
REVIEW

Gambling Policy

Productivity Commission, Australia's Gambling Industries, Report No. 10, Ausinfo, Canberra, 1999

Reviewed by John Quiggin

Reading the reports of the Industry Commission (previously the Industries Assistance Commission) was always an odd experience. The reports were invariably well-argued, followed extensive public hearings, and frequently included useful empirical studies. But the policy conclusions could be predicted before the first data point was collected — almost invariably they favoured less government intervention. It seemed reasonable to expect reports of the Productivity Commission to follow the same pattern. The Commission's report on gambling belies this expectation. Although the Report cannot easily be placed on a simple policy spectrum with central planning at one end and *laissez-faire* at the other, it clearly rejects simplistic free-market solutions.

The first part of the Report consists of an assessment of the welfare effects of gambling, a topic which has been the subject of numerous errors. The easy part of the Commission's work is the demolition of various forms of the 'materialist' fallacy — the view that value arises solely from the production of physical goods. One form of this fallacy is the view that gambling necessarily yields negative net social output, since physical resources are consumed but no physical output is produced. A related, but opposite, error counts all the resources used in the gambling industry, plus multiplier effects, as a net contribution to social output.

Problem gamblers pose a more substantial challenge. Although only two per cent of the adult population (defined by self-reported behaviour such as going into debt to gamble), they contribute about one-third of the gambling industry's revenue. 'Problem gambling' is the core policy problem of gambling.

To respond satisfactorily to this issue, it is necessary to deal with the theory of rational addiction, put forward by ACIL (1999) on behalf of several major gambling enterprises in an attempt to deny the existence of problem gambling. The idea of rational addiction, first put forward by Becker and Murphy (1988) has had a surprisingly easy ride in the economics literature, although its claims to empirical accuracy have been criticised by Ferguson (1996). Moreover, it is the kind of idea that would certainly have appealed to the Commission's precursor bodies in their crusade against what they saw as economic irrationalism.

Rational addiction theory is based on a model in which demand for addictive goods rises with previous consumption. The standard empirical test presented in studies cited in support of the model consists of the estimation of a demand equation in which anticipated future price increases are shown to affect future

demand. As the Commission observed, such a test is very weak, since it relies on the assumption that the only alternative to perfect rationality is complete irrationality, or even, according to ACIL (1999), 'insanity'. The theory also fails a basic reality check, in that it is obviously inconsistent with the self-reports of addicts, and the fact that they often seek to have themselves excluded from gambling venues.

Another aspect of behaviour associated with addictive commodities is the phenomenon of 'kicking the habit'. Many addicts undergo substantial pain in order to cure themselves of their addiction, and many others undergo pain in unsuccessful attempts at a cure. No doubt, with a suitably complex pattern of discounting it might be rational to build up an addiction and then break it, but this is intellectual tennis with the net down. Given suitable discount rates and preferences, Russian roulette would be rational.

The debate on rational gambling is of interest for the light it throws on the views of ACIL's sponsors (Crown Casino, Jupiters, Star City, TABCorp, TAB Limited and Tattersalls). While they do not deny the large proportion of revenue derived from problem gamblers, they deny responsibility for such behaviour and defend their right to promote it without significant regulation. Such an irresponsible attitude brings into question their suitability to hold a licence to provide gambling services, let alone their retention of the monopoly privileges they now enjoy.

The Commission assessed the welfare effects of current gambling policies by weighing the consumer surplus associated with gambling (including that accruing to problem gamblers) against estimates of the social costs associated with the adverse effects of problem gambling, including suicide, crime and divorce. The estimates, summarised in Table 1, show that lotteries yield substantial consumer benefits but are not associated with significant problem gambling. This is scarcely surprising, since, unlike most other gambling forms, the revenue from lotteries is derived from the relatively small expenditures of a large numbers of consumers rather than large expenditures from small numbers of gamblers. The contrast with gaming machines, the other large source of gambling revenues, is striking. Even with the Commission's relatively conservative estimates of social costs, it seems likely that the social costs of gaming machines exceed the benefits.

Table 1: Estimates of Social Costs and Benefits of Gambling (\$m)

<i>Gambling form</i>	<i>Costs</i>	<i>Benefits</i>	<i>Net benefits</i>
Wagering	267-830	629-885	-201-618
Lotteries	34-106	1232-1498	1126-1464
Scratchies	24-74	219-266	145-242
Gaming machines	1369-4250	1617-2491	-2633-1122
Casino games	48-150	580-769	430-721
Other	57-176	103-184	-73-127
<i>All gambling</i>	1799-5586	4380-6093	-1206-4294
<i>All except lotteries</i>	1765-5480	3148-4595	-2332-2830

Source: Productivity Commission (1999:Tables 5.13 and 9.4) and author's calculations.

The final row of Table 1 shows the effect of excluding lottery gambling from the Commission's estimates of costs and benefits. The range of estimates of net benefits is large, from -\$2.3 billion to \$2.8 billion, but is centred near zero. On these estimates, the question of whether the expansion of gambling over the past few decades has been, on balance, beneficial or harmful remains open.

This agnostic conclusion does not, however, apply to gaming machines, where the centre of the range of estimates is negative. Given an aggregate benefit less than or equal to zero, the marginal benefit of gambling expansion (contraction) will be negative (positive), under the standard assumptions that marginal benefits are decreasing (and hence less than average benefits), while marginal costs are constant or increasing. Hence, a policy which reduces aggregate expenditure on gaming machines will be beneficial, provided that the consumers excluded are marginal and that the reduction does not bear disproportionately on non-problem gamblers.

Gambling policy

The second part of the Report deals with the complex topic of gambling regulation. Until the 1960s, wowsersism ensured that legal gambling in Australia was confined to the rich. Various forms of gambling were legalised in subsequent decades, mostly as public monopolies (TABs and State Lotteries) or licensed private monopolies (casinos and, in New South Wales, licensed clubs). These monopolies were originally justified as controls on the adverse effects of gambling, but residual wowsersism contributed to a view that it was legitimate to exploit 'sinful' gamblers to provide revenue for state governments.

From the 1970s, governments stopped trying to protect gamblers and began to exploit them. Steady cuts in Commonwealth grants to the States ensured that the demand for exploitation became greater and greater. From being barely tolerated, gambling was encouraged and then vigorously promoted. On reaching the limit of their own capacity to exploit the monopolies they had created, the States sold them off to private entrepreneurs (a practice almost unknown since the days of the Tudors and Stuarts, and even then correctly regarded as an abuse of power.) Thus State governments not only gained a powerful financial interest to perpetuate the flow of taxation revenue from the gambling, but also created powerful private enterprises critically dependent on the monopoly rights.

Even if it could be assumed that government was motivated by public interest, gambling would still pose difficult policy problems. The standard response to an externality problem is a Pigouvian tax. Taxes also discourage addictive behavior such as drugtaking, whether or not addicts are fully rational. Hence, taxes reduce the physical harm and negative externalities caused by addictions.

The harm caused by gambling, however, results from the financial losses incurred by gamblers. Assuming, as seems plausible, that problem gamblers exhibit inelastic demand, a tax-induced increase in the price of gambling services will exacerbate the harm caused by gambling.

The Commission's consideration of options to reduce the harm caused by gambling reflects these difficulties. A simple policy of reducing the number of gaming machines, for example, would increase demand for the use of the remaining machines. Owners would rationally respond by reducing the frequency and size of payouts, thereby increasing the effective price of gambling. Machines could also be reconfigured to conform more to the preferences of high-return gamblers, who are more likely to be problem gamblers. In either case, the net social loss arising from gambling could increase.

It follows that a policy to reduce harm arising from problem gambling must combine a number of elements. It must include both a binding maximum price (minimum payout ratio) and a reduction in the total supply of gambling services. In addition, it must include changes in the conditions imposed on gambling providers that are designed to reduce the proportion of revenue derived from problem gamblers. Examples of conditions that seem likely to reduce problem gambling more than recreational gambling include prohibition of locating automatic teller machines in gambling venues, a requirement for gambling venues to act on attempts by patrons to self-exclude, restrictions on 24-hour gambling and enforced breaks from gambling.

Although the Commission provides a useful and balanced treatment of the strengths and weaknesses of alternative policies aimed at reducing the harm associated with gambling, it generally resiles from recommending policy options that would significantly disrupt the existing structure of the industry. On the whole, the Commission fails to follow the welfare analysis through to its logical policy conclusions.

Nevertheless, these criticisms should not be overstressed. The Report combines rigorous economic analysis with careful attention to the broader range of social issues that must be taken into account in the formulation of economic policy. It is to be hoped that future reports will live up to this high standard.

References

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