

25 February 2011

Paul Baxter
Senior Commissioner
Independent Competition and Regulatory Commission
Level 2, 12 Moore St Canberra City

Dear Paul

SUPPLEMENTARY SUBMISSION: INVESTIGATION INTO THE ACT RACING INDUSTRY

Thank you for the opportunity to comment on the ICRC's Report 11 of 2010 ('the Draft Report') and to present at the public hearing.

Terms of Reference

My reading of the Terms of Reference was that the ICRC was being asked to undertake a valuation of racing industry product fees (in total, and the three-code split) and to look at the efficiency of the industry. In contrast, the Draft Report appears to: use an 'industry assistance' framework; questions the industry's existence; and, questions whether it should receive 'public funding'. The seeds of the Terms of Reference are in the free rider / intellectual property issues facing the racing industry, as indicated by the Minister's use of the term 'product payments'. The Productivity Commission's chapter on wagering (*Gambling*, 2010) also tackles the issue as one of product fees to solve the free rider problem. In contrast the Draft Report uses terminology such as 'public funding' or 'subsidy'.

ICRC could perhaps draw on its background in valuing and pricing services to calculate allowable revenues, in circumstances where markets would not generate optimal outcomes, such as monopoly businesses in electricity, water and gas. Of course, the free rider / intellectual property market failure problem facing the racing industry is different to the monopoly market failure problem in those other industries. Even so, finding a level of allowable revenue, that **emulates the revenue** that a well-functioning competitive market might generate, could be a way forward.

So, how could a level of revenue be determined, that emulates the revenue the racing industry would receive in a world where the free-riding of wagering operators was not a problem and the performance of ACTTAB had not deteriorated in the face of changing technology? (Noting that TABs in most States are performing well and growing – and the hybrid TAB-RFL funding model is still adequately funding the racing industry in those States – it is only in the ACT where it is necessary to estimate where ACTTAB's revenues should have been, had its technology not lagged its competitors.) In my view there are two potential methods available:

1. Find a suitable historical benchmark – prior to ACTTAB's decline (since the RFL only deals with the interstate leakage of racing product to corporate bookmakers and betting exchanges: the RFL was never intended to deal with ACTTAB's broader decline) – and use that (along with other interstate

While every effort has been made to ensure the accuracy of this document and any attachments, the uncertain nature of economic data, forecasting and analysis means that Access Economics Pty Limited is unable to make any warranties in relation to the information contained herein. Access Economics Pty Limited, its employees and agents disclaim liability for any loss or damage which may arise as a consequence of any person relying on the information contained in this document and any attachments.

benchmarks) to emulate the revenues the industry would be receiving today, had the TAB-RFL hybrid funding model in the ACT kept pace with the other jurisdictions, where it continues to work well. This is the broadly the approach used by Access Economics in its previous papers on this topic, using a base year of 2005-06.

2. Calculate allowable revenues that emulate what a national product market would generate for the ACT racing industry. However, this is a difficult and speculative task. The structure of a national product market – and how small jurisdictions would be treated in that – will take years to evolve.

Given the investigation's Terms of Reference, and the difficulties of emulating the revenues the ACT racing industry might yield from a national funding model, it would appear that the first of the above two options is most appropriate.

The other aspect of estimating allowable revenue for the industry is to ensure it is operating efficiently. There appears to be ample evidence that the racing clubs have a lean cost structure, have been innovating to get better Sky coverage and scheduling, and have been expanding their unregulated revenue streams (such as advertising and conference facilities). The racing clubs are generating a strong and growing following for their products from interstate punters.

The missing link appears to be: ACTTAB's ability to capitalise on the growing popularity of racing is not keeping pace with the growing popularity of ACT racing product. It is that divergence (not a breakdown in the Gentlemen's Agreement more broadly) that has caused all the product payment issues in the ACT over the past few years. There has not been a similar divergence in other jurisdictions – the problem is peculiar to the ACT. There is not a nationwide problem with the Gentlemen's Agreement, nor the hybrid TAB-RFL funding model. With the problem being peculiar to the ACT, the solution is also close to home.

The most obvious medium-term solution to the current product fee issues in the ACT (given that the long-term solution of a national product market seems a very long way off) is to restore ACTTAB's performance back to a similar level of performance as the TABs in the other States, at which point the ACT could return to the TAB-RFL funding model that works well in most other States. However, examining the changes to ACTTAB's ownership arrangements, governance, capital raising and management needed to make that happen is beyond the ICRC's Terms of Reference.

As such, it seems difficult for the ICRC to solve the racing industry product payment dilemma, when the most obvious solution is excluded from its remit, and a national model will not be introduced to fix a problem peculiar to the ACT. Given that, the best way forward may be to narrow the scope of what this Investigation can reasonably achieve, by setting in place some sensible product payments, benchmarked against other jurisdictions, and to raise the ACTTAB solution as something requiring further evaluation, beyond this Investigation.

General comments

The Draft Report proposes that the wagering and racing industries in the ACT are essentially independent, so it possible for the ACT Government to conduct its monopoly retail wagering business (ACTTAB) without supporting the racing industry. This is a considerable departure from the product fee arrangements between wagering and racing in other jurisdictions.

There may be considerable risks to the ACT Government if it were to accept final recommendations from the ICRC that were similar those in the Draft Report. If the ACT Government were to profit from racing industry intellectual property (via ACTTAB) without returning adequate product fees to the racing industry, it could diminish ACTTAB's ability to continue operating a retail wagering monopoly, to access pooling arrangements and to access Racing Information Services. The ICRC needs to canvas the risks to

ACTTAB and the ACT Government if it were to adopt recommendations, which the racing industry views and 'free riding' on its intellectual property.

The Draft Report makes selective use of the ACT's status as a small jurisdiction. For example, the Draft report argues that (being a small jurisdiction) ACT-resident wagering on racing does not overlap much with Australian wagering on ACT races. Yet elsewhere, the Draft Report seems to assume that the ACT is a large jurisdiction, where job losses in the ACT racing industry would be displaced by increases in employment elsewhere. That is not the case. A contraction in activity, resulting in job losses in Canberra, tends to result in the interstate emigration of those people, to find employment elsewhere in Australia.

The Draft Report suggests that wagering is independent of racing in terms of economic impacts, but then attributes an 'impact' of problem gambling to the racing industry (Figure 2.2). This is hard to reconcile: if the Draft Report claims the economic activity associated with wagering **cannot be** attributed to the racing industry, should it claim that problem gambling due to wagering **can be** attributed to the racing industry?

The Draft Report relies heavily on two data items:

3. A chart of past and future product fees paid to racing clubs (Figure ES.1). This chart is shown in nominal terms, that is, it is not adjusted for inflation. The chart is also sourced from Access Economics (among other), whereas the primary source for this chart is the letter from Minister Barr to Peter Stubbs, CEO of the Canberra Racing Club.
4. The proportion of ACTTAB wagering on ACT racing clubs as a proportion of total ACTTAB wagering.

Of the wide range of metrics in the Investigation's Terms of Reference (TOR), a disproportionate amount of attention is given to the above chart and the above ACTTAB statistic. It is unclear what latitude the ICRC has in selecting which of the metrics in the TOR it gives weight to. It appears that some items in the TOR (such as comparisons of product fees per capita with other jurisdictions) are given little weight while others are relied on more heavily.

Access Economics compiled a range of data (product fees per capita, per FTE, and the like) to address the Investigation's Terms of Reference and Issues Paper. The Draft Report gives the impression that Access Economics proposed these criteria, then dismisses much of the data Access Economics submitted as 'not an appropriate criterion'. This could be reworded to make it clearer that the criteria were set by the Minister in his Terms of Reference, and the ICRC requested these data in its Issues Paper. Access Economics then attempted to assist the ICRC by compiling the data it had requested.

As noted above, I remain of the view that the Terms of Reference gives a suitable suite of metrics for benchmarking and valuing the product payments that proxy the racing industry revenues that would be generated by a well-functioning market for racing product.

The submissions received by the ICRC seemed broadly supportive of the current arrangements. The Draft Report does not appear to reflect a consensus of the submissions received. It is unclear the extent to which the ICRC is required to reflect the consensus of submissions received?

Specific matters

The Draft Report (p24) draws an incorrect conclusion that the 'industry contracted'. Rather, we estimated that expenditure had increased between 2005-06 and 2008-09, but that when converting this into value added, AE was not able to verify the ratio used by IER in its 2005-06 report. Instead, AE used the latest ratio (of expenditure to value added) from the ABS. It was this change that resulted in the lower value added result for 2008-09, not a contraction in economic activity.

The Access Economics submission (Table 1.2) estimated that thoroughbreds alone generated direct value added of \$26.6 million including wagering, or \$11.6 million excluding wagering. The Access Economics submission and IER report both provide a transparent breakdown of 'racing and wagering' value added into its components (wagering, racing club, participants, etc: see Table 1.2 in the Access Economics submission or p26 in the IER report). However, the Draft Report repeatedly claims that Access Economics and IER only provided a total for "racing *and* wagering". These breakdowns of the total into wagering and other components in the IER report and AE submission are transparent and are more reliable estimates than the rough 'percentage of GSP' methodology used in the Draft Report.

The Draft Report estimate of racing value added (three codes combined, Table 2.20, \$5.3 million to \$8.6 million), appears implausibly low – the CRC Annual Report shows that it generates more value added than this range, and that is before adding in the value added of the CHRC and CGRC, plus the value added of the ACT-based trainers, vets and other industry participants.

Chapter 2 in the Draft Report discusses various data sources, some relating to thoroughbreds, some relating to the three codes combined (or 'racing industry'). Some of the text could be clearer, for example, Table 2.13 is labelled as the 'racing industry' when the data is actually for the 'thoroughbred racing industry'.

Table 2.5 in the Draft Report divides 'Races' by 'Race meetings' and labels this 'Average number of starters'. The label should instead read 'Average races per race meeting'.

The Draft Report (p22 and p23) finds an issue with the IER report having Victorian GSP being higher than NSW GSP. This appears to simply be a typo on p30 of the IER report (0.78% should read 0.48%).

The Draft Report (p36) claims that the ACT Government "would not expect to receive all of the funding freed up by the change in funding arrangement". The ACT Government, as 100% shareholder of ACTTAB benefits from both ACTTAB's retained earnings (which in turn add to ACTTAB's balance sheet and hence shareholder value) and ACTTAB's cash distributions received in a given fiscal year. Hence, the ICRC should consider the ACTTAB impacts using accrual accounting rather than cash accounting principles. Cash retained by ACTTAB is put towards investments and upgrades that presumably increase cash distributions in subsequent years. This is a benefit to the ACT, regardless of ACTTAB's remittances in a given year.

The Draft Report (p49) refers to Access Economics using the term 'racing expenditure'. The term used in the relevant table was 'wagering expenditure'.

Conclusion

I trust this supplementary submission provides some ways forward on the issue of racing industry product payments. Please let me know if I can help clarify anything raised in this supplementary submission.

Yours sincerely



Stephen Corcoran
Senior Consultant
Access Economics