gaming operator's licence. This requirement had been believed necessary to ensure probity of gaming machine operations.

The requirements are further defined through regulations on monitoring in *Gaming Machine Control (Monitoring and Control) Regulations 1991*. These specify:

- the events that must be monitored; and
- the speed with which they must be recorded (s.10).

The effect of this restriction is to prevent the use of the alternative monitoring systems, such as a lower cost dial-up system.

*clearly the cost structures of both operators has been significantly affected by the government's prescription for an on-line real-time monitoring system ... the cost differential between the systems is significant.*⁸¹

Given the methodology used to compensate the two operators, it is not clear that this specification added to the share for the operators. Undoubtedly, the revenue-sharing formula allowed them to take on this responsibility more easily.

In South Australia where there is also a dial-up monitoring system, the service is provided through a co-operative of the South Australian Licensed Clubs Association and the Australian Hotels Association. The charge for monitoring is approved by the Treasurer to ensure that it covers costs. Before the introduction of GST, it was set at \$51.67 per month per machine.

The benefits of the restriction are not obvious. Queensland and, in the immediate future, New South Wales, have also opted for dial-up monitoring. In terms of the probity objective, none of the gaming regulators in NSW, Queensland or Victoria identified superior features in practice. The restriction is therefore anti-competitive. It is an example of input regulation of performance standards.

⁸⁰ In particular, see the debate on the Second Reading Speech for the *Gaming Machine Control Bill* in 1991, speeches by the Hon. Mrs Wade in Committee, 27 and 28 August, the Hon. Mrs Hirsh, the Hon. Dr Napthine, 21 August. Most speeches to the debate mentioned the necessity of this system to ensure probity.

⁸¹ Schilling (1994), pp. 84-85

We conclude that this restriction is anti-competitive and can not be justified on public interest grounds.

We recommend that the legislation be amended to remove the requirement that monitoring and control be a requirement of the operator’s licence. There would consequently be no need to require the system to be on-line, real-time.

4.6. SUMMARY

In summary, assessment of benefits and costs of the Victorian dual operator restrictions against the benchmark of the Queensland model (or the evolving NSW model) suggests no advantage in the Victorian model and indeed substantial disadvantage. This conclusion is neither new nor recent. The first specific finding of the Schilling Review in 1994 was that:

*the design of the Victorian system has been heavily influenced by concerns about crime. This has led to an industry structure and distribution of profits which limits competition and produces sub-optimal outcomes.*⁸²

In terms of the NCP review, we conclude that two-operator restriction is strongly anti-competitive and cannot be justified on public interest grounds. Indeed, the public interest would be very much better served by its termination.

However, the early termination of a licence under the GMCA Act requires an order from the Supreme Court arising from either a material breach or persistent breaches of its licence. Further, the current Agreement Acts (Gaming and Betting and Gaming Machine Control) provide substantial compensation for the incumbents where they do not receive a renewal of their licence. Under these constraints, there appears little opportunity or benefit from revoking the existing licences before 2012.

However, well ahead of that time the Government should examine those conditions associated with the existing market structure and determine the sequence by which they should be unwound.

A key aspect directly associated with the two-operator system that may be reviewed immediately is the profit sharing formula contained in s. 136 (3B). The excessively generosity of the licences and the resulting huge monopoly rents currently given to the machine operators can be examined and corrected immediately. As noted, clause 8 of the licences does not preclude subsequent reviews within the period of the contract although the phrasing of the 1996 review decision may have closed out this option.

We recommend that the excessive generosity of the current licences and resulting monopoly rents end as soon as practicable.

⁸² Schilling (1994) p. 97.

Reflecting its highly anti-competitive nature and lack of public interest benefits over more competitive structures, we recommend the two-operator system should not be continued beyond the expiry of the current contracts and that a competitive model based on Queensland. However, whichever model is chosen we strongly recommend that there be no profit sharing

5. RESTRICTIONS ON DISTRIBUTION OF MACHINES AND OTHER RESTRICTIONS

5.1. PRIORS

The Terms of Reference direct attention to several restrictions affecting the distribution of gaming machines, geographically, and in and between venues. These restrictions are set out in the Ministerial Direction (see Attachment B). This review must provide findings and recommendations on:

- *gaming venue market structure. This includes the 50:50 split of gaming machines between hotels and clubs. It should also include consideration of the concentration of gaming venue ownership and the emergence of quasi-clubs;*
- *the allocation of at least 20 per cent of gaming machines outside the Casino to non-metropolitan Victoria;*
- *the numbers of gaming machines per venue;*

The specified restrictions for review are part of a wider set of restrictions and regulations affecting the number and distribution of machines in Victoria. This wider set includes:

- the cap of 27,500 machines on gaming venues outside the casino;⁸³
- the caps on gaming machine numbers in specific regions of the State;
- the venue limit of 105 gaming machines for venues located within 100kms of the casino;

The *Casino (Management Agreement) Act 1993* prohibits venues within 100km of the casino, other than the casino, to have more than 105 gaming machines. The further cap of 45,000 machines is currently not binding due to the Government decision above.

- the requirement that to obtain a licence for any new location or to increase the number of machines at any existing location, the net social and economic impact on the municipality must be considered by the VCGA to be not negative; and
- the reinstated⁸⁴ requirement for any agreement or arrangement between a venue operator and its gaming operator to be approved by the VCGA or be in

⁸³ The current cap was introduced in 1995 “*pending a comprehensive research study by the Authority*” and “*was based principally on the results of the Authority’s research activities to date dealing with the social impact of gambling*”.

See Auditor General (1998) *Victoria’s gaming Industry: an insight into the role of the regulator*, Special Report No. 54, march, p. .

A cap has been in place throughout the history of gaming machines in Victoria. In 1992, the cap was 10,000 and in 1993 it was increased to 20,000. State of Victoria (Schilling) (1994) *Review of Electronic Gaming Machines in Victoria*, Vol. 1, April, p. 108.

accordance with an approved form. Of particular note, contracts are not to be approved if they are "*harsh and unconscionable*" (s. 68(3)(a)).

Within this wider set of restrictions and regulations, the first three restrictions are beyond the scope of this review since they have been confirmed by explicit Government decision, or are captured by the commitment to honour all existing contracts.

The Government is committed to maintaining the numeric limit of 27,500 gaming machines outside the Melbourne casino

Similarly regional caps on gaming machine numbers represent a Government commitment in the public interest. It is therefore beyond the scope of the review's brief to develop reform options that propose lifting machine number caps;

The Government "... will continue to uphold all its contractual agreements"

While this last commitment was explicitly associated with the dual operator agreements, similarly binding contracts exist with the casino regarding gaming machine distribution and numbers.

Within the wider set of restrictions and regulations identified above, the latter two are seen as regulations. That is, we do not see these as restricting competition and as offering potentially major benefits. Nonetheless, they will undoubtedly impact on the distribution of gaming machines across the State and in gaming venues.

⁸⁴ In 1997, the equivalent section was removed. In his second reading speech introducing the Gaming Acts (Miscellaneous Amendments) Bill, the Minister for Sport the Hon Mr Reynolds stated "*It is considered to be unnecessary intervention in the commercial relationship between the gaming operator and the venue operator. In addition, there are other more appropriate remedies available to parties who believe the terms of a contract may be unfair or unjust -- for example, through the courts or the Australian Competition and Consumer Commission.*" House of Assembly (1997) Hansard, 9 September.

CHART 5-1: CASINO-RELATED RESTRICTIONS

There is little doubt that gaming machines compete in the same market as the casino. This is highlighted by two facts. In awarding the casino licence, the government included a number of anti-competitive provisions in the *Casino (Management Agreement) Act 1993* which reduced the direct competition from gaming machines in licensed venues.⁸⁵ Specifically,

...

24.2 Notwithstanding clause 24.1, the State shall restrict the playing of gaming machines within the following limits--

(a) during the period prior to the date 12 years from the Licensing Date, the maximum number of gaming machines permitted to be used at any approved venue located within a radius of 100 kilometers from the Site shall be 105; and

(b) the total number of gaming machines permitted to be used in the State during the period prior to the date 12 years from the Licensing Date shall not exceed 45 000.

These restrictions must be taken into account in setting Ministerial Directions under s. 12 of the GMCAct.

Second, during the recent closure of Crown Casino during the World Economic Forum, VCGA statistics indicate that inner city gaming venues reported expenditures of over 50 per cent higher in that week.⁸⁶

⁸⁵ It also limits the existence of a competing casino anywhere in the State for six years and within 150km for 12 years of 1993.

⁸⁶ *pers. comm.* gaming industry source, 19 September 2000. VCGA declined to comment.

5.1.1. NET SOCIAL AND ECONOMIC BENEFIT

The requirement for local government views to be considered by the VCGA and the requirement for an assessment of the net economic and social impact are important changes. These are summarised in Chart 5-2.

CHART 5-2: IMPACT OF GAMING ON THE COMMUNITY

In regard to applications for a licence for a venue, an applicant must make a copy of its application available to the relevant local authority (section 12B(4) and section 12CA applies.

12CA. Impact of gaming on municipal district

- (1) *Within 28 days after receiving a copy of an application for approval of premises, the relevant responsible authority may make a submission to the authority –*
- (a) *addressing the economic and social impact of the proposal for approval on the well-being of the community of the municipal district in which the premises are located; and*
 - (b) *taking into account the impact of the proposal on surrounding municipal districts ...*
- (3) *The Authority must consider a submission so made:*

Further, if an applicant wishes to apply for opening hours in excess of 20 hours for its premises, section it mus provide a submission on the net social and economic benefit for the local municipality and impacts on surrounding municipalities (section 12B(3A)).

In considering any such application for new premises (or alterations), the VCGA is governed by section 12D which under the recent amendments requires there be no net social and economic detriment.

12D. Matters to be considered in determining applications

- (1) The Authority must not grant an application for approval of premises as suitable for gaming unless satisfied that

...

- (c) *the net economic and social impact of approval will not be detrimental to the well-being of the community of the municipal district in which the premises are located.”*

Where a local municipal council is opposed to expanding gaming, this new requirement places an extra hurdle for operators moving machines to new or larger venues:

While imposing a restraint on competition, it invokes the (reversed) onus of proof test on gaming. Expanded gaming in a region may only occur where the VCGA is satisfied that there will be no reduction in net social and economic benefit.

5.1.2. GENERAL REQUIREMENTS

The Productivity Commission provided a broad range for the net benefit of the gaming machine industry from a significant positive impact to a significantly larger negative.

The benefits associated with gaming entirely come from recreational gamblers. The potential net costs of their calculation are associated with problem gamblers.

*For most consumption (that undertaken by recreational gamblers), the presumption is that the [consumer] surplus represents a **genuine** addition to welfare of consumers is a reasonable one.⁸⁷*

In contrast,

[For] problem gamblers ... the loss ('lack of value for money') on their spending in excess of this \$438 million [equivalent to a recreational gambling level], is considerably higher than any consumer surplus on the lower consumption level.⁸⁸

Moreover, the Productivity Commission noted that

... Finding that gambling in total contributes greater benefits than costs does not say whether the industry should be further expanded or wound back. An important issue is whether changes in the size and accessibility of the gambling industry are likely to produce net gains or benefits.⁸⁹

As noted in the chapter on Framework and Objectives, the current key objective driving community concerns and policy is harm minimisation. For all of the restrictions considered below (and indeed for much of the analysis of gaming), there is currently no empirical evidence on measures that directly address problem gambling nor of the effect of existing restrictions. A particular problem is that we don't know what measures address problem gambling but with at least minimal impact on recreational gamblers. This review recognises that effective measures to address problem gambling and harm minimisation more generally are still to be identified, put into place and demonstrated to be effective.

There is currently no practical method of separating recreational and problem gamblers at the venue. Equally there appears to be no evidence to suggest that reducing gaming will not reduce harm. As a result, measures which stop the general expansion of gaming can be expected to reduce the growth in problem gambling.

We conclude the identification of drivers of problem gambling, the consideration of measures to address these drivers and the testing of these measures should be an integral part of the gaming industry and a condition of the licence. The current legislation directing the Gambling Research Panel to research these issues constitutes the first two steps in the process.

Testing the effectiveness of measures introduced is the most important step in removing existing restrictions on competition. The widespread introduction of effective measures

⁸⁷ Productivity Commission (2000) p. 5.17.

⁸⁸ Productivity Commission (2000) p. 5.22.

⁸⁹ Productivity Commission (2000) p. 11.6.

to address problem gambling and minimising harm will open the way for relaxation of controls on the industry which may be adversely affecting recreational gamblers. Currently, higher spend levels, which are associated on average with higher levels of problem gambling are obtained by hotels and larger venues. Without prejudicing the program of the Gambling Research Panel, introduction of harm minimisation strategies may be most effective in these two categories – say venues with more than 50 machines and those establishments taxed at the hotel rate.

5.2. THE 80/20 METRO-REGIONAL SPLIT

The Ministerial Direction states

... that, in respect of the 27,500 gaming machines permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the proportion of gaming machines to be located outside the Melbourne Statistical Division is not less than 20 per cent

The objective of this restriction was to ensure that the benefits associated with gaming would be available to non-metropolitan Victorian areas. The restriction appears to be unnecessary and is being easily met with around 27 per cent of machines outside of the Melbourne Statistical Division.

In terms of benefits and costs, the restriction appears unnecessary therefore to distribute the benefits of gaming outside of Melbourne. Moreover, this objective conflicts at least in part with the new objective of minimising harm.

Under the harm minimisation strategy being implemented through regional caps, it is not clear that the retention of this direction would assist in this objective.

Under circumstances of realigned objectives and a current market tendency to meet the previous objective, there is no reason to retain this direction.

If effective measures to address harm minimisation are adopted in the future and if the government considers that the benefits from responsible gaming should be guaranteed through a minimum share of machines in non-metropolitan areas, then the benefits of some form of quota may be assessed at that time.

We recommend that this restriction be removed from the legislation.

5.3. CLUB-HOTEL 50/50 SPLIT

The Ministerial Direction states:

that, in respect of the 27,500 gaming machines permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the proportion to be placed in premises, in respect of which -

(i) a residential licence under section 46 of the Liquor Control Act 1987 or a general licence under section 47 of the Act is in force, is 50 per cent; and

(ii) a club licence under section 48 of the Liquor Control Act 1987 or a licence under Part I, II or III of the Racing Act 1958 is in force, is 50 per cent

The aim of this restriction was to ensure that the benefits of gaming machines were obtained by clubs. It was believed that the club system would direct more of the gaming dollar back into the community (or at least their members). While the objective of promoting clubs is not explicitly stated in the second reading speeches associated with the *Gaming Machines Control Act 1991*, there is little doubt that clubs were intended to be major beneficiaries of the introduction of the machines. The objective was explicitly stated in the second reading speech to the 1993 amendments.

A second objective of this restriction is to reduce the harm of problem gambling. Although initially this objective may have been incidental it has assumed increasing relevance and importance.

The effects of this restriction include:

- ensuring that a minimum proportion of machines are located in clubs which follow the principles of mutuality and co-operation, rather than in profit focussed hotels;
- by preventing the vast majority of machines from being allocated to hotel venues;

Originally, the government of the day conceived of all machines being located in clubs...As events transpired ... the machines in hotels became more profitable for the gaming operators than the machines in clubs. The effect of the 50:50 Rule is now to ensure that the club movement is given access to machines ... The removal of this Rule, while the dual operator system exists, would very soon result in there being almost no machines in clubs in Victoria.⁹⁰

- slowing the growth in numbers of electronic gaming machines in Victoria;
The ministerial direction underwriting a share of EGMs for clubs ... was also designed to ensure that hotels were not allocated all of the EGMs at the outset by virtue of the better capitalisation of the hotel industry.⁹¹

[All of the restrictions] allow for the orderly development and expansion of the gaming market

⁹⁰ Clubs Victoria Submission to review, p. 27.

⁹¹ TABCORP Submission to review, p. 34.

- keeping the level of gaming much lower than it would be if the hotel sector was able to obtain an unrestricted share of available machines. Not only is turnover per machine lower at club venues but it is lower for all sizes of venue (Chart 5-4); and
- increasing competitiveness in the club sector and reducing competition in the hotel sector. As a result, this restriction limits the ability of hotels to compete effectively with each other. Hotels (as well as gaming operators and the government) that may have benefited from the introduction of gaming machines, have been restrained from entering the market. This occurred before the overall cap had an effect.

The benefits and costs of the 50 : 50 split in machine numbers between hotels and clubs can be assessed against the benchmark of no such restriction. Clearly, competition is adversely affected by the restriction. However, we need to examine the benefits and costs in terms of the impact of relevant objectives i.e., harm minimisation, probity and efficiency issues unrelated to the level of competition.

Potential benefits include:

- *prima facie*, the mutual and co-operative objectives of clubs should be less in conflict with the objectives of responsible gambling than the profit focussed objectives of the hotel venues;
- greater focus on community objectives and higher distribution of revenue For instance, the InterChurch Gambling Task Force submit:

EGMs should only be permitted in clubs, due to the profit motive of hotels leading them to compete on EGM revenue and not on aspects which are of benefit to the community or wider community. The Task Force believes that there is a higher probability of EGM revenue from clubs being used for the benefit of the community;

The evidence suggests that clubs to date have not made the potential contribution expected of them. This may reflect the heavy investment required of clubs – as distinct from hotels – and the much lower level of profitability of electronic gaming for venues in Victoria.⁹² As noted by the RSL:

The situation is that when gaming was first introduced, there was a need by the community clubs which in general had poor infrastructure to upgrade their infrastructure to a reasonable standard and to do so they incurred considerable debts, which most of the clubs, and in particular RSL Sub-branches, are still seeking to pay off. It is anticipated, at least by the RSL, that once the premises are paid off,

⁹² For an early and reasonably extensive analysis of relative venue profitability in Victoria and other Australian jurisdictions, see Schilling (1994), p. 73.

*that a larger amount of the proceeds from gaming will be able to flow to RSL activities and ... to the local community.*⁹³

The evidence on this benefit is therefore not wholly conclusive.⁹⁴ *Prima facie*, there are strong reasons to believe that the club structure should be beneficial. In practice, this is not observed, in probability due to the particular constraints of the Victorian gaming industry structure (see Chapter 4 above).

- with their mutual structure and focus on objectives other than profits, in a commercial sense the club are often seen to lack efficiency. This is apparent in the substantially lower machine turnovers in club venues compared to hotel venues in Victoria.

As a result, the level of electronic gaming is significantly lower than it would be without this restriction. Since there is a lack of any evidence to the contrary, it is reasonable to conclude that in all probability, the lower turnover in club venues has also lowered the level of harm;⁹⁵

- the spread of gaming has been slowed by the interaction of the 50 : 50 split between clubs and hotels, the 50 : 50 split between Tattersall's and TABCORP and the total cap on numbers.

By specifying a proportion of actual gaming machine numbers, this restriction has acted as a brake on the expansion of machines through the State. As noted above clubs have been less willing to take on the more onerous financing requirements associated with installing infrastructure to take gaming machines.

It has the effect that hotel machine numbers cannot grow faster than club machine numbers. In general, clubs have not been as willing to take up gaming machines as hotels. Without the 50 : 50 split between hotels and clubs the incentive structure and allocation mechanisms would have driven a faster rate of expansion of gaming and therefore likely harm from problem gambling.

If the objective were merely to ensure that clubs did not miss out, then the restriction may have specified 50 per cent of the capped number. In the current case, this would mean that both clubs and hotels would 'have access' to 13,500

⁹³ RSL Submission to review.

⁹⁴ This suggests that where the clubs have installed machines, much if not all of the revenue has gone into establishing and financing the infrastructure associated with the machines with limited return to the community.

The intended benefits to the clubs are drained away by the existing income splitting formula, discussed above.

Consequently, the benefit for the community from requiring club participation is reduced by the existing income sharing formula (see above).

⁹⁵ However, where clubs seek to emulate private companies in the pursuit of profit, or are captured by other interests as in the case of quasi-clubs these arguments do not hold. The issue of quasi-clubs goes to the heart of the club issue and is discussed below.

machines – but that hotels could expand as quickly as the market would allow. Clubs would not be disadvantaged in terms of their own access to machines and hotels would not be restricted by lack of growth of clubs.

5.3.1. ALTERNATIVES

In opposition to this brake, the amount of machines allocated to hotels is significantly higher than in other Australian jurisdictions. In NSW, hotels have only recently been allowed to obtain limited numbers of machines after clubs had 30 years with the field to themselves. In Queensland, which introduced gaming machines at much the same time as Victoria, hotels have had significantly less access to machines: currently hotels may obtain 35 machines and clubs, 280. Neither State however has had a target cap.⁹⁶ In contrast, South Australia has the same limit for both hotels and clubs. This limit, at 40, is still well below the Victorian maximum. With no limit on relative numbers of venues, at 30 June 1999 there were 416 hotels operating 10,495 gaming machines but only 82 clubs operating 1,449 machines.⁹⁷

Possibly, where hotels are not major players in provision of gaming services, a cap on total numbers is not necessary.

If the aim of the restriction is to ensure that clubs have access to gaming machines then a separate (even if identical) limit would meet this aim without restricting the growth of the hotel sector. If the aim is to restrict the hotel sector because they are shown to be associated with higher incidence of problem gambling, then more direct restrictions on the number of machines available to hotels, the number available to any one hotel or the types of machines available to hotels would directly address the volume of gambling associated with this venue. This alternative would be more – rather than less – restrictive of competition in the hotel sector.⁹⁸

We have received no evidence that the requirement for one-half of machines to be located in clubs impacts on the objective of promoting probity.

The effect of the restriction in conjunction with the overall cap is to retard competition between venues that have and don't have machines. Not all hotels (and to a much lesser extent clubs) that would generate net financial benefits currently can access machines.

As with most of the restrictions on the distribution of machines, there is little doubt that this restriction has limited the expansion of machines and limited the expansion of

⁹⁶ Machine numbers have been frozen in New South Wales, which while limiting numbers, does not affect the way in which the government regulates the growth and normal interaction of the market.

⁹⁷ Office of the Liquor & Gaming Commissioner (1999) *Gaming Machines Act 1992 Annual 1998-99*.

⁹⁸ Such restrictions would also place greater pressure to establish quasi-clubs to get around these restrictions.

gaming through slowing the growth of hotel-based machine numbers. In the absence of known effective controls on problem gambling, a hold-the-line course of action that limits all gambling will effectively limit problem gambling.

Under a no restriction policy, the vast majority of machines would gravitate to those venues with the highest returns. Historically and as we would expect, this would mean that most would be located in hotels. The restriction has therefore stopped machines going to where they derive the greatest financial benefit for stakeholders.

As a blunt instrument (now) of harm minimisation, the retention of this restriction remains necessary while the primary motive of machine ownership is machine revenue.

The restriction also has had the impact of restraining growth of number of machines in hotels by tying these to club numbers. As we are now effectively at the overall cap, this mechanism is currently irrelevant.

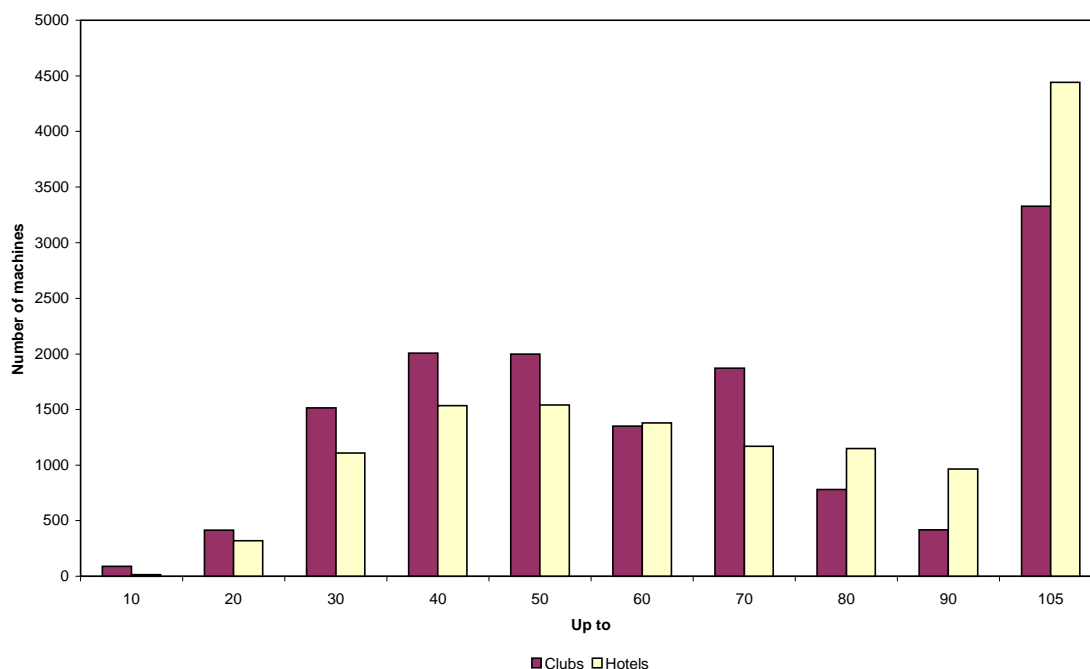
We conclude that under the current industry structure, there would be no benefit to allowing greater access for hotels to machines – on the contrary. We conclude that it would be imprudent to remove this restriction until effective measures are developed to address problem gambling.

We recommend that this restriction be retained.

5.4. LIMITS ON MACHINE NUMBERS PER VENUE

In contrast to NSW and Queensland, which place substantial restrictions on the number of machines in hotels leaving clubs either unrestricted or restricted only by a very high limit, Victoria currently imposes a uniform limit of 105 machines total per venue. As at June 2000, the one-third of hotel machines and one-quarter of machines in clubs were in venues with more than 90 machines (Chart 5-3).

CHART 5-3 : DISTRIBUTION OF MACHINES BY VENUE AND SIZE



Source: VCGA Complete List of Gaming Machines,

http://www.gambling.vcga.vic.gov.au/domino/web_notes/vcga/vcgasite.nsf/pages/CompleteVenues

The restriction is set out in the Ministerial Direction which states:

that, in respect of the 27,500 gaming machines permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the maximum permissible number of gaming machines to be placed -

(i) in restricted areas in the State is 100 with no bet limit applying; and

(ii) in unrestricted areas in the State is five with a bet limit of \$2.00 to apply

This restriction was recently amended to require that no machines are to be located in unrestricted areas.

The initial objectives of the restriction on the maximum number of machines per venue appear to be two-fold.

First, the *Casino (Management Agreement) Act 1994* limits per venue gaming machine numbers to 105 for venues within 100 kilometres of the casino, until 12 years after the (casino) licensing date. This requirement, which does not distinguish between clubs or hotels, aims to improve the competitive position of the

casino and to limit the erosion of that position. By improving the competitive position of the casino a higher price could be extracted for its licence.⁹⁹

Second, the objective or principle of parity appears to have been applied to extend the 105 limit to all venues across Victoria.

At first sight, the restriction under review here is the 105 machine limit for venues outside the 100 km radius of the casino. However, consistent with the *Casino (Management Agreement) Act, 1994*, the Government has the option of removing or raising the venue limit in venues outside the 100 km or lowering the venue limit for some or all venues.

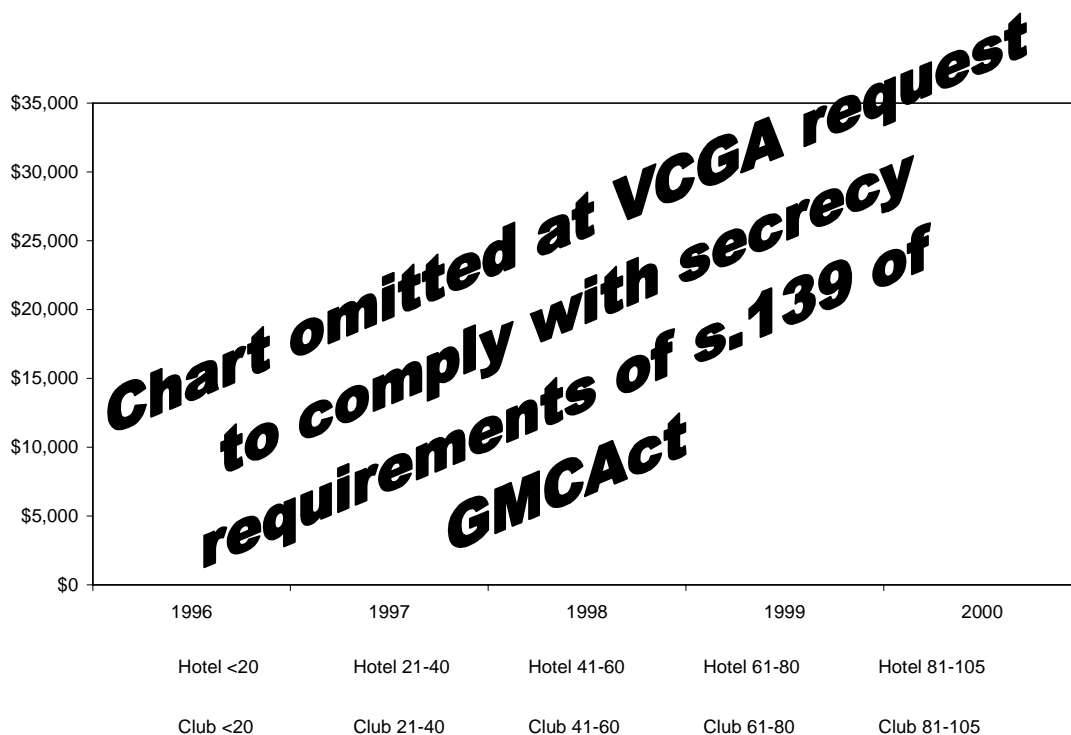
This restriction may also impact on the objective of harm minimisation.

The effects of extending the 105 machine limit to venues outside the 100km radius include:

- to prevent large venues “mini-casinos” from being established in the country;
- to lower the total level of gaming. The statistical evidence indicates that machine income is higher in larger venues (Chart 5-4);
- to ensure that geographic location within the State does not advantage any other venue or group of venues;
- to lower the competitiveness of Victorian venues located adjacent to the NSW border across which larger and possibly more attractive venues may be operated; and
- potentially, to slow the relocation of machines from small (typically low turnover per machine) venues to very large (typically higher turnover per machine) venues.

⁹⁹ Conversely, the limitation reduces the value of the gaming operators’ licences by reducing their ability to compete directly with the casino.

CHART 5-4 : INCOME PER MACHINE BY HOTEL & CLUB VENUE SIZE (1996-2000)



Source: VCGA October 2000

The restriction therefore has the effect of lowering competition and reducing efficiency.

The benefits of the restriction need to be assessed against clear alternatives and set in the context of other interacting restrictions including the new regional limits. The alternative chosen for this evaluation is the situation of no restriction on machine numbers per venue outside the 100km radius of the casino.

As noted the restriction also has the effect of stopping the growth of effectively mini-casinos anywhere in the State. This limit is binding. TABCORP point out that

Evidence from Victoria and other States suggests that larger venues tend to be more profitable, both in aggregate and in terms of revenue per machine. In the context of the State cap on EGMs, it might therefore be expected that gaming operators would install machines in only a select number of large clubs and hotels.

We might therefore expect the operators to support its removal as an impediment to their own expansion.

But

... The venue cap regulation is a necessary by-product of other quantitative limitations. It has the objective of ensuring adequate access to machines by both venues and consumers.

In conclusion, TABCORP supports the retention of the restriction.¹⁰⁰

Whether the development of mini-casinos in country regions would be a cost or benefit is not immediately clear.

To the extent that Victorians are incurring gambling losses across the river in NSW, the social problems associated with gaming are already being incurred without the economic benefit being retained in Victoria. In this case, removal of the venue limit would result in net benefits to Victoria.

The impacts, benefits and costs of this restriction and its removal outside the 100 km radius is heavily impacted by the new requirements applying to venues outside the zone. Venues outside of the zone that wish to increase their machine numbers must now meet any regional cap and the net social and economic benefit criteria. The former is intended to identify regions where there is greater likelihood of harm from expanding machine numbers, and the latter will allow for the identification of potential social and economic concerns for individual locations. The second restriction however only stops further harm rather than addressing existing. The use of regional caps, as with the overall cap and this venue cap, addresses harm by limiting all gambling.

Larger venues tend to obtain greater revenue from each machine (Chart 5-4 above and Chart 5-5). Consumers may prefer larger venues where it is more likely that at any one time, a jackpot is being won. Greater gambling expenditure is known to be associated with higher levels of problem gambling.¹⁰¹ Again, as a very blunt instrument, by limiting the efficiency of venues and restricting turnover, the limit on venue numbers appears to reduce the harm from problem gambling. In contrast, the alternative of no restrictive venue limit may increase the machine turnover and problem gambling.

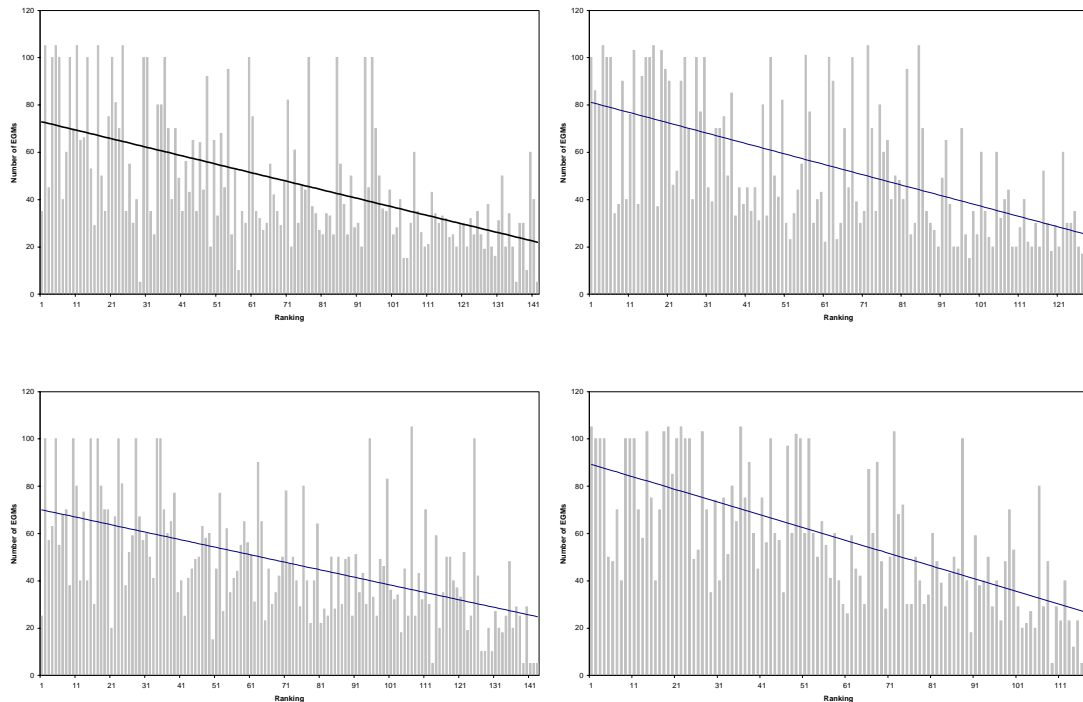
Examination of the league tables put together by Tattersall's and TABCORP indicates that in mid 2000, venues with more machines rank significantly higher in terms of turnover per machine than venues with fewer machines. On average, for each additional five machines ranking tended to be four places higher.

Inspection of this relationship indicated that machine numbers had a consistent impact on gaming revenue rank across the two machine operators and across hotels and clubs.

¹⁰⁰ TABCORP Submission, pp. 35-36.

¹⁰¹ Productivity Commission (2000), p. 8.10.

CHART 5-5 : NUMBER OF MACHINES PER VENUE AND LEAGUE PLACING CLUBS AND HOTELS FOR BOTH TAB AND TATTERSALL'S



Source: League Tables for TAB and Tattersall's, mid 2000.

We have received no evidence that the cap on machine numbers in a venue impacts on the objective of promoting probity.

On balance the restriction of a maximum 105 machines per venue outside the 100 km limit appears to likely to be redundant in terms of advancing the harm minimisation objective. On the other hand, neither the regional caps nor the net social-economic impact tests have been implemented and demonstrated to be effective in reducing the level of gaming or the level of problem gambling.

We therefore recommend that this restriction be retained pro tempore.

5.4.1. ALTERNATIVES

The above discussion focusses on the benefits of the existing limit on venue numbers compared to a higher limit or an unrestrained level.

The Productivity Commission noted that

On balance, venue caps can play a role in moderating the accessibility drivers of problem gambling from gaming machines – and are preferable to global caps for this purpose.¹⁰²

¹⁰² Productivity Commission (2000), p. 39.

While the existing limit appears to becoming redundant, i.e., non-binding, it is possible that a more restricted limit may offer some greater advantages in terms of the harm minimisation objective and in terms of offsetting adverse effects of the dual operator system in readily relocating machines from lower machine turnover venues to higher performance venues. We therefore examine the options for a more restrictive venue limit across Victoria.

Any lowering of the maximum number of machines per venue would increase venue access to machines across Victoria. More hotels and more clubs would be able to access machines. To the extent that larger venues are more attractive to gamblers, lowering the venue limit would mean that gaming per machine would be lower and total levels of gaming and likely problem gambling, similarly lower.

Chart 5-4 indicates that significant improvements in average revenue per machine are achieved in the range of 21-40 machines but after that, improvements are more erratic. However overall, gaming income per machine is indeed higher in the bigger hotel venues. Chart 5-5 shows that the greater the number of machines per venue, the higher the rank in the respective performance league tables.

These broad observations need to be explored further in detail.

- If a lower limit, say 50 machines, were imposed on all existing and future venues and the 50 : 50 split between hotels and clubs retained, then existing clubs above the new limit would need to shed machines and extra clubs would need to be found. While the same requirements would apply to hotels, extra new hotel venues could be found much more easily than extra new club venues. On the other hand, for most lower limits, more machines will need to be relocated from hotels than clubs (Chart 5-6). As a result, the imposition of a lower venue limit on all existing venues would have the effect of reducing the total number of machines in place. That is, the 50 : 50 split between clubs and hotels would become again the binding limit, rather than the overall cap of 27,500. This mechanism would create further strong incentives for quasi-clubs to develop. Overall, a lower limit imposed on all existing venues and retention of the 50 : 50 split would lead to a lower level of gaming.¹⁰³

¹⁰³ If a lower limit were imposed on all existing venues and the 50 : 50 split between hotels and clubs abandoned, then existing clubs and hotels would need to shed machines and the balance would be taken up primarily by hotels. The outcome reflects two offsetting effects and may increase or decrease the total level of gambling. On balance we judge this would cause a rise in the level of gambling in Victoria since the club to hotel switch would result in a larger increase than would the reduction in gaming due to a change to smaller venues. Nonetheless, the requirement for a net social and economic benefit test may well override these mechanisms so that lowering maximum machine numbers in existing venues may defacto lower actual machine numbers to below the 27,500 limit.

CHART 5-6 : NUMBER OF MACHINES THAT WOULD NEED TO BE RELOCATED UNDER A LOWER VENUE LIMIT

New Cap:	Clubs	Hotels	Total
10	10,915	11,181	22,096
20	8,170	8,771	16,941
30	5,786	6,630	12,416
40	4,028	4,884	8,912
50	2,750	3,554	6,304
60	1,838	2,504	4,342
70	1,166	1,656	2,822
80	704	1,005	1,709
90	357	480	837
100	40	61	101

Source: Marsden Jacob estimates based on venue numbers from Chart 5-3.

- If a lower cap is imposed on new venues only, a lower maximum limit per venue would not affect the distribution across existing venues unless the machines were reallocated – as would be required by the now binding nature of the total cap on the number of machines. This option would appear to achieve very little while creating two classes of venue.
- If a lower cap is imposed differentially with a maximum of, say, 50 machines for all venues currently below that limit and a freeze on machine numbers in all existing venues above that limit, then machines would be able to be reallocated from small to medium sized sites but would not be able to be relocated into the larger sites. This would prevent the larger sites from benefiting from the reallocation process but would not fully protect the smaller venues. The level of gaming in the community would rise, albeit more slowly.
- If imposed differentially with a total freeze on existing machine numbers per venue, the existing industry structure would be frozen and there would be no further opportunity to reallocate machines to maximise gaming revenue. The net benefits tests and the need to consider the view of local government would become redundant, as would most of the need to inspect all contracts to reduce harsh and unconscionable behaviour. The short-run benefits of this move would switch to long-run costs over time given the inherent inflexibility. This option has recently been implemented in NSW.
- Differential limits could also be imposed on the machine operators, for instance, by requiring that, say, no less than 20 per cent of machines should be in venues with less than 10 machines and so on. Differential limits of this type would substantially remove their discretion to rearrange machines from smaller to larger sites. However, it would not fully protect small venues from having their

machines relocated to other small venues. Machine operators would still actively reallocate machines within each size category.

In summary, there are a number of options for imposing lower machine limits per venue than currently exist and the majority of these options offers some benefits in terms of reducing the total level of gaming, and therefore, problem gambling and in reducing the inequities which arise from the ready ability of the machine operators to relocate at their sole discretion machines from one venue to another.

None of these options is highly attractive for other than short-term purposes since none deal with the fundamental causes of the two problems at which they might be directed, i.e., problem gambling and the inequity of exercising market power through machine reallocation.

Among the short-term options, a total freeze is the crudest, simplest and most effective.

Note, however, that none of these crude measures to stop machine allocation to high turnover venues would be necessary if the unique profit-sharing arrangements could be terminated within the period of the current contracts/licences.

5.5. QUASI CLUBS

As noted, the terms of reference also direct attention to the issues of “quasi-clubs”. The term “quasi-clubs” refers to venues which are licensed as clubs but where the commercial arrangements are structured to transfer the power, discretion and profits to other parties. The terms of reference direct this review to examine:

gaming venue market structure. This includes the 50:50 split of gaming machines between hotels and clubs. It should also include consideration of the concentration of gaming venue ownership and the emergence of quasi-clubs;

The incentive to create quasi-clubs is essentially a Victorian phenomenon. They arise because the regulatory and legislative framework provides strong incentives to find mechanisms to establish super efficient and commercial gaming operations under the auspices of a club.

Because the number of machines in hotels is tied to the number of machines in clubs and the traditional club sector has been understandably slow to adopt gaming machines in substantial numbers, machine operators and others have – for different reasons – strong incentive to support the entry of new management into club processes.

Club members can also benefit from arrangements where premises are leased and more professional management contracted in and may have a similar incentive to promote such arrangements. Since many clubs lack capital and free cash flow, like hotels clubs

may enter into contracts and agreements for leasing and/or managing venues, catering and so on. Leasing and subcontracting can be efficient modes of operation, especially for cash deficient clubs.

However, the concern arises where the club's contracts and agreements are predominantly with one party and contain profit sharing arrangements which shift most profit to that party.

Relevant concerns include:

- the loss of control by the nominal venue owner and licensee, and resulting loss of transparency, accountability and integrity;
- the loss of tax revenue to government where the venue is nominally a club but essential a hotel in substantive matters (since clubs pay a lower tax rate than do hotels);
- the blurring of the distinction between clubs and hotels in terms of community and mutual purpose and responsible gaming; and
- the increased accessibility and level of gaming in the community since the quasi club site (often previously operating as a hotel) can be selected for their location and ability to attract regular gamblers:
 - when machine numbers are below the 27,500 ceiling, the establishment of a quasi-club also allows the equivalent number of additional machines in hotel venues;
 - when machine numbers are at 27,500, the establishment of a quasi-club requires the removal of machines from clubs lower down the league table.

In both cases, the phenomena of quasi-clubs increases the extent of gaming in the Victorian community.

Within the context of licensing applications and hearings, the accusation that a new entrant is a quasi-club may be an effective method of slowing or blocking competitors.

The concern over undue influence and loss of control has led other States to ban profit sharing arrangements and to distinguish more sharply between liquor and gaming licences. For instance,

- New South Wales bans all such arrangements (except for defined linked jackpots)

(G) *Sharing of receipts from poker machine*

(G) *A registered club shall not:*

(G) *share any receipts arising from the operation of a poker machine, or*

(G) *make any payment or part payment by way of commission or allowance from or upon any such receipts.*

- Queensland bans all sharing of revenue except for area linked jackpots and – in the future – arrangements with small, under capitalised clubs.

Cancellation or suspension of gaming machine licences and letters of censure

97.(1) A ground for cancellation or suspension of a gaming machine licence arises if –

...

(G) *the chief executive—*

...

(v) if the licensee is a category 2 licensee—considers—

...

(G)that payments for services provided to the licensee are unreasonable or are on the basis of a percentage of the licensee's income, profits or earnings from the conduct of gaming or spending related to the conduct of gaming; or

...

Other grounds include that:

- the licensee is no longer a non-proprietary club, if the proceeds are not being used to promote the objectives of the club;
- if the objects of the club are not being pursued; or
- if some payments for services or goods are unreasonable.

As a result, in both NSW and Queensland, all contracts are inspectable by the gaming authority and there is a formal requirement for a gaming licence over and above a liquor licence.

These same provisions would appear to deal with most concerns arising from the growth of quasi-clubs.

Traditionally, Victorian legislation has not required a separate gaming licence and has treated the presence of a liquor licence or status as a racing club as sufficient. Moreover, Victorian legislation does not ban or prohibit in totality or generally, profit sharing arrangements. In Victoria, the power and requirement for the VCGA to inspect contracts was removed under the 1997 amendments although reinstated in 2000 as part of the Responsible Gambling legislation.

For Victoria, the policy objective is to establish rules and operating procedures which ensure the transparency, accountability, integrity and complete control of the club as gaming licensee without compromising efficient commercial practice in the best interests of the club membership and the wider community.

Several measures are available. Rather than being mutually exclusive options, these measures are essentially reinforcing. These include to:

- i) separate liquor and gaming licences and break the presumption that award of a liquor licence automatically qualifies the venue for a gaming licence. The legislative change has already been made, but the change needs to be signaled;
- ii) provide legislative clarity and guidance to the VCGA by explicitly listing the items to be considered in any case by case assessment of the 'reasonableness' or otherwise of commercial arrangements. The Queensland legislation cited above provides an example;
- iii) prohibit in totality profit-sharing arrangements or prohibit, subject to specifically authorised exceptions, profit-sharing arrangements;
- iv) require and resource the VCGA to undertake ex-post analysis of the sources and uses of funds from gaming and other activities in those clubs contracting external management contract services and leasing premises from related third parties; and
- v) provide and enforce penalties on companies, their directors and the club directors found to be involved in non-genuine club gaming activities. For instance, banning these persons and entities from further involvement in gaming;
- vi) tighten direct responsibilities for clubs engaging in substantial gaming activity. For instance, amend the gaming machine control act to require directors of such clubs to be bound by the same responsibilities of directors of companies under Corporations Law.

We recommend that this package of measures be adopted.

5.6. DENOMINATIONS AND BETTING LIMITS

Betting limits previously existed only for machines in unrestricted areas. Machines in unrestricted areas had a bet limit of \$2.00. These restrictions have been effectively removed with the banning of machines in unrestricted areas.¹⁰⁴ Machines in restricted areas do not currently have a bet limit.

¹⁰⁴ The Hon. Mr Pandazopoulos, Minister for Gaming (2000) *Government Unveils Further Gaming Reforms*, Press Release, 21 August.

The Minister may still determine the maximum bet limit for any machine in the restricted (or unrestricted) area.

Restricting the betting limit was seen as one means of restricting overall gaming. However, as noted by the Productivity Commission

There is some evidence that problem gamblers tend to play the highest denomination machines to a significantly greater extent than non-problem players, but most usually play 1, 2 and 5 cent machines. Consequently, the principal issue is not one of the denomination of the machine, by itself, but the overall intensity of play.

Problem gamblers have a higher tendency to play more than one line at each button push than recreational gamblers, and a much higher likelihood of betting more than one credit per line.¹⁰⁵

Limits on maximum bets per button push may have more influence on spending by problem gamblers than by recreational.

We recommend that the general ability to set bet limits under Ministerial Direction be retained. We also recommend that the use of more aggressive bet limits should follow appropriate research and testing.

5.7. OTHER RESTRICTIONS

There are a further range of restrictions associated with this legislation. For these restrictions, we recommend no change until the key industry structure issues are addressed.

5.7.1. GENERAL PROBITY REQUIREMENTS

The general probity restrictions relating to various licence holders and conditions of licences were reviewed by the Auditor-General in 1998. The Auditor-General's concerns and the VCGA's response are noted above. These restrictions and conditions are common across Australian jurisdictions.

The GMCAct separates most functions associated with gaming machines. It specifies the licensing requirements and activities allowed for:

- gaming machine operators;
- gaming machine manufacturers and providers;
- gaming venue operators;
- gaming machine technicians; and

¹⁰⁵ Productivity Commission (2000) p. 16.79.

- employees of venue operators and machine operators.

These restrictions impose a barrier to unfettered competition but are one of the cornerstones (with machine monitoring) of the probity requirements. As noted the effect of these probity requirements is a consistent view that gaming operations are free of organised criminal influence. Existing systems have been adequate also to identify crimes associated with provision of gaming services and more generally with handling of large cash flows.

We recommend that existing probity restrictions be retained and continue to be subject to on-going independent review.

5.7.2. 24-HOUR GAMING RESTRICTION

New restrictions were introduced in the *Gambling Legislation (Responsible Gambling) Act 2000* which set a maximum 20 hours of continuous gaming (with a minimum 4 hours break following this period) for venues that do not have approval for extended hours. Extended hours are only allowed for venues that have approval from the VCGA to operate up to 24 hours a day on specified days. Apart from transitional arrangements, venues licensed under section 8 or 10 of the Liquor Control Reform Act may apply for extended hours where:

- they are located in the Melbourne Statistical Division; and
- the application is accompanied by a submission on the net social and economic benefit for the municipality and effects on surrounding municipalities.

The effects of this restriction are to:

- restrict hours for venues outside the Melbourne Statistical Division
- potentially allow venues within the MSD to operate for longer hours where the VCGA assesses there is a net social and economic benefit from allowing longer hours (see Chart 5-2).

The cost of this restriction is to prevent gamblers from remaining in the same venue for 24 hours and to restrict the availability of gaming. The benefits are relevant to the legislative objective of harm minimisation and responsible gaming. Of particular relevance the duration of gambling sessions appears to be a major driver of problem gambling. The potentially discriminatory impact of this restriction between venues approved to gamble for greater than 20 hours and the remainder does not appear to be material. Indeed, under the Act gaming longer than 20 hours will only be approved where there is no net social and economic detriment to the municipality.

We recommend this restriction should be retained.

5.7.3. OTHER RESTRICTIONS ON VENUES

Only Licensed Premises

Only venues with one of: a general licence under the *Liquor Control Reform Act 1998*, a club licence under s. 10 of the same Act or a licence under Part I of the *Racing Act 1958* (or a licence issued under these sections but with conditions under s. 80 of the *Liquor Control Act 1987*) can be approved premises (s.12A).

Venue Operator Cannot Have Two Premises Within 100m

Where an applicant (or an associate) has an existing venue within 100m of a proposed venue, these venues must be independent of each other.

5.7.4. SECRECY RESTRICTIONS: SECTION 139

Free and competitive markets depend upon the free flow of information. Section 139 of the GMCAct states:

139. Secrecy

(1) *Subject to sub-section (3), a person must not directly or indirectly, except in the performance of duties or exercise of powers under this Act, make a record of, or divulge to any person, any information with respect to the affairs of another person acquired by the first-mentioned person in the performance of those duties or exercise of those powers.*

...

(3) *A person may—*

(a) *divulge specified information to such persons as the Minister directs if the Minister certifies that it is necessary in the public interest that the information should be so divulged; or*

(b) *divulge information to a prescribed authority or prescribed person; or*

(c) *divulge information to a person who is expressly or impliedly authorised by the person to whom the information relates to obtain it.*

(4) *An authority or person to whom information is divulged under sub-section (3), and a person or employee under the control of that authority or person, is subject, in respect of that information, to the same rights, privileges, obligations and liabilities under this section as if that authority, person or employee were a person performing duties under this Act and had acquired the information in the performance of those duties.*

From the Second Reading Speech, amendments in 1996 allowed the publication of statistical information:

The amendments are designed to allow publication of statistical information on the Victorian gambling industry. It is considered that the publication of

the statistics is a necessary part of the government's function to monitor and report on the development of the gambling market in Victoria and that it is in the public interest to do so.

Thus

(4A) Nothing in this section or any other Act applies to prohibit or restrict—

(a) the giving of statistical information with respect to gambling in Victoria;

The administration of these clauses falls to the VCGA. The effect of the secrecy restrictions are to constrain the flow of information to market participants and to policy advisors. (While VCGA officers have been very helpful in the conduct of this review, they have felt very constrained in providing key statistics that would assist in a deeper understanding of the industry.)

The benefit of this restriction appears to accrue with the gaming operators who already have most of this information.

Full information is also necessary for effective regulation and policy formation.

Where information necessary for policy development or the effective operation of the market is not available, sub-optimal decisions and outcomes are likely.

The alternative would be to provide explicit legislative clarification on the priority to clauses 139(4) and (4A).

We recommend accordingly that guidance that is more explicit be given to the VCGA on its role and responsibilities.

Attachment A

THE TREASURER OF VICTORIA
1 Treasury Place Melbourne 3002
Victoria Australia
Telephone (03) 651 6255 FAX: (03) 651 6228

29 June, 1994 (stamped)

The Chairman
TABCORP Holdings Ltd
Office of State Owned Enterprises
1 Treasury Place
EAST MELBOURNE 3002

The Chairman
VicRacing Pty Ltd
4th Floor
Racing Industry Centre
1 Queens Road
MELBOURNE 3004

Dear Sirs,

PRIVATISATION OF THE TOTALIZATOR AGENCY BOARD

I am writing to you to confirm the principles on which the Government of Victoria is privatising the TAB. It is important that applicants for shares in TABCORP Holdings Limited understand why the Government has decided to proceed with the privatisation. These principles are reflected in the Memorandum of Understanding signed between the Government and the Racing Industry on 15 March 1994, the Gaming and Betting Act 1994 and my Parliamentary speeches in relation to the Act.

I must however make it clear that the statement of principles in this letter does not bind this Government or future Governments and, of course, that the Victorian Parliament has the power at any time to amend existing legislation or pass new legislation affecting the operations of the TABCORP group of companies, the Victorian Racing Industry or the terms on which those operations are conducted.

They are as follows:

1. TABCORP Holdings Limited has the sole licence for 18 years under the Gaming and Betting Act 1994 to conduct off-course wagering on horse, harness and greyhound racing and a concurrent right (with Tattersalls and Crown Casino) to conduct gaming, for a fixed period.
2. It is important that the Victorian Racing Industry should, after the TAB's privatisation, continue to grow and develop and derive appropriate financial

support from TABCORP's wagering and gaming activities. Consequently, an unincorporated joint venture will be established between a subsidiary of TABCORP and VicRacing Pty Ltd, representing the Racing Industry. The joint venture will include the conduct and development of wagering, gaming, approved betting competitions and Club Keno games. A TABCORP subsidiary will act as the joint venture manager. The joint venture will be owned as to 75% by TABCORP's subsidiary and 25% by the Racing Industry. The joint venture will be established in order to generate for the Racing Industry a more secure level of income than would have been available under a continuing of the current arrangements, which is in the long term interests of the development of racing and racecourses in Victoria. The Racing Industry will also be deregulated in the interests of efficiency subject to the Government's social policies and to the maintenance of the highest standards of probity. Similarly, and subject to the same overriding policies, the TABCORP group will be subject to a less intrusive regulatory environment than that which currently applies to the TAB.

3. In order to maintain and improve the competitiveness of the Victorian Gambling Industry, amounts payable to the Government in relation to wagering operations under the new TABCORP licences will be reduced from an average across bet types of approximately 42% of net wagering revenue under the Racing Act to approximately 28.2% of net wagering revenue for the period of the licences. Amounts which may be retained by TABCORP by way of commission on gaming will be maintained at 33.33% for the period of the licences.
4. The TABCORP group will have the flexibility to conduct any kind of business whether under the new licences or otherwise and whether in or out of Victoria, where it is permitted by law or the terms of the Racing Industry joint venture.
5. Consistent with all of these objectives, the maximum commercial value for the licences should be recouped by the State of Victoria.
6. Accordingly:
 - TABCORP has now been granted a wagering licence and a gaming licence which will come into effect on the successful conclusion of this float.
 - The licences will be for terms of 18 years and will be concurrent and not separable.
 - The Government does not currently intend to grant further gaming or wagering licences to persons who are not now authorised to conduct gaming or wagering during that 18 year period.

TABCORP may apply for new licences after the initial licences terminate and on the same terms as other applicants. It is expected that the process of award of new licences will involve a public tender. It is also expected but not guaranteed that the new licences would be awarded to the highest qualifying bidder. If the new licensee is not TABCORP, TABCORP will be entitled to receive from bid proceeds received by the State an agreed capital compensation amount of approximately the net amount TABCORP will pay the Government for the initial licences calculated in accordance with the Gaming and Betting Act 1994 (subject to the bid proceeds being sufficient).

- The Gaming and Betting Act 1994 provides that the Governor in Council must not grant new licences to any third party when the initial licences expire unless there is satisfaction that steps have been taken, or reasonable opportunity given, to ensure that the Racing Industry joint venture has satisfactorily been wound up and the applicant for the new licences has entered into, or has made a binding offer to enter into, arrangements with the Racing Industry that in the opinion of the responsible Minister after consultation with the Victorian Casino and Gaming Authority, are no less favourable to the Industry than those last in force between them and the TABCORP Group.
7. It is intended that any new licences will be granted on conditions which include conditions substantially to the same effect as those to which the TABCORP licences are subject.

The Government recognises both the importance of the Victorian Racing Industry and the importance of the gaming and betting industries to the Victorian economy and in recognition of that it will continue to deal with the Victorian Racing Industry and the TABCORP group of companies reasonably and in good faith.

On behalf of the Government, I wish both the Victorian Racing Industry and TABCORP well and I am confident that the future for them will be one of healthy growth and much success.

Yours sincerely,

Alan Stockdale
Treasurer

Attachment B

MINISTERIAL DIRECTIONS
Under the *Gaming Machine Control Act 1991*

I, Roger M Hallam, MLC, Minister for Gaming, pursuant to section 12 of the *Gaming Machine Control Act 1991*, hereby revoke all previous directions to the Victorian Gaming Commission and the Victorian Casino and Gaming Authority and in substitution therefore, hereby direct the Victorian Casino and Gaming Authority

(a) that the maximum number of gaming machines permitted in the State to be available for gaming in all venues licensed under the *Gaming Machine Control Act 1991*, other than the Melbourne Casino, is 27,500; and

(b) that, in respect of the 27,500 gaming machines permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the proportion of gaming machines to be located outside the Melbourne Statistical Division is not less than 20%; and

(c) that, in respect of the 27,500 gaming machines permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the maximum permissible number of gaming machines to be placed -

(i) in restricted areas in the State is 100 with no bet limit applying; and

(ii) in unrestricted areas in the State is five with a bet limit of \$2.00 to apply; and

(d) that, in respect of the 27,500 gaming machines permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the proportion to be placed in premises, in respect of which -

(i) a residential licence under section 46 of the *Liquor Control Act 1987* or a general licence under section 47 of the Act is in force, is 50%; and

(ii) a club licence under section 48 of the *Liquor Control Act 1987* or a licence under Part I, II or III of the *Racing Act 1958* is in force, is 50%; and

(e) that, in respect of the 27,500 gaming machines that are permitted to be available for gaming in all licensed venues, other than the Melbourne Casino, the proportion of gaming machines which each gaming operator is permitted to operate is 50%.

ROGER M HALLAM MLC

Minister for Finance

Minister for Gaming

Date: 4 April 1997