Dear Stakeholder

As you maybe aware, the New Zealand Racing Board has undertaken very significant work to achieve a more appropriate taxation treatment for the racing industry.

The case we have put to government is, we believe, very strong. It demonstrates categorically that there is significant potential for growth in the industry and consequently an improved contribution to the New Zealand economy.

Following initial discussions and correspondence in 2004, a completed final document was delivered to it on January 11, 2005.

Regrettably the recent budget did not contain any direct intervention in the taxation regime that would benefit the Racing Industry. We did however gain a commitment to a resource which will facilitate additional analysis of our argument and the issues the government has with some of the assumptions in the report.

We believe the quality of the document is outstanding and of international standing. The NZRB is very grateful for the specific input of the taxation task force. We remain disappointed at the immediate reaction of the government to the arguments we have put forward.

I want to assure you that we believe this case is far from dead and we intend to continue working with the relevant authorities in pursuit of a more equitable taxation platform for racing.

To optimise the impact of this work, the analysis was conducted by way of access to specific analytical groups. As part of this process the NZRB took a decision to release the report to government alone and then undertake a process of constructive dialogue with them on content.

Given that the government has now made reference to the report publicly the NZRB has decided to distribute the document to the industry.

You will note in the report references to additional supporting material. The relevant conclusions from the supporting documents are included and referred to in the report we have distributed.

Yours sincerely

W.A. Larsen

Warren Larsen
Chairman

NEW ZEALAND RACING BOARD TAXATION CASE

The push for tax reform is part of a wider set of measures to lift racing in New Zealand. The Racing Act 2003 now governs the Racing Industry and the first objective of the Act is very clear:

> **"To promote the economic development of the racing industry and the economic well-being for those who derive their livelihoods from racing"**

The New Zealand Racing Industry makes a significant contribution to the economy in terms of value added and employment. Directly and indirectly the racing industry accounts for $1.5 billion of GDP and 18,320 FTE jobs, the large majority of which are in provincial and rural communities. In addition, New Zealand-bred and trained animals 'punch above their weight' in premier races in Australia, Asia, Canada and the United States, and horse exports earn about $130 million per year. Simply put, New Zealand has a competitive product on the global stage.

The contribution of the Racing Industry to the New Zealand economy has been shrinking though, with long-term declines in the amount wagered and the number of animals raced. To return the Industry to growth and realize its potential, the NZRB believes that at least an additional $50 million is required. It reaches this figure by comparing the New Zealand industry with the State of Victoria and with other tier-one racing industries. The additional funds are to be channeled into increased returns to wagering, increased returns to animal owners, and the injection of much needed capital funds into the industry to provide the appropriate facilities to deliver the product.

The NZRB and the Racing Industry is seizing on the opportunity provided by the recent organisational restructuring to racing, to implement a four-pronged plan to lift the money returned to race clubs to $100 million a year. Current figures are in the order of $80 to $85 million. Three of the four measures are largely within the NZRB's control, working with the industry. These are improving industry performance with cost, product and channel initiatives; increasing participation through enhancing the entertainment component of race meetings, and internationalising the New Zealand product, i.e. co-mingling betting pools and income from offshore product sales. However, these measures only get the industry half-way to a sustainable and healthy future.

The fourth measure is a reduction in the betting duty. The need for action on this front is—or already has been—encountered by other leading racing countries with which New Zealand is increasingly competing. Australia, Great Britain, Ireland, the United States, South Africa and

Hong Kong have or are developing plans to improve the offering of their racing product and the competitiveness of the tax regime within which their industry operates.

In comparison with the above countries, New Zealand has the second highest taxation rate (as a proportion of total wagering turnover) behind Hong Kong, which—although it has unique circumstances—has just announced a new taxation regime. Thus the NZRB firmly believes an integral part of the pathway to enhanced performance is a reduction in the taxation of race wagering in New Zealand. A reduction to the level currently enjoyed by casinos would provide the shortfall in funding required to deliver a healthy industry.

Economic modeling undertaken by the NZIER to support the NZRB case illustrates that this is not simply a handover of tax from the Government to the industry but that the proposed package of initiatives, could

> **"deliver a healthier and economically more vibrant domestic racing industry while providing a similar level of taxation revenue as today, when upstream effects are considered"**

Those upstream effects include the growth in all those people and businesses that combine to deliver the racing product, that is animals running at tracks and export that product internationally.

The NZRB is in no doubt that the situation is urgent and the impacts of doing nothing can be seen in the continuing reduction in the number of racing animals and the loss of industry skills offshore. There is a clear path to move forward but to achieve it requires a partnership with Government. That partnership would provide an internationally competitive rate of duty to allow an internationally competitive industry to deliver on its potential. If the partnership does not come to fruition quickly, it will not be a matter of standing still but of the industry declining further.

FOR FURTHER DETAILS CONTACT:

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Warren Larsen	Chair NZRB	(021) 449 543
Dr. Alan Jackson	Director NZRB	(021) 997 836

11 January 2005

Hon Damien O'Connor
Minister for Racing
Parliament Buildings
WELLINGTON

Dear Minister

Injection Into The New Zealand Racing Industry

In response to recent meetings between yourself and Departmental Officials, The New Zealand Racing Board (NZRB) respectfully submits a paper that makes four major recommendations for your consideration.

These are:

1. That the industry needs approximately $55 million of increased funding to deliver on its economic potential and enhanced returns to all stakeholders, including the Government.
2. That both industry improvements and a reduced rate of taxation duty on race wagering are required to achieve this level of funding.
3. That because a window of opportunity exists now, the Government injects $25 million potentially through the first step of a two-step reduction in duty, to provide an impetus to current improvement programmes that will take three years plus to deliver their potential.
4. That on successful implementation and monitoring of the initial programmes, the Government, in Year 3, injects the balance of funds.

The NZRB is in no doubt that the situation is urgent and that the new Act will allow strategic and effective allocation of the monies.

In addition, all Code Chairmen have agreed in general terms to a NZRB suggested partitioning of the first tranche of increased funding to ensure it is effectively allocated.

Discussion has confirmed agreed deployment of these funds towards:

1. Increased stakes payments, principally directed at encouraging enhanced ownership and participation, across all three codes – approximately $17 million to be directed in this area.

2. Limiting further erosion, and winning back overseas betting revenue is the third category, and emphasis here is directed at co-mingling opportunities and product enhancement. Approximately $6 million to be allocated in this area.

3. Upgrading <u>specifically identified</u> assets within the industry. I stress this is <u>not</u> an across the board distribution. The industry wants to use this funding to start to re-shape asset deployment, as part of the enhanced industry performance improvement plan. Approximately $7 million to be deployed in this manner.

You can be absolutely assured that the industry is very much prepared to ensure that any funding improvement, forthcoming from the taxation initiative, will be effected as described. There is total agreement from Code Chairmen on the need for a disciplined approach, facilitated by the NZRB, aimed at lifting the overall economic performance of the sector, an objective shared by racing industry leaders and in the interests of all New Zealanders.

Finally, it is important to reiterate that the NZRB, fully supported by the Code Chairmen, firmly believe that embarking on such a programme will allow the industry to deliver on its economic potential, both domestically and within the broader international arena.

Yours sincerely

W A Larsen

Warren Larsen (on behalf of Taxation Taskforce)

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New Zealand Racing Board

The Plan For Lifting Economic Performance In The Racing Industry

Support Materials

January 2005

Contents

1 Introduction

This material supports the submission to Government through the Minister of Racing that seeks a reform to the taxation of race wagering in New Zealand. The aim is to present a case for immediate actions whereby the Industry and the Government work as partners to deliver on the requirements of Racing Act 2003. This initiative is a key part of a major industry plan to improve the international competitiveness and performance of the New Zealand Racing Industry by the New Zealand Racing Board.

In presenting a case for reform, this submission highlights the contribution of racing to New Zealand, the domestic and international challenges it faces, and the plans for change. It also outlines the benefits that would flow to the New Zealand economy and Racing Industry if the proposed package of industry initiatives and taxation reform were introduced.

2 The Requirements Of The Racing Act 2003

The New Zealand Racing Board (NZRB) was established under the Racing Act 2003 and has three primary objectives. These are:

1. To promote the economic development of the racing industry and the economic well-being of those who derive their livelihoods from racing
2. To conduct and promote racing betting and sports betting
3. To use its resources for the long-term benefit of New Zealand racing.

Racing in New Zealand comprises three separate codes: thoroughbred (galloping), harness (trotting) and greyhound. Thoroughbred racing accounts for about 74 per cent of the value added by the racing industry, harness racing, 22 per cent, and greyhound racing, 4 per cent. The three codes share racing and wagering infrastructure, and there are numerous commonalities between the thoroughbred and harness sectors and between horses and greyhounds in the sharing of facilities.

TABLE 2.1: RACING INDUSTRY CODES

	Thoroughbred	Harness	Greyhound	All Racing
Number of clubs	68	49	12	129
Number of meetings	286	228	261	775
Number of races	2,818	2,325	2,906	8,049
Number of animals raced	5,469	3,240	n.a.	8,709
Amount wagered	$418 million	$243 million	$87 million	$748 million
Net prize money	$30.5 million	$19.4 million	$3.9 million	$53.8 million

Source: NZ Racing Industry Board *Annual Report 2002-03*; Code documents

The industry structure is ‘code driven’ to a significant degree, which means that each of the three codes, in addition to the Board, must have aligned objectives to promote and develop their code within the overall industry structure and in a coordinated manner.

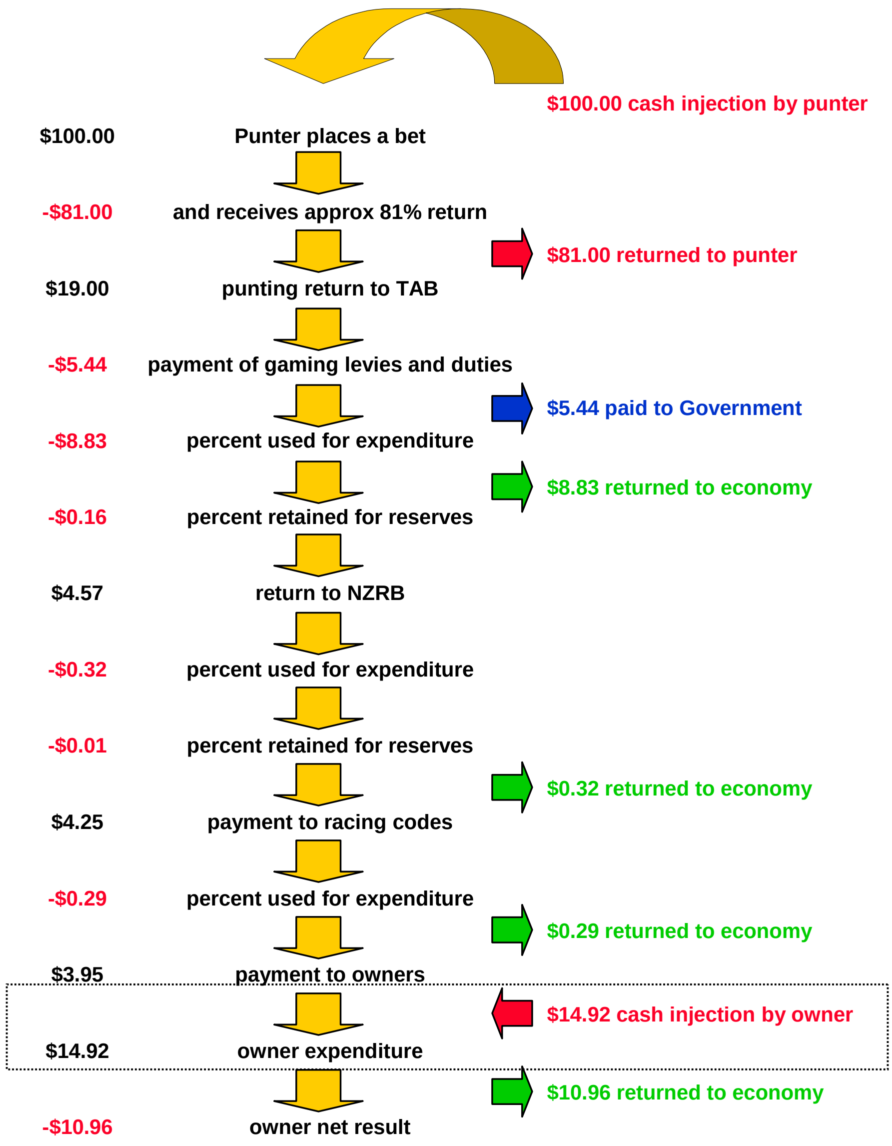
Wagering

Race wagering in New Zealand - as in most countries - is based almost entirely on the pari-mutuel system, otherwise referred to as the totalisator[1]. Here, all wagers of the same type are placed in a pool from which dividends are paid, after an amount is taken out (the

[1] The main alternative is fixed-odds betting, where bettors wage against the operator who assumes risk

'take-out') to cover Government duty, TAB costs, support of the racing clubs and through them, the animal owners (Figure 2.1). Bettors are wagering against each other, and the operator provides the infrastructure and product for them to do so. The level of take-out and how it is distributed, are crucial to the racing industry.

Figure 2.1: Flow Of Funds Through The Racing Industry



SUMMARY

Total bet/net cash contribution by owners and punters	$29.96
Funds paid to Government	$5.44
Funds returned to economy	$24.35
Retention of funds by TAB and NZRB	$0.17

Source: KPMG, Tax Review, October 2004

The New Zealand TAB's profits from wagering provide most (nearly 90 per cent) of the prize money paid out by racing clubs. The prize money is the major source of income for horse and dog owners from racing who demand the services of breeders, trainers and stables or kennels. Even for those breeders and trainers who look primarily to export markets, local racing opportunities in quality fields are important to building and proving the worth of their animals, at least in the first stage of their careers. Sizable local racing activity also provides the industry scale needed to support a range of specialised capabilities and services.

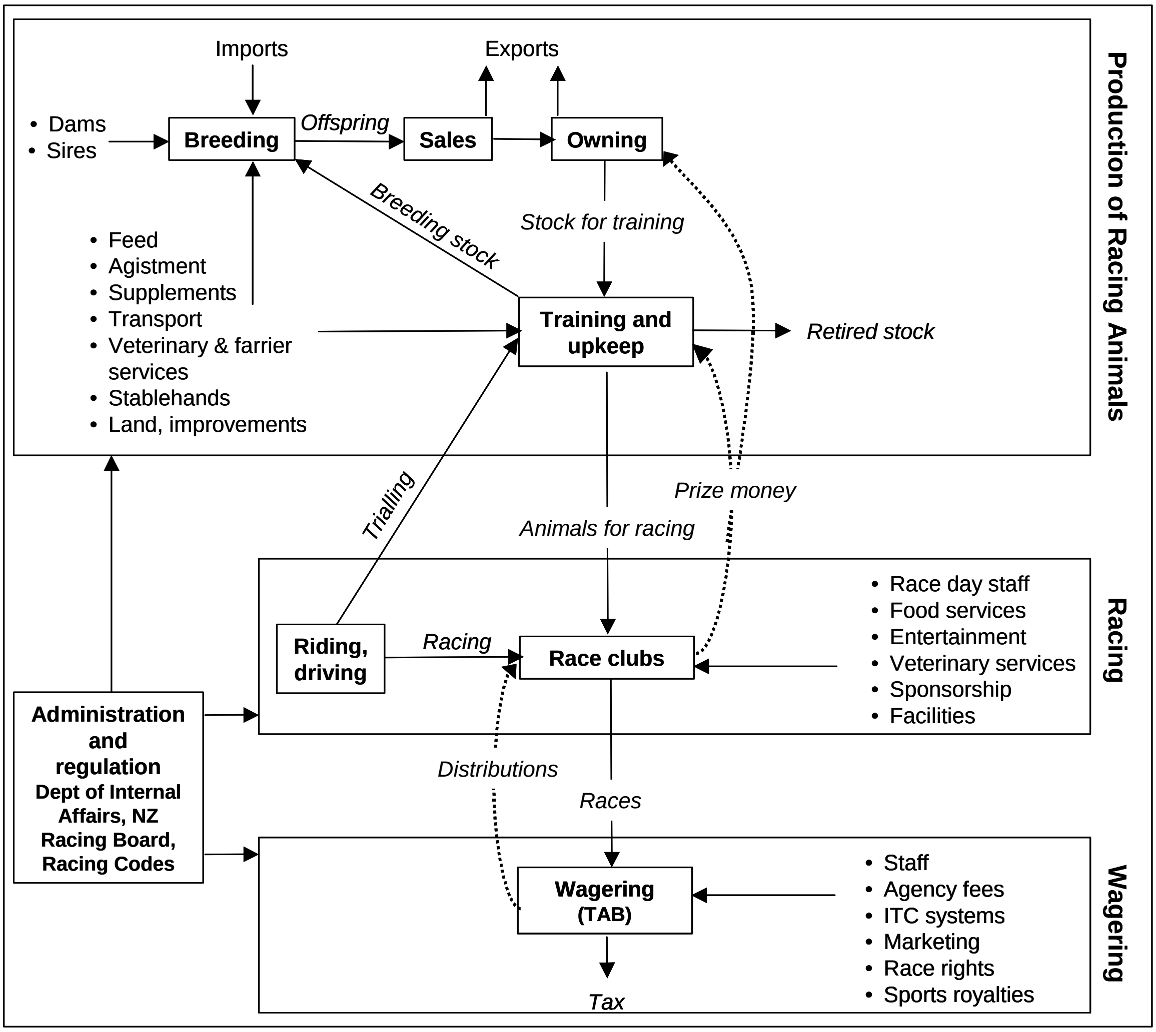
Industry Development and Well-Being

While the NZRB has wagering and governance functions, its over-arching responsibility is the development and economic health of the racing industry. The industry falls into three main parts: (i) the production of racing animals, (ii) the racing of them, and (iii) wagering on the races (Figure 2.2).

The split in economic activity is roughly three-quarters in the production of racing animals, and one-quarter in racing and wagering. The predominant activity of breeding, upkeep and training of racing animals is by its nature concentrated in rural areas, drawing in a large range of inputs from local businesses. Spending by breeders and trainers amounts to an estimated $800 million a year.

The New Zealand racing industry's upstream activities are, in many regards, of international scale and reputation. For example, New Zealand ranks sixth among 21 leading racing countries in terms of the number of foals produced (Figure 2.3). A high volume of racing — New Zealand ranks second after Australia in terms of horse races per head of population — creates much of the demand for those upstream activities. However, the race wagering that ultimately supports much of the New Zealand racing industry (through prize money paid to horse owners) is not of international scale; it is relatively small. The situation of a substantial industry producing race animals and a fairly small wagering base is not sustainable and that is seen in the declining number of horses raced locally and reduced quality of stock for export markets.

Figure 2.2: New Zealand Racing Industry Network

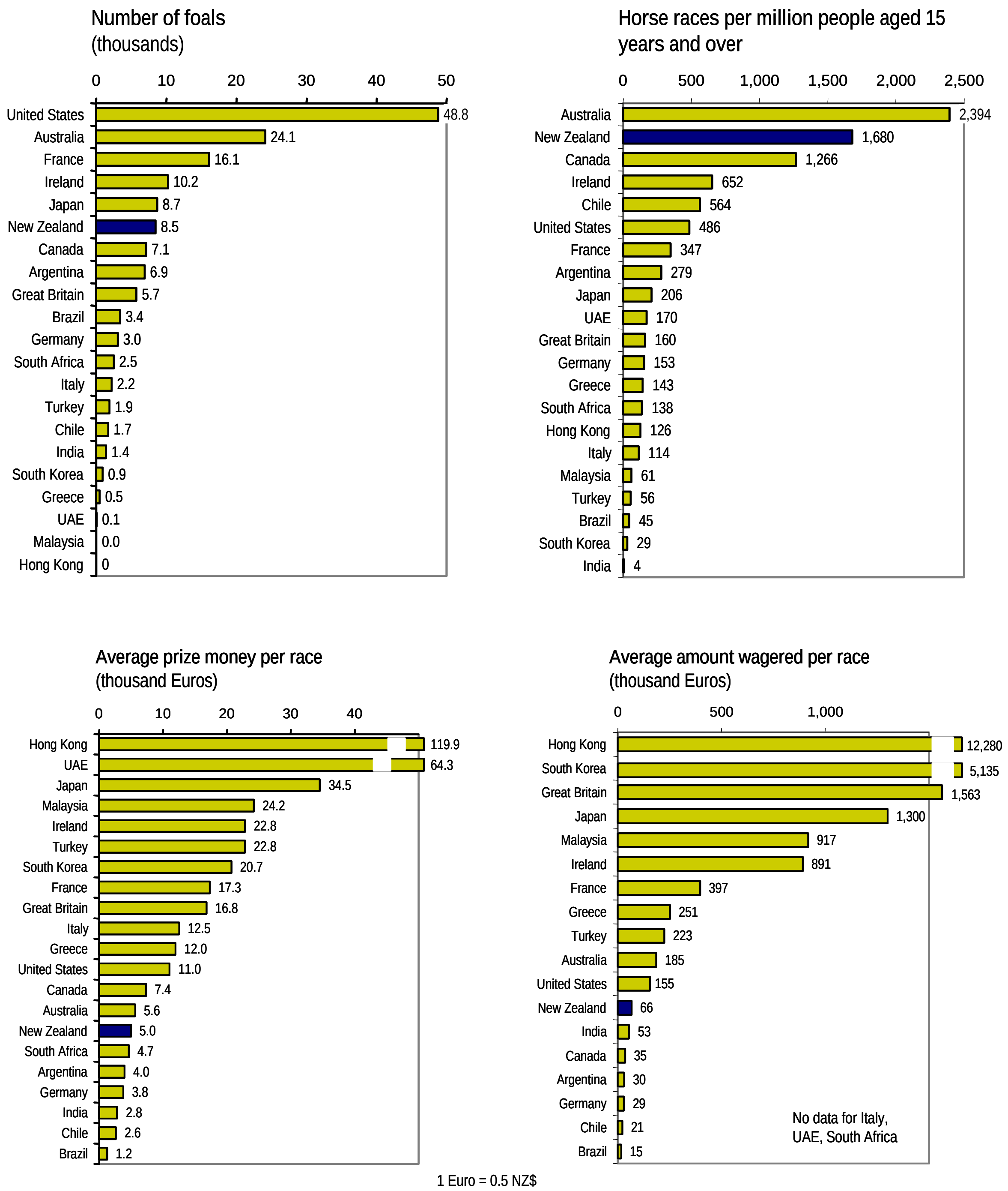


Adapted from Australian Racing Board. 2003. *Review of Issues Related to Commonwealth Interactive Gambling Regulation*

The requirements to both conduct wagering and develop the local racing industry sets the NZRB apart from many other wagering organisations overseas. This is particularly true where competing wagering operators have no responsibility for product payments to support development of the race animal industries from which they extract wagering profits.

Accordingly, and as will be returned to later, the NZRB will always have a higher cost structure than those organisations that compete purely for wagering. The obligation to support the industry becomes extremely important when considering the improvement opportunities available to racing and the intense domestic and increasingly international competition for wagering and gaming expenditure.

Figure 2.3: New Zealand's Ranking Across Four Dimensions Of Horse Racing Among 21 Leading Racing Countries 2002



Source: International Federation of Horseracing Authorities; NZ Racing Industry Board *Annual Report 2001-02*

3 The Economic Contribution Of The Racing Industry

The New Zealand racing industry is a network of activities that span the agriculture, sports, entertainment and gaming industries. These activities are distributed throughout New Zealand, with a bias toward provincial and rural communities.

The New Zealand Racing Board has funded a major study — *Size and Scope of New Zealand Racing Industry: Economic Impacts & Community Social Benefit* — cataloguing the situation of the New Zealand Racing Industry in 2002/03, to provide a sound fact base for decision-making within the industry, as well as for policy formulation by Government[2]. The study provides the base for much of the discussion in this Section.

Economic Impacts

The economic contribution of the racing industry can be measured in terms of value added, people employed, the duties and GST paid on wagering, and export earnings. Less quantifiable but also very important, are the difficult-to-replicate capabilities that the industry has built up over time.

TABLE 3.1: ECONOMIC IMPACT OF RACING INDUSTRY CODES

	Thoroughbred	Harness	Greyhound	All Racing
Direct value added	$312 million	$94 million	$18 million	$424 million
Total value added	$1,094 million	$327 million	$62 million	$1,484 million
Direct employment (FTE)	6,752	2,077	419	9,248
Total employment (FTE)	13,567	4,005	754	18,326
Tax paid to Government	$35.0 million	$14.1 million	$4.8 million	$53.9 million*

* The Government receives a further $6.3 million in taxation on sports betting

Source: *Size and Scope of New Zealand Racing Industry*

Value Added. The racing industry directly accounts for $424 million of value added[3], equal to 0.37 per cent of New Zealand's GDP. When the indirect or flow-on effects of

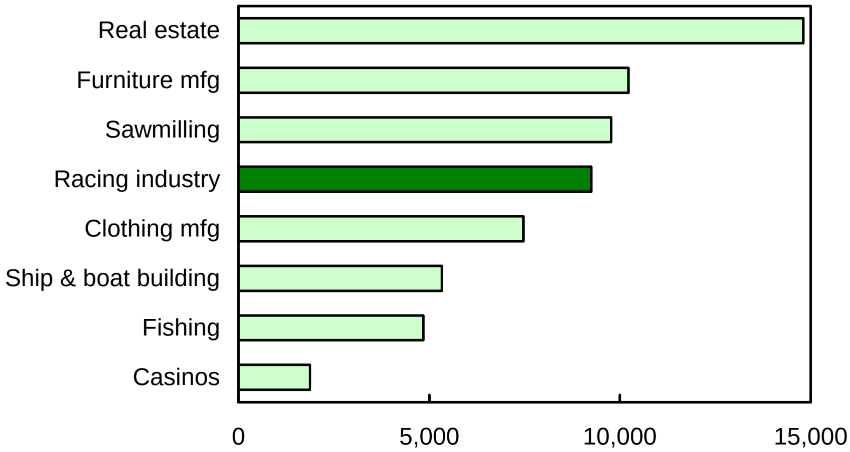
[2] The study was undertaken by IER Pty Limited who had completed similar exercises for racing in several Australian states and uses economic models developed by the New Zealand Institute of Economic Research (NZIER) and breeding and training data from Massey University

[3] The difference between the cost of goods and services purchased, and the price of goods and services sold

the racing industry are included, the figures rise to $1,480 million and 1.3 per cent of GDP.

Employment. The racing industry is relatively labour-intensive. The industry directly generates 9,250 full-time equivalent (FTE)[4] jobs, equal to 0.55 per cent of New Zealand's total employment. When the flow-on effects of racing industry activity to other sectors of the economy are considered, the total FTE jobs created are 18,320 or 1.1 per cent of the New Zealand number. The salaries and wages paid to those workers total $679 million and amount to nearly half of the value added by the racing industry, directly and indirectly. Figure 3.1 compares the racing industry's direct employment with seven other industries:

Figure 3.1: Employment in Selected Industries 2003 (FTEs)



Source: *Size and Scope of New Zealand Racing Industry*; Statistics NZ *Business Demographics*

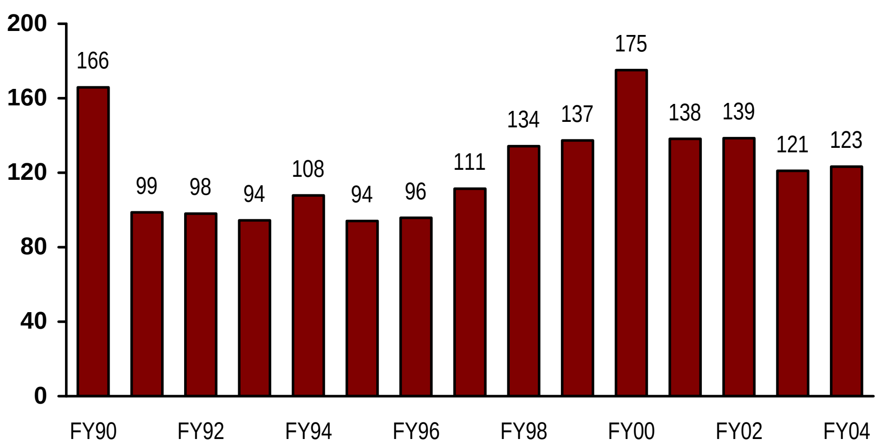
Direct Government Revenue. In 2002-03 the Government received $37.4 million in gaming duty from horse and greyhound racing and sports betting and a further $22.8 million in GST payments on wagering, a total of $60.2 million. Both race club operation and racing animal ownership make substantial losses in aggregate and so the gaming duty is in effect a social tax, not an income tax. Later sections of the report consider in some detail, taxation in the racing industry and its competitive implications both domestically and internationally.

[4] Part-time jobs (less than 30 hours a week) are assumed to equal half a full-time job in calculating FTEs

Export Earnings. The New Zealand racing industry has a global reputation that belies the country's size and remote location and the difficulties in transporting horses.

New Zealand Trade and Enterprise lists the strengths of the thoroughbred industry as New Zealand's physical environment, the low cost of rearing and training horses, access to internationally recognised bloodlines, and input from world renowned horsemen and women. The country benefits too from the absence of any serious equine diseases. In Australia, New Zealand-bred thoroughbreds consistently win more than 20 per cent of the 'black type' (top ranked) races with less than 10 per cent of the runners. The annual yearling sales at Karaka and Christchurch are important international and Australasian events in thoroughbred and harness racing. Over the past four years, New Zealand's exports of live horses, both yearlings and tried horses, have averaged $130 million a year. Of these approximately $115-$120 million worth are thoroughbreds and $15-$20 million are standardbred horses destined primarily for the United States.

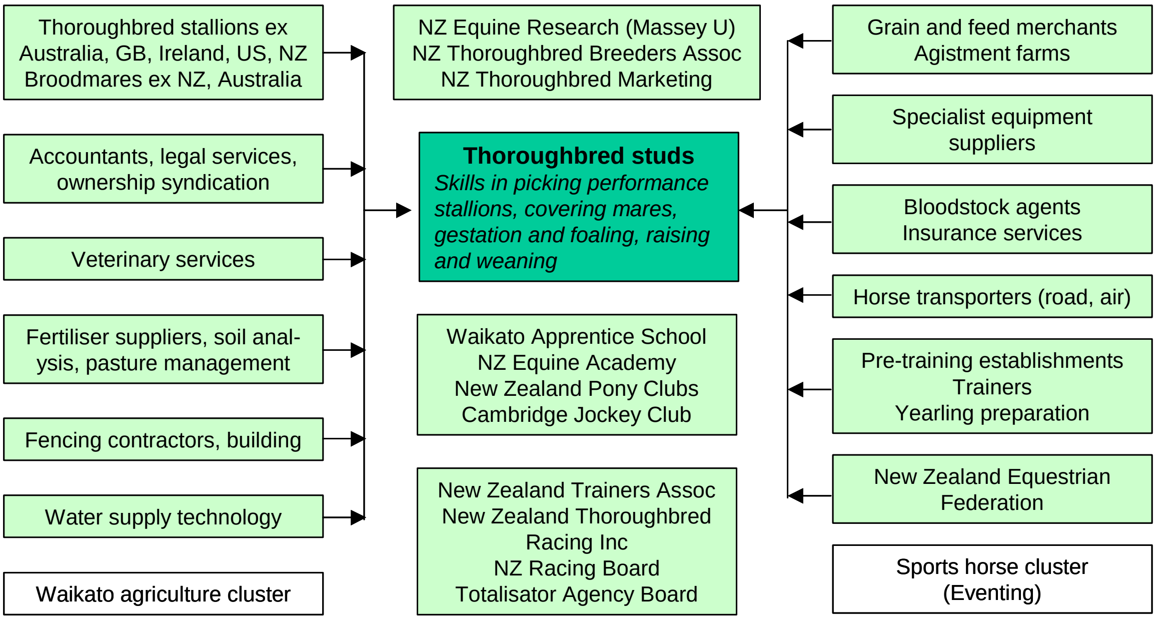
Figure 3.2: New Zealand Exports Of Live Horses FY1990 To FY2004
($m adjusted for inflation to 2003$)



Source: Statistics NZ *INFOS*

Competitive Capabilities. New Zealand has built valuable capabilities in horse breeding and training, as well as in race wagering products and the technical delivery of them. The racing industry has been sufficiently large that is has been able to support the development of specialist skills, and its very long history has allowed substantial experience to accumulate. A cluster of activities around thoroughbred breeding and training has grown up around Cambridge in the Waikato (Figure 3.3). A similar cluster for standardbred (harness) breeding and training exists around the outskirts of Christchurch. These clusters, as well as focussing on the production, rearing and racing of horses, also include research and development activities to promote continued growth of New Zealand's animal stock and racing capabilities.

Figure 3.3: Cambridge Bloodstock Cluster



Adapted from M. Akoorie. 2001. Research on business clustering and networking in New Zealand, In J. Yeabsley (ed). *Global Player? Benchmarking New Zealand's Competitive Upgrade,* NZIER Research Monograph 67.

Social Impacts

The racing industry is characterised by widespread participation, geographic dispersion, and often strong community ties. Wagering leads to some problem gambling but the concern is much smaller than for gaming machines and the racing industry is active both in seeking to prevent it and in dealing with it when instances arise.

TABLE 3.2: RACING INDUSTRY PARTICIPATION

	Thoroughbred	Harness	Greyhound	All Racing
People participating	23,339	14,674	2,632	40,645
Race attendance	609,900	389,425	45,270	1,044,595
Race club membership	16,340	10,953	520	27,813

Source: *Size and Scope of New Zealand Racing Industry*

Participation. More than 40,000 people are involved on the production side of the racing industry, on a full-time, part-time, casual and voluntary basis. Three-quarters are involved in the production of racing animals and one-quarter in racing and wagering (Table 3.3). There is a large number of volunteers (nearly 4,000) involved in racing clubs, especially in smaller centres and rural areas, which points to racing's importance as a community and leisure activity.

TABLE 3.3: BREAKDOWN OF PEOPLE PARTICIPATING IN THE PRODUCTION SIDE OF THE RACING INDUSTRY

Production of Racing Animals		
Breeders & staff	9,245	22.7%
Breeders/Owners	4,640	11.4%
Owners & syndicate owners	12,835	31.6%
Owners/Trainers	745	1.8%
Trainers & staff	2,710	9.0%
Total	**30,175**	**74.2%**

Racing and Wagering		
Jockeys/Drivers	1,015	2.5%
Race club admin & staff	7,555	18.6%
Wagering	1,900	4.7%
Total	**10,470**	**25.8%**

Source: *Size and Scope of New Zealand Racing Industry*

On the consumer side, there are 27,800 race club members, annual racecourse attendance is 1,040,000, and an estimated 15 per cent of New Zealanders over 18 years of age, wager on races each year. Eight per cent wager on sports through the TAB. Racing is the third most popular form of gaming, after lotteries and gaming machines (other than machines located in casinos).

The composition of the people who wager on racing is fairly typical of New Zealanders as a whole (Table 3.4):

TABLE 3.4: CHARACTERISTICS OF PEOPLE WHO WAGER ON RACING 2000

Attribute	Options	Race Wagerers	Overall Population
Gender	Male	53%	48%
	Female	47%	52%
Age	15-24 years	17%	19%
	25-34	20%	20%
	35-44	16%	19%
	45-54	17%	15%
	55-64	13%	11%
	65 years and over	16%	15%
Ethnicity	NZ Maori	11%	10%
	Pacific	5%	7%
	Other	83%	82%
Household income	Under $30,000	20%	25%
	$30,000-$60,000	33%	34%
	Over $60,000	37%	27%
Occupation	White collar	43%	35%
	Blue collar	24%	22%
	Home duties	8%	10%
	Retired	18%	16%
	Beneficiary/unemployed	4%	5%
	Other	4%	13%
Education	No qualification	27%	25%
	School certificate	13%	18%
	UE/6FC/Bursary	19%	16%
	Trade/tech qual	12%	15%
	Other tertiary	28%	26%

Source: B. Amey. 2001. *People's Participation in and Attitudes to Gaming, 1985-2000*, Department of Internal Affairs.

Regional Dispersion. Racing industry activities are spread throughout New Zealand, with some bias toward provincial centres and rural areas (Figure 3.3). In absolute terms, Auckland is the largest region, followed by the Waikato, Canterbury and Wanganui-Manawatu regions. When standardised[5] for differences in regional GDP, though, Auckland ranks 7th out of the 15 regions: Waikato, Southland and Wanganui-Manawatu are where the racing industry accounts for the largest share of the regional economy (Table 3.5).

[5] A location quotient is a common measure of the extent to which an activity is geographically concentrated and is calculated here by dividing a region's share of participants in the racing industry by

TABLE 3.5: LOCATION QUOTIENTS FOR RACING INDUSTRY GDP

Region	Location quotient>1.0
Waikato	2.33
Southland	2.13
Wanganui-Manawatu	2.02
Taranaki	1.37
Canterbury	1.21

Region	Location quotient<1.0
Otago	0.92
Auckland	0.82
Hawkes Bay	0.69
West Coast	0.64
Wellington	0.52
Northland	0.40
Bay of Plenty	0.38
Marlborough	0.23
Gisborne	0.20
Tasman-Nelson	0.13

When the regional pattern of participation in the racing industry is considered (Figure 3.4), the distribution is even more dispersed, in part reflecting the larger proportion of part-time and voluntary participants in the industry outside the main centres and the role racing plays in community life. Southland, the West Coast and Wanganui-Manawatu are the regions where racing is strongest in terms of participation (Table 3.6).

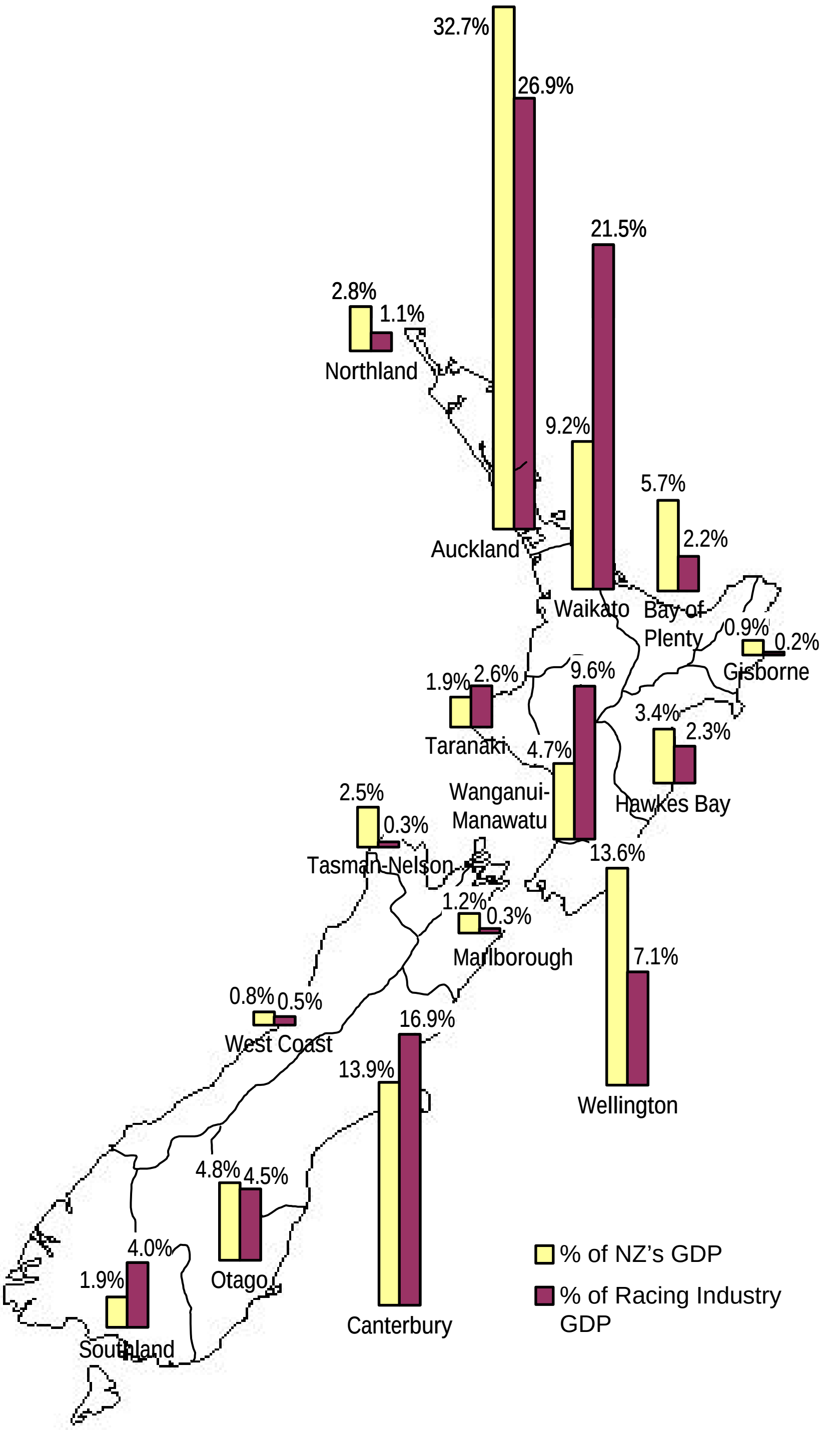
TABLE 3.6: LOCATION QUOTIENTS FOR RACING INDUSTRY PARTICIPATION

Region	Location quotient>1.0
Southland	3.55
West Coast	2.35
Wanganui-Manawatu	1.89
Canterbury	1.71
Waikato	1.63
Taranaki	1.33
Otago	1.10

Region	Location quotient<1.0
Hawkes Bay	0.65
Wellington	0.56
Marlborough	0.58
Auckland	0.57
Bay of Plenty	0.46
Northland	0.39
Tasman-Nelson	0.36
Gisborne	0.32

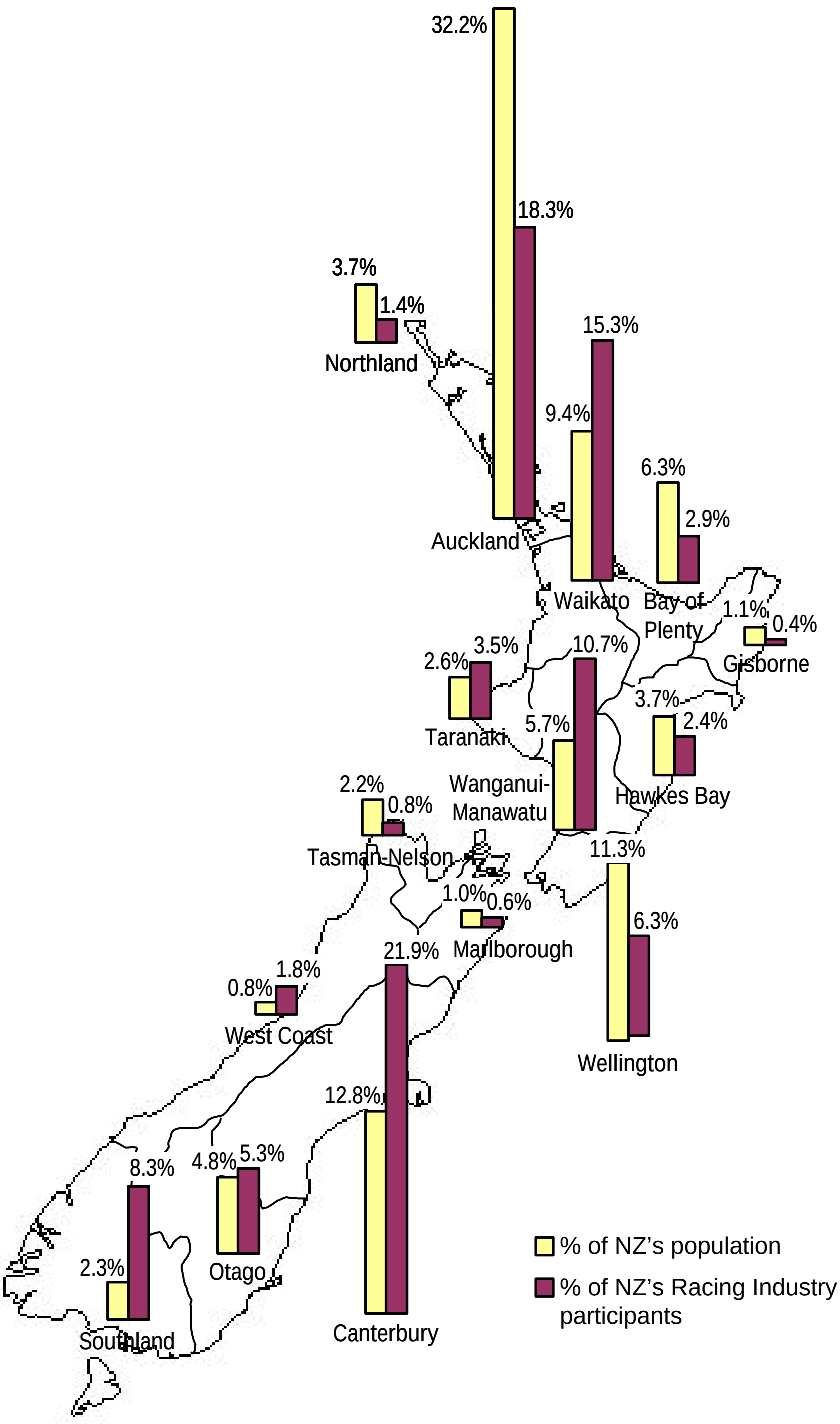
the region's share of national population. A figure above 1.0 means racing is over-represented in a region's economy; less than 1.0 means that it is under-represented.

Figure 3.3: GDP Contributed By The New Zealand Racing Industry Versus Total GDP, By Region



Source: *Size and Scope of New Zealand Racing Industry*; NZIER for regional GDP data

Figure 3.4: Participation In The New Zealand Racing Industry Versus Population, By Region

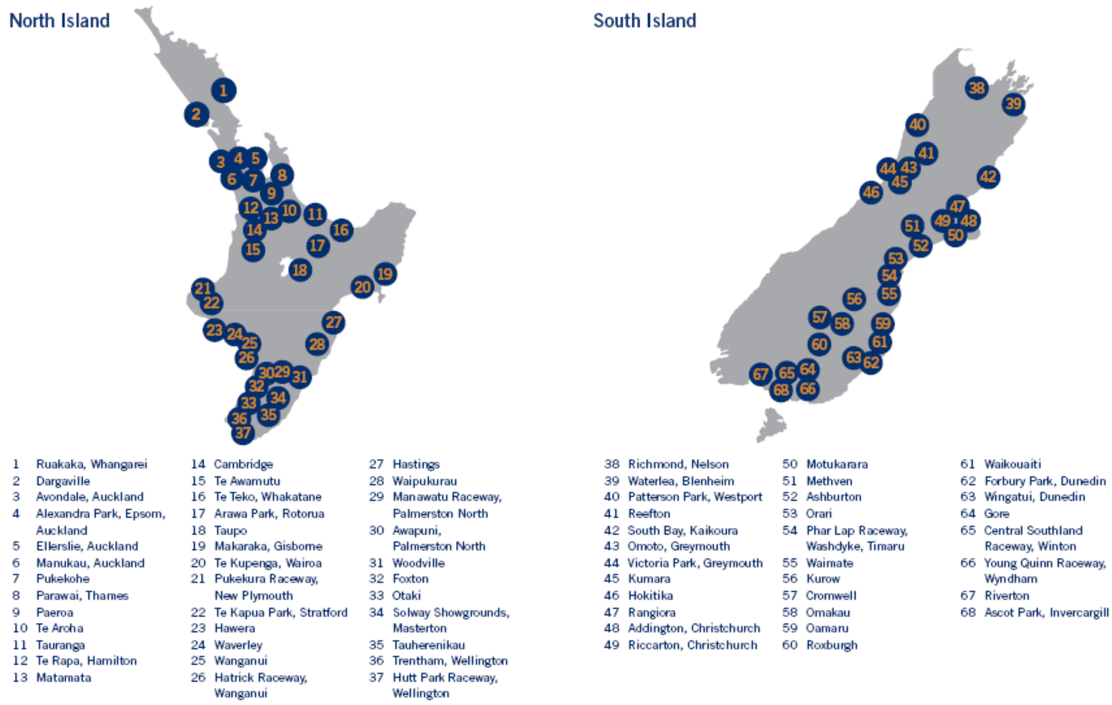


Source: *Size and Scope of New Zealand Racing Industry*; Statistics NZ for population data

Community Connections. Most race clubs and racecourses trace their history back to before 1900. In many non-metropolitan communities, the racecourse and its facilities form a major community asset.

There are 129 racing clubs in New Zealand, 68 of which are thoroughbred racing, 49 harness racing, and 12 greyhound racing. Their size varies widely: for example, the Auckland Racing Club runs 25 meetings a year and the Auckland Trotting Club, 32 meetings a year, while many small clubs hold only an annual meeting. Those non-metropolitan clubs, though, are community institutions and the racecourses are often key community infrastructure. While race clubs and racecourses are pivotal to delivering the racing product, they are under considerable pressure, with average race day attendance and on-course wagering having declined dramatically over a number of years.

Figure 3.5: New Zealand Racecourses



The study *Size & Scope of the New Zealand Racing Industry* identified a variety of racing-community ties, among them:

- 333 community organisations share race club facilities or resources
- 243 community events are supported by race clubs

- 274 community organisations or charities receive financial assistance from race clubs
- 153 race days (out of 780) have a community leisure theme.

Race clubs seek to cater for a wide spectrum of people, for example:

- Attractions and facilities to support attendance by children (with their parents)
- Discounts for disadvantaged groups
- Access for community and family groups to race club facilities on non-race days.

Problem Gambling. There is a social cost to wagering in the form of problem gambling. The 2003 *National Problem Gambling Statistics* show that 5.3 per cent of people receiving counselling for problem gambling, stated that racing is the primary source of their problem; for 1.9 per cent, it is sports gambling. While not seeking to diminish the problem, these proportions (7.2 per cent in total) compare with race and sports betting's 12.5 per cent share of total wagering and gaming expenditure in 2003.

The racing industry has a long history of addressing the issue of problem gambling. Prior to the introduction of the Problem Gambling Levy in October 2004, the industry set aside a voluntary levy, which was $1.1 million in 2002/03 (about the same level as the new compulsory levy in its first year). The industry has been active in providing staff training to ensure TAB staff are fully appraised with problem gambling: its risks, its impacts, how problem gamblers can be identified, recommended ways of intervening, and sources of support.

The growth in wagering on overseas racing through the Internet and enhanced mobile phone technology, poses a risk of increased gambling problems, and in by-passing the New Zealand TAB, not only is problem behaviour much less likely to be identified, the funds from the Problem Gambling Levy will be reduced.

Conclusions

The New Zealand racing industry is a significant sector of the economy and one where the country has an international reputation, for its breeding and training of horses.

Directly and indirectly, the racing industry accounts for 1.3 per cent of GDP and 18,320 FTE jobs. New Zealand bred and trained horses routinely "punch above their weight" in premier races in Australia and Asia and horse exports earn about $130 million a year.

The racing industry is characterised by a high level of upstream activity, viz. breeding, upkeep and training. There are three times more participants in the production of racing animals than in the racing of – and wagering on – them and their market is exports as well as local racing.

The size and export potential of the upstream businesses that produce the wagering product, sets race wagering apart from other wagering and gaming activities in New Zealand. Nor has the industry realised its full export potential yet.

The horse clusters that have grown up around Cambridge and Christchurch are valuable and difficult-to-replicate resources with their bundle of breeding and training capabilities and know-how, built assets, and physical environment. New Zealand should be seeking to lever further growth off such successes, building on them and where possible replicating them elsewhere in the racing industry. New Zealand can occupy an even stronger place in the racing industry internationally, if it is underpinned by a strong domestic racing product.

4 Industry Pressures And The Need For A Turnaround

The sizeable contribution that the racing industry makes to the New Zealand economy and society has been under pressure since the late 1980s when the liberalisation of gaming in New Zealand began, putting an end to whatever economic monopoly that the TAB had. The growth in gaming competition has been paralleled by the proliferation of other entertainment choices, the deregulation of shopping hours and increasing pressures on people's discretionary time. Participation rates in racing have fallen, not only in relation to customers and domestic wagering activity but the number of horses being raced has dropped as well.

The racing industry has responded in part by taking costs out at the racing club and racing track levels, primarily through a number of regional amalgamations and relying more heavily on voluntarily labour. It benefited too from a reduction in the betting duty rate in 1996 but the rate is still relatively high.

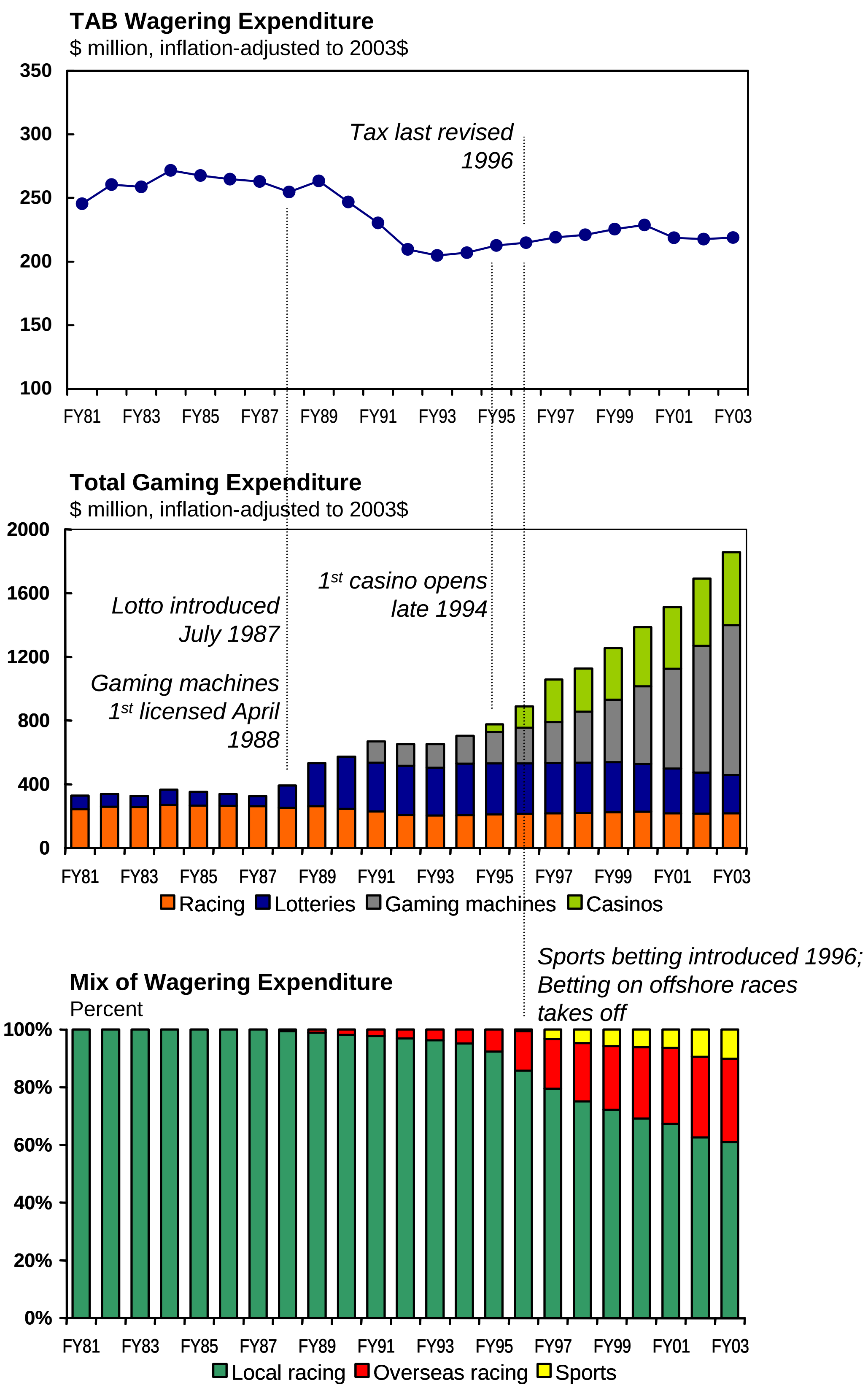
The racing industry has also responded by adopting advances in information and communication technologies and developing new wagering products, in order to sustain total wagering revenues. While these initiatives have helped to keep the industry competitive and modernise the business, the increasing cost of the wagering product has squeezed the funds available to the industry to increase stakes and to promote racing in additional ways.

Off-Course Racing Turnover And Expenditure

Off-course betting turnover (racing and sports) in 2002/03 was $1,129 million, of which 81 per cent was paid out as dividends to customers, leaving net betting expenditure of $219 million. Removing the effect of inflation, that figure is down 16 per cent from the average annual racing expenditure of $261 million during the 1980s but up 7 per cent from the low of $205 million in 1992-93. The result since 1996 includes the additional contribution from sports betting.

The sharp decline in racing expenditure from 1989 to 1993 coincided with intensified competition from lotteries and the introduction of gaming machines (Figure 4.1) and was reinforced by a slow down in the overall economy.

Figure 4.1: Trends In Wagering In New Zealand FY1981 To FY2003



Source: NZ Statistics and racing publications

The recovery in betting expenditure since 1993, in the face of accelerated growth in gaming machines, the opening up of casinos and the proliferation of other entertainment choices (Figure 4.2), has been achieved through four main measures:

1. The introduction of new types of race wagering such as 'multi' products and 'percentage' betting, both of which increase customer choice and in the second case, affordability versus return
2. The provision of additional services to customers including increased distribution to leverage the social, interactive nature of the race wagering experience versus the 'individualist' gambling experience
3. The rapid growth in betting on overseas races which now accounts for 29 per cent of TAB turnover
4. The introduction in 1996 of sports betting which has grown to 10 per cent of turnover.

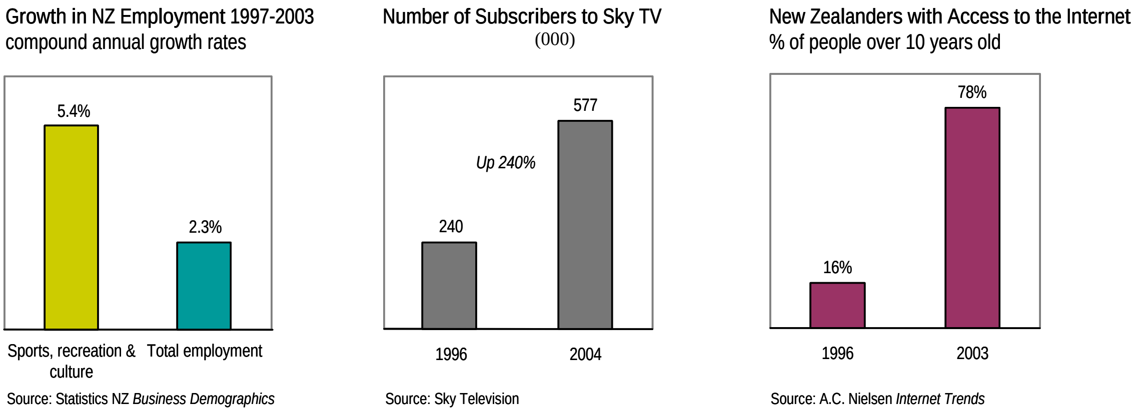
The level of turnover has stabilised, but that is in sharp contrast to the rapid growth in both casinos and gaming machines. The proportion of the population participating in race wagering has fallen significantly since 1995, contrasted with the rise of casinos:

	1995	**1998**	**2000**
Race wagering	23%	20%	17%
Casinos	5%	17%	16%

Source: B. Amey. 2001. *People's Participation in and Attitudes to Gaming, 1985-2000.* Department of Internal Affairs.

However, wagering is not the only reason for participating in horse racing. Many attendees of major carnivals or country picnic meetings do so for the entertainment. One overseas example is that an estimated 50 per cent of those who attend the Melbourne Cup do not wager on the day. The industry captures the benefit of their presence through admission charges and food and beverage spending and, indirectly, sponsorship.

Figure 4.2: Indicators Of Growth In Recreation And Entertainment



With the proliferation of recreation and entertainment options available to the New Zealand population, as evidenced in the above charts, racing needs to compete more effectively for the discretionary entertainment dollar. This will require stronger investment in racing industry marketing, venues and facilities and enhanced standards for event management. This investment will need to be funded from increasing overall returns to the industry.

Increasing Costs To Support The Industry

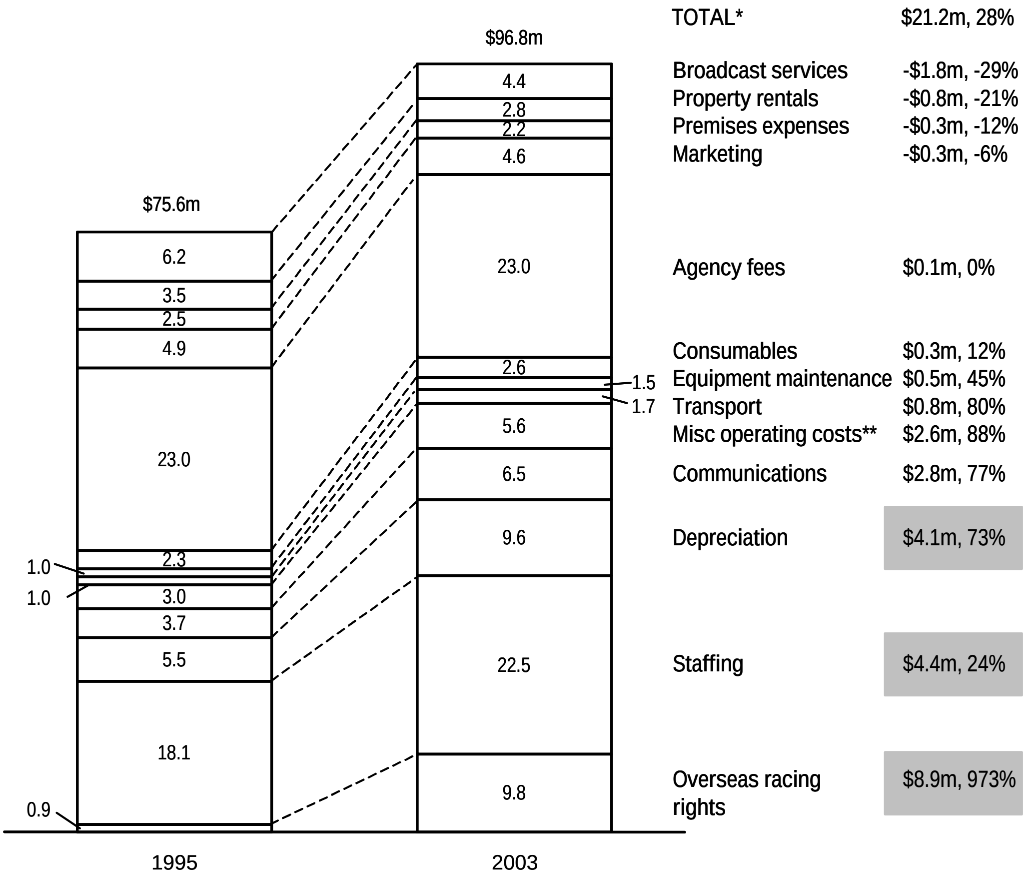
The TAB, being the major source of income to support the racing industry, has had to increase spending to keep race wagering competitive in this new environment. The TAB has developed new distribution channels, expanded the services provided to people who wager on racing, and bought rights to overseas races and to local and overseas sports events.

The increase in distribution channels, the expanded services provided to wagerers, and the growth in wagering on sports events and overseas races, have all significantly lifted the TAB’s operating costs. Figure 4.3 plots TAB costs in 1994/95 — the last season before the tax changes in January 1996 — against costs for 2002/03. Over those eight years, racing expenditure has risen only 6 per cent in real terms, whereas TAB operating costs have risen by 28 per cent.

Three items account for most of the rise in operating costs:

1. Overseas racing rights have increased nearly ten-fold over the eight years, roughly increasing at the same rate as the growth in revenues from wagering on overseas races
2. Staff costs have increased by 44 per cent, reflecting the higher service levels, greater range of distribution channels, and the more complicated business that the TAB now runs
3. Depreciation has nearly doubled, as a result of the large investment in computer hardware and software and communications, and their short commercial life.

Figure 4.3: New Zealand TAB Operating Costs, Change From 1994-95 To 2002-03 ($ Million, Adjusted For Inflation To 2003$)



•Excludes sports royalties which were zero in 1994-95 and$2.1 million in 2002-03
•Includes a problem gambling levy of $1.1m in 2002-03

Source: NZ TAB *Annual Reports* 1994-95 and 2002-03

Not included in the operating costs — it is netted out of revenues — is $2.1 million in 2002/03 of royalties that the TAB paid to New Zealand sports bodies for its sports betting, up from zero in 1995/96. Through these royalties paid, the TAB is an important funder of sports in New Zealand. This situation is in stark contrast to many countries where the sport codes receive nothing from betting on their events.

While these initiatives helped to keep the industry competitive and modernise the business, the increasing cost of the wagering product has squeezed the funds available to the industry to increase stakes and to promote racing in the face of greatly increased competition.

In addition to the industry initiatives undertaken, racing received a reduction in 1996 in the betting duty rate from 5.5 per cent of wagering turnover to a nominal 20 per cent of racing expenditure (i.e. wagering net of dividends paid), equivalent to about 3.3 per cent of turnover. The impact of this was to increase total race wagering by approximately $100 million in the following year. However, this change, although significant, was offset by substantially increased competition from casinos and gaming machines. At the time of the tax reduction, racing had approximately a 35 per cent share of the domestic gambling dollar; today, that share is less than 13 per cent as expenditure on gaming machines and casinos has roughly increased four-fold since 1995.

Accordingly, with the dramatically increased number of wagering opportunities (i.e. industry capacity), the industry initiatives and the 1996 tax reduction have done well to prevent a substantial decline in the real dollars wagered on racing.

Current Threats To Industry Performance

Currently the New Zealand racing industry faces three major new or heightened challenges:

1. The supply of local racing has declined, as seen in falling horse numbers, and placed further pressure on racing clubs

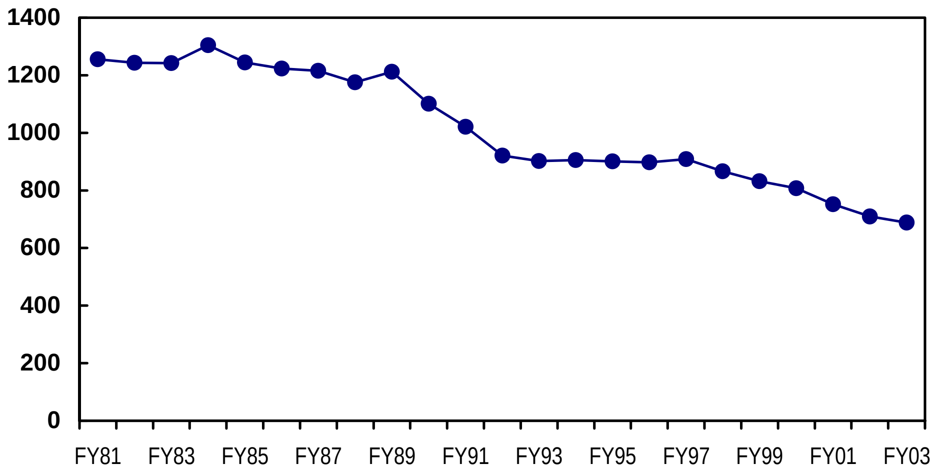
2. The industry is facing growing competition from overseas

3. The industry is disadvantaged in its tax treatment, both relative to other gaming in New Zealand and compared to race wagering in many overseas jurisdictions.

<u>Supply Of Local Racing Has Declined</u>

Wagering on overseas races and sports events has sustained racing expenditure over the past seven years. Wagering on local races has continued to decline, falling 4 per cent a year in inflation-adjusted terms since 1996/97. In 2002/03 the amount wagered on local races was just over half that in 1980/81 (Figure 4.4).

Figure 4.4: Racing Turnover From Local Races FY1981 To FY2003 ($ million, inflation-adjusted to 2003$)



Source: NZ TAB *Annual Reports*

The falling share of wagering that is on local racing has three disadvantages:

1. Wagering on local horse races makes a larger contribution (10.0 per cent) than does both wagering on overseas races (8.1 per cent) and betting on sports (mainly fixed-odds) that yields 7.3 per cent. The product mix has shifted somewhat to lower contribution and higher risk products

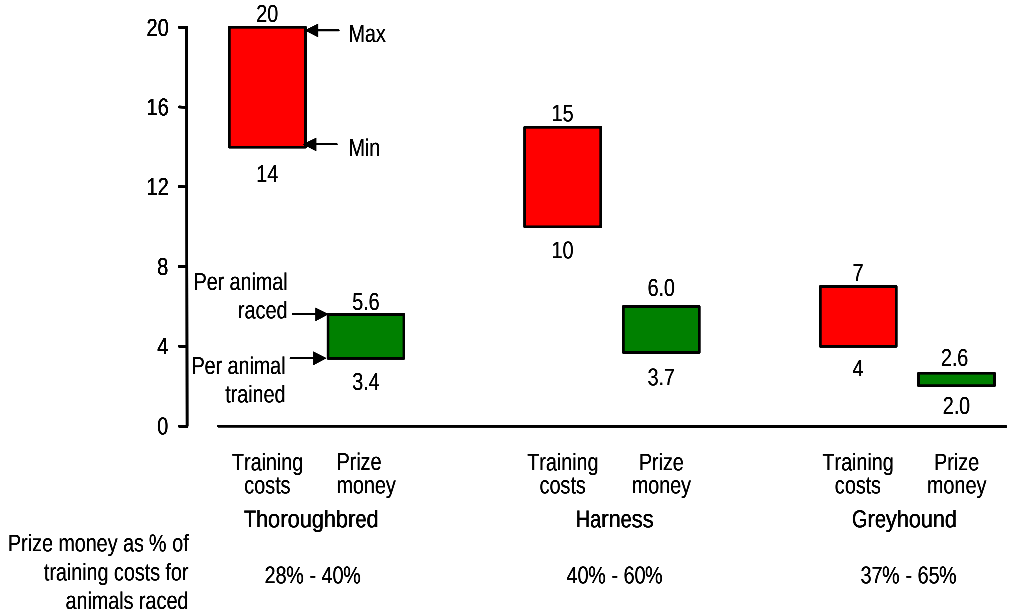
2. Wagering on local races better develops the local product and the pool for potential top class animals for domestic, Australasian and international competition and exports.

3. Wagering on overseas races, for example Australian and Hong Kong, is more vulnerable to capture by offshore gaming services e.g. New Zealanders betting through offshore bookmakers or agencies by telephone or the Internet.

Falling Horse Numbers. A key factor in the fall in wagering on local races has been a decline in the betting opportunities available, especially in thoroughbred racing. The number of thoroughbred horses raced has fallen 15 per cent from 1994/95 to 2002/03 (from 6,426 to 5,469) and the number of thoroughbred races run has fallen by almost the same proportion (from 3,254 to 2,810). The number of standardbred horses raced has declined 8 per cent since 1994/95 though the number of races is little changed.

Behind the declining horse numbers is the large losses that most horse owners incur: the average prize money a thoroughbred horse earns is in the order of a quarter to a third of the average cost of keeping and training a horse (Figure 4.5), not allowing for a return on the purchase price. Most horse owners subsidise the racing industry but the level of losses they are willing to carry, especially among thoroughbred owners, is being severely tested and is declining. The changing composition of who owns horses is reinforcing this shift.

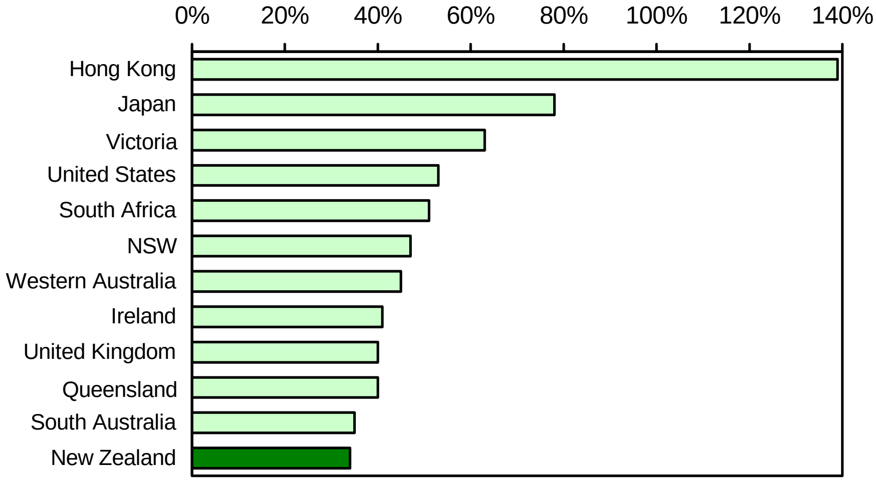
Figure 4.5: Annual Training Costs And Prize Money ($000)



Source: *Size and Scope of New Zealand Racing Industry*; NZ Racing Industry Board *Annual Report 2002-03*

Nearly all of the money returned from wagering to the New Zealand racing industry is used for prize money. That is the horse owner's principal source of revenue from racing. The proportion of keeping and training expenses that is covered by prize money won is lower in New Zealand than most countries (Figure 4.6). Previous studies and international comparisons clearly suggest that an increase in prize money is required to increase the number and quality of horses raced, that in turn increases bettor interest and leads to bigger race pools, and that increases returns to bettors, creating a virtuous cycle. Presently the New Zealand racing industry runs the risk of being caught in a downward cycle, while on the other hand, an improvement in economics will see a stabilising of horse numbers and most likely an increase in the quality of the breeding stock.

Figure 4.6: Percentage Of Keeping And Training Expenses Covered By Prize Money Won, Per Horse Having Run

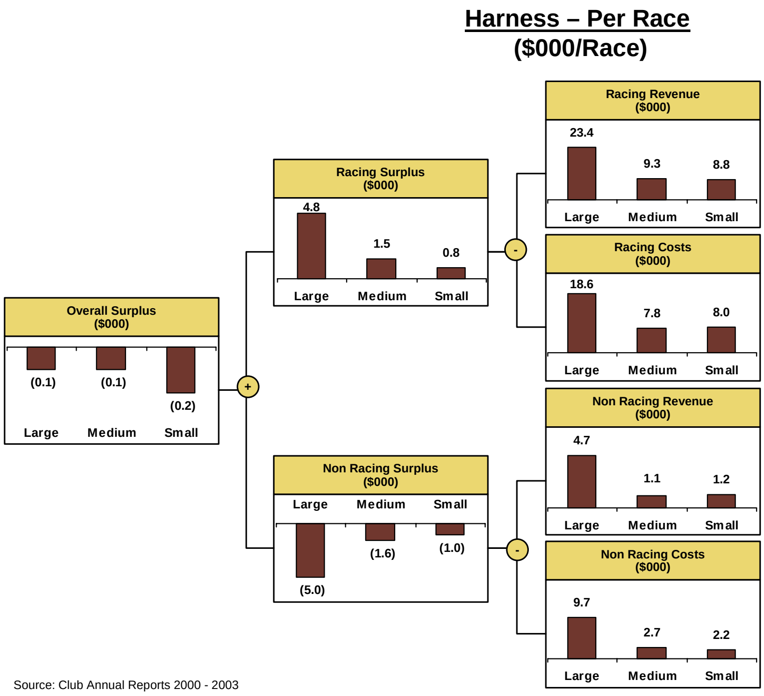


Source: Racing Victoria *Annual Report 2003*; British Horseracing Board; Horserace Betting Levy Board (UK); Horse Racing Ireland; International Federation of Horseracing Authorities

Poor Race Club Profitability. The different parts of the racing industry come together at the race club level. Race meetings create much of the demand for breeding and training and provide the showcase for racing animals and the product for wagering on the TAB.

There is large variability in the financial performance of race clubs, but over 53 per cent face major financial challenges, and that proportion would be higher still were it not for voluntary workers. Approximately 40 per cent of race clubs have negative operating cash flows and that includes clubs of all sizes. The weak financial position of many race clubs means that there is inadequate investment in key infrastructure assets and, in many instances, those assets are declining in quality. Figure 4.7 provides comparative performance across a sample of harness racing clubs. The picture is similar for greyhounds and more dramatic for thoroughbreds given the relative asset intensity of the codes.

Figure 4.7: Comparative Harness Club Financial Performance



Club Category ($000)	Large	Medium	Small
Industry + On course income	15.6	7.7	7.4
Sponsorship	2.3	1.2	1.1
Entries and Acceptances	0.8	0.1	0.1
Admissions	4.6	0.1	0.0
Other (Misc)	0.2	0.2	0.1
Stakes	14.1	5.7	5.6
Race day services	0.5	0.7	0.7
Advertising and Promotion	1.8	0.3	0.4
Race meeting wages	1.0	0.5	0.5
Other (Racebook, levies Misc)	1.2	0.6	0.8
Membership	0.3	0.1	0.1
Rent	2.3	0.2	0.2
Investment income	0.4	0.2	0.4
Grants and Donations	0.0	0.1	0.3
Other (Misc)	1.7	0.5	0.2
Administration	3.3	1.1	1.0
Property	0.9	0.3	0.2
Depreciation	2.2	0.2	0.1
Other (Interest, Prof, Misc)	3.3	1.0	0.9

Source: Club Annual Reports 2000 - 2003

<u>Growing Competition From Overseas</u>

The industry is facing growing competition from overseas. Through the ubiquity of the Internet and new mobile telephone technologies, New Zealand bettors can by-pass the New Zealand TAB and wager offshore on New Zealand racing and racing in many other countries, as well as on other gaming activities. This growth in cross-border wagering — coupled with the growth of other gaming activities within New Zealand — has eliminated any remnants of economic monopoly that race wagering had. Moreover, the industry is not well positioned to respond to offshore competition. A comparison with key overseas jurisdictions and distribution channels confirms that New Zealand has a relatively high take-out rate (as is necessary to deliver on its objective of supporting the industry), a high taxation rate, and a lower than expected proportion of take-out distributed back to the racing industry. These issues are discussed more fully in Section 7 and the attached review of *New Zealand's Competitiveness In Global Wagering*, undertaken by Applied Industry Analysis Limited, November 2004.

<u>Taxation Burden</u>

The tax paid on race wagering, compared with competing forms of gaming, is also a burden, particularly given the overall poor financial health of the racing industry. An accompanying KPMG report concluded that New Zealand racing is over-taxed compared with other gaming activities given its regulatory requirements to develop a strong racing industry. Also, the take-out rate for racing is uncompetitive with gaming machines and casinos, reflecting the different objectives and business model of each industry. Further, the determination of tax on the basis of gross profits has squeezed the funds available to the industry as the net cost of wagering has increased.

The taxation regimes for each of the four main types of gaming are as below:

TABLE 4.1: TAX AND DUTY PAID 2003[6]

	Racing	Casinos	Gaming machines	Lotteries
Total wagered	$1,129m	$3,805m	$7,845m	$540m
Winnings paid	$911m	$3,348m	$6,904m	$301m
Gross profit	$218m	$457m	$941m	$239m
Gross profit margin (Take-out rate)	19.3%	12.0%	12.0%	44.3%
Operating costs	$165m	$347m	$320m	$78m
Operating costs as % of gross profit	75%	76%	34%	33%
Net profits	$53m	$110m	$621m	$161m
Tax base	Betting profit	Casino win	Machine profit	Tickets sold
Gaming duty rates				
% of tax base	≈17%	4%	20%	5.5%
% of total wagered	3.3%	0.5%	2.4%	5.5%
Gaming duty collected	$37.4m	$18.3m	$188.2m	$29.7m
Problem Gambling Levy rates	0.57%	0.51%	1.11%	0.14%
Income tax position	Not subject to	33% tax	Not subject to	Not subject to

Source: KPMG. 2004. *New Zealand Racing Board Tax Review*.

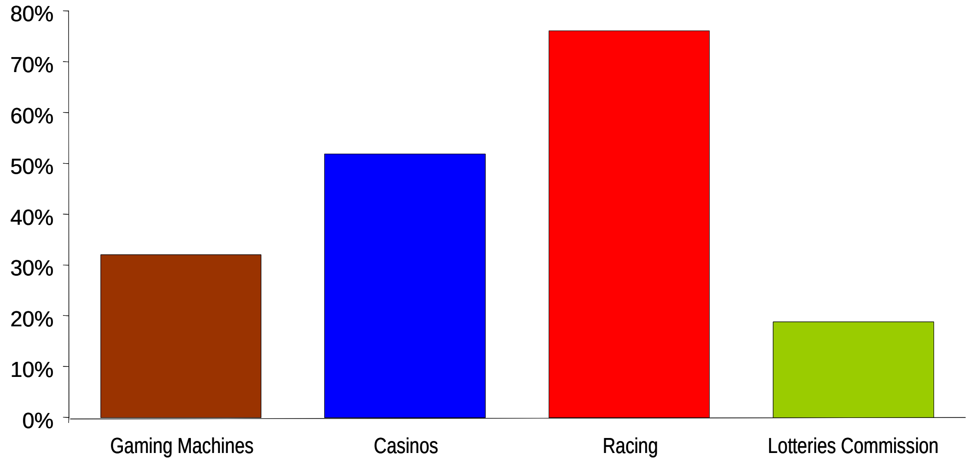
Comparing Taxes Across Gaming Types. The tax regimes applying to gaming operators vary and so comparisons are not easy. To remedy this difficulty, KPMG in their analysis:

[6]To be as relevant as possible, the table incorporates the Problem Gambling Levy which did not come into effect until October 2004

- Used actual operating data provided to calculate actual tax percentages
- Applied the actual tax percentages to a standard $100 bet to calculate the tax burden for each sector across varying levels of operating costs
- Varied this calculation by applying a standard payout percentage to illustrate the effect of different payout ratios on the tax burden
- Applied actual payout percentages and actual operating costs to determine the relative tax payable as a percentage of net profit, and
- Applied the casino model of taxation to the racing industry data so as to directly compare the two.

This analysis shows a much higher tax burden as a proportion of net profit (before tax) for racing than for the other three types of gaming. In calculating net profit, the payments by the Racing Board to the racing codes are treated as deductible because they are payments for the racing product, without which there would be no race wagering.

Figure 4.8: Actual Operating Costs And Prize Return – Duties And Taxes As Percent Of Net Profit

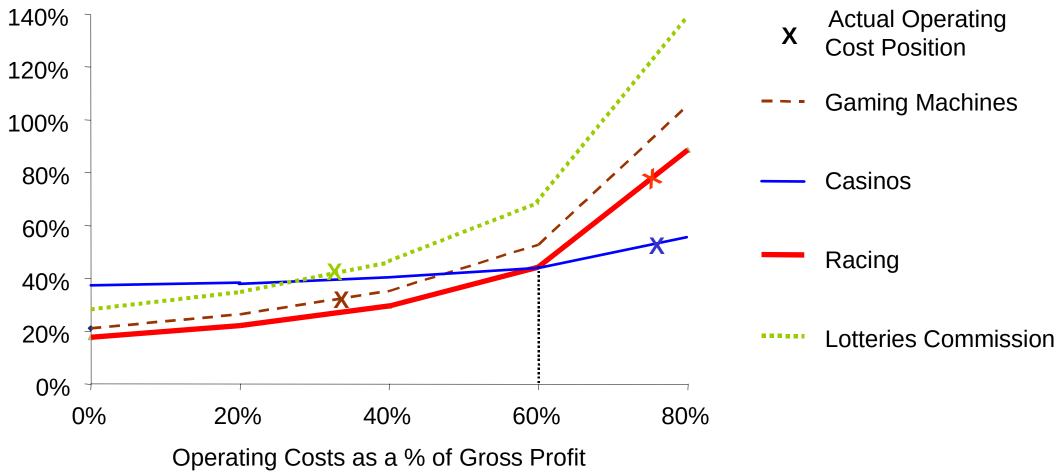


Source: KPMG. 2004. *New Zealand Racing Board Tax Review.*

KPMG looked at how the tax position was affected by alternative operating cost percentages and standardization of the take-out rate.

Alternative Operating Costs. KPMG calculated the actual duties and levies and potential income tax payable for casinos across a range of operating cost percentages, as plotted below:

Figure 4.9: Duties And Taxes As A Percent Of Net Profit – Actual Gaming Returns



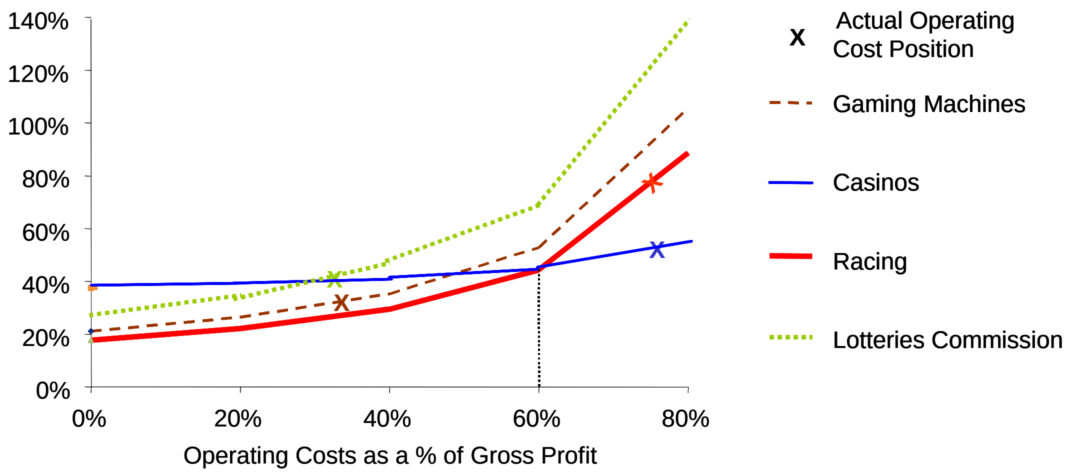
Source: KPMG. 2004. *New Zealand Racing Board Tax Review.*

For any rate of operating costs above about 60 per cent of gross profits, racing has a higher tax burden as a percentage of net profits than do casinos and the gap widens rapidly. The inherently low operating costs for gaming machines and lotteries means that for any realistic range, a higher proportion of racing net profits would go to taxes than would be the case for gaming and lottery net profits.

Application Of A Standard Payout Ratio. Except for lotteries, the tax base on which gaming duty is paid is the gross profit and so the amount of duty payable will be less in an activity where more is paid out in winnings. KPMG calculated the amount of duty and taxes payable, assuming a standard take-out rate of 20 per cent (i.e. 80 per cent of total wagering paid out in winnings). Again, for all realistic ranges of operating costs, the tax burden of racing relative to net profit, is the highest (Figure 4.10).

KPMG observe that one reason for the high taxation of racing is its lower payout. The low payout is a function of the high costs of delivering the racing product and the duty paid does not take account of those high operating costs, being calculated on gross profits.

Figure 4.10: Duties And Taxes As A Percent Of Net Profit – 80% Payout Rate



Source: KPMG. 2004. *New Zealand Racing Board Tax Review.*

Also, the determination of duty on the basis of gross profits has been especially inequitable for the racing industry since 1995/96. The TAB has been relatively successful in maintaining racing expenditure (gross profits) in the face of greatly intensified competition. To do so, though, it has had to incur significantly higher costs. As noted above, racing expenditure in real terms has grown by 6 per cent over the eight years but TAB operating costs have increased by 28 per cent. The burden of those higher costs to generate the gross profit and thereby the tax pools are all carried by the racing industry.

The comparison of tax positions among the different types of gaming threw up some other observations on the take-out rate.

The take-out rate is a determinant of the attractiveness of different forms of gaming to a significant number of punters. The take-out rate for race wagering is over 19 per cent compared with 12 per cent for casinos and gaming machines. That is a sizable difference and will explain in part the much larger market shares for casinos and gaming machines than for racing.

The NZIER in its modelling work for the NZRB, looked at the degree of substitution among alternative types of gaming. The overseas literature suggests there is some substitution. NZIER's model found that the level of expenditure on non-racing gaming had a material effect in the long-run on race wagering but not in the short-run.

There is probably more actual and potential switching among gaming types than econometric modelling can capture:

- When gaming machines and casinos were first introduced into an area, there would be a displacement effect on racing. People had choices that did not exist before
- With the current very large gap in take-out rate between racing and casinos/gaming machines, the small variations in racing take-out rates since 1995/96 would be of little consequence.

Finally, it should be kept in mind that modest changes in casino or gaming machine expenditures are much more significant amounts for racing. For every one per cent of casino expenditure that racing is able to (re-)capture, racing expenditure would increase by 2 per cent; for gaming machines, the corresponding figure for racing is four per cent. So if the TAB was to take 5 per cent of the gaming machine market, racing expenditure would jump 20 per cent.

The Need For A Rapid Response

In the view of the NZRB, the industry has a window of opportunity to turn performance around or face serious decline. That window is created by the reforms to the industry introduced in the Racing Act 2003, the strictures placed on casinos and gaming machines by the Gambling Act 2003, and in advance of further rapid growth in cross-border betting detailed in Appendix A.

The anticipation of a serious decline in the industry may seem a dramatic conclusion, however there is mounting evidence that this is a likely case. A few relevant indicators are:

1. The decline in thoroughbred broodmares served from 7,300 in 1999/2000 to approximately 6,600 today, with only an estimated 4,600 live foals on the ground in the current breeding season, equivalent to a 53 per cent available foaling ratio.

The imperative for the industry is to make it attractive for mares to be served to meet the needs of both the domestic market and the increasingly important Asian export market. This broodmare population and more importantly those who own it, will rapidly disappear from the industry unless the hope of increased returns becomes reality

2. The loss of skills at all levels of the racing industry. Indicative of this is the recent loss of top training professionals moving to Australia, Singapore and Hong Kong, following leading New Zealand trainers cutting salaries for economic reasons. More generally this is reflected in ‘family’ labour replacing third-party wages

3. The state of facilities and amenities across many New Zealand racing tracks is below standard. While further track rationalization will progressively occur, many tracks must be upgraded (on a prioritized basis), or the ability to attract and entertain patrons, which is essential for the industry to rebuild public participation, will further decline.

In addition to these economic realities, the industry is eagerly looking for leadership and evidence of improved performance, especially given the new organisational arrangements, which reflects the government’s commitment to the industry. Culturally the industry participants are moving from being inward-looking to being outward-looking and the “finger-pointing” across organisation boundaries is declining. However, it will not go away until there is confidence in the future and direction of the industry.

Conclusions

The New Zealand racing industry is facing similar challenges to many traditional sports and entertainment industries. Consumers now have a multitude of choices and demands on their discretionary time and spending. New technologies have evolved to provide new distribution channels to those wanting to wager on races, thereby reducing the need for a ‘close experience’ of the product, and accordingly racecourse attendance has declined, certainly on a regular basis. At the same time, other forms of wagering and gambling have arrived and the racing industry has lost any monopoly position.

These issues are well known and are being faced by many other sporting organisations. New Zealand Rugby, New Zealand Cricket, the National Rugby League and the Australian Football League are a few local examples. However, the challenges for New Zealand are always greater because the domestic population base is less and the economics often at the lower end of global comparisons.

The challenge then for the New Zealand racing industry can succinctly be stated as one of presenting a competitive and efficient product not only locally, but also internationally, as is highlighted in some of the following sections.

Industry initiatives to counter these challenges include:

- Enhanced product presentation to grow participation
- Greater internationalisation of the product
- Improved performance and efficiency of the industry.

Again, these issues are not unique to New Zealand racing, although they are probably more intense given the comparative factors. It is interesting to note that similar improvement plans exist in Great Britain, Ireland, Australia, the United States and Hong Kong and are captured in the aspirations of these organisations. For example:

> *'To develop and provide Ireland as a world centre of excellence for horse racing and breeding'*
>
> \- Horse Racing Ireland

> *'…we will build on Britain's reputation for providing to our customers the most exciting and competitive racing in the world, run to the highest integrity standards, as efficiently as possible'*
>
> \- British Horseracing Board

The New Zealand racing industry has been aware of these challenges for some time but organisationally has been constrained in its ability to address them in a coordinated manner. The formation of the New Zealand Racing Board and the new industry arrangements provide the opportunity of enhanced industry performance through a multi-pronged programme involving the Board, the codes, the clubs and the other key stakeholders.

These programmes, summarised in Section 6, will move the industry forward but its fundamental competitiveness will also depend on the implementation of a competitive taxation regime. Section 7 discusses how new technologies have internationalised wagering flows and increased the importance of global product competitiveness.

In summary, the challenges for the industry are clear, as they are for other international racing industries. However for New Zealand they are often more acute. The new industry arrangements facilitate a more concerted approach to the three challenges that the industry has under its control — domestic product presentation, internationalisation and industry efficiency — and as will be argued, a restructured taxation regime will provide the fourth initiative. Between them these four initiatives form a coherent package (as opposed to a menu from which to pick and choose) of actions that can take the industry forward both domestically and internationally.

When the four initiatives are put in place the Board is confident the racing industry will improve its performance both as a significant source of economic activity and an increasing contributor to exports.

5 Funding Levels Required To Generate A Sustainable Industry

It is not a simple matter to determine exactly what is required in terms of financial returns to the racing codes, and therefore to clubs, owners and employees, in order to build a strong racing industry. However, estimates can be made through two different lenses: one is comparisons with racing in Victoria (Australia) and the other is modelling work undertaken for the NZRB by the NZ Institute of Economic Research (NZIER).

Comparison With Victoria Racing

The Victorian racing industry has turned itself around since the mid-1990s, having faced many years of decline as the New Zealand industry has. Although Victoria has the benefit of significant gaming machine income, using Victorian output measures as a guide to what a healthy New Zealand industry could look like, suggests:

- Returns to owners would increase from under 40 per cent (currently $60 million) in New Zealand to the level of 65 per cent as in Victoria. (The industry in Victoria is looking to raise these returns further)

- Capital expenditure (including repairs and maintenance) would be lifted to at least twice the current level of depreciation i.e. an additional $10 to $15 million per year

- The take-out rate would be reduced by 2.7 per cent on $300 million of wagering or approximately an additional $8 million paid out to wagerers on domestic win & place and quinella for New Zealand races not shown in Australia. The proposed co-mingling initiative with Australian TABs will look to align take-out rates on shared product

- Industry operating costs in New Zealand are already more competitive than Victoria and both industries have plans for further improvement.

To reach similar levels as the Victorian racing industry, the New Zealand industry would need to add $56 to $61 million per annum to its current total industry payments of $79 million in today’s dollars.

Estimates by NZIER

To estimate the impact of the reinvestment of funds into the racing industry, NZIER was engaged to undertake modelling of economic outcomes under different scenarios. The NZIER report is discussed further in Section 8 and their full report is appended to this main report.

The NZIER modelling concluded that increased funds in the order of $34 million a year (what is referred to as Option 4A) provides an improved economic outcome for the industry and New Zealand as a whole, boosts the number of race starters and therefore foal numbers, and leaves the total taxation take for the Government virtually unchanged, albeit more of the tax revenue comes from upstream (producing racing animals) than downstream (betting duty) sources. Of this $35 million, $7 million was assumed to be returned to punters in the form of better odds, with the balance used to increase returns to horse owners. No allowance was made here for capital investments as the model did not consider the sustainability of infrastructure investment.

Implications

Combining these two different perspectives, then a reasonable estimate of the improved industry returns necessary to deliver a healthy and growing racing industry would be:

Increased return to wagering:	$7-8m
Minimum increased return to owners:	$28-38m
Capital investment funds:	$10-15m
Total:	$45-61m per annum

As will be discussed below (Section 6), this improvement in performance will require a number of initiatives that the industry will deliver. However, these industry initiatives will take upwards of three years to come to fruition and will not be sufficient in their own. The NZRB does not believe the industry can afford this wait and gradual build-up, nor does it believe it can get there on its own. The remainder of this report will discuss the required industry initiatives and the request for Government input to help achieve the improvement targets.

6 Industry Plans For Lifting Performance

On a number of measures, the New Zealand racing industry has been static and in some key areas such as local wagering turnover and thoroughbred horse numbers, it has experienced significant declines. Among the pressures on the industry are increased competition in the domestic gaming market and totally new forms of competition from overseas. Inadequate funds are flowing back from race wagering to sustain the racing clubs and the horse breeding and training industries and accordingly, this is putting at risk the economic contribution and potential of the industry.

In the face of these pressures, the New Zealand racing industry is acting to lift its operating performance. It is also growing the entertainment dimension to racing and increasing the attractiveness of racing horse ownership, in order to improve the participation rate i.e. the proportion of the population involved in the racing industry in some form or other (e.g. meeting attendance, horse ownership, or off-course wagering).

To this end, a detailed 3- to 5-year plan to lift the performance and efficiency of the New Zealand racing industry has been developed and presented to the industry stakeholders. This plan is in addition to the improvement plans outlined by the three racing codes. The NZRB plan includes both revenue and cost opportunities and draws upon significant benchmarking with like and competing organisations internationally.

In developing these improvement programmes, a wide range of radical options were considered including substantial industry downsizing; the relocation of wagering activities offshore; and the like. At the extreme, wagering could be offered on virtual ('electronic game') races, as some overseas operators now do, or the bulk of the wagering product could be race rights purchased from overseas. However, while these options might create a more efficient <u>wagering</u> business, they simply do not deliver on the need and desirability of developing further a broadly-based, internationally competitive racing industry in New Zealand. Rather, there would be a significant contraction of breeding, upkeep and training businesses, as well as of racing clubs.

Accordingly the three main initiatives to be pursued are:

(i) performance improvement
(ii) an enhanced entertainment proposition
(iii) internationalisation of the race wagering product.

Performance Improvement

The focus here is lifting the performance of the industry through cost, product and channel initiatives that fall directly under the Racing Board, along with a significant number of initiatives within the racing codes and across the racing clubs. Key measures are detailed in Figure 6.1 below.

Preliminary benchmarking versus Australian operators suggested that opportunities exist to reduce compressible costs, though there are unique factors in the New Zealand situation. There are also clear opportunities to align promotion behind different wagering products[7], increase the understanding of the offering by the public, and enhance product competitiveness. More effective channel[8] strategies are particularly important as market research undertaken during the Economic Impact Study indicated the potential to improve the retail, agency and social channels to provide a more appealing experience.

In addition there are a large number of initiatives that the Board and the industry can undertake in an increasingly coordinated manner to introduce cost and asset efficiencies. The 2004 New Zealand Thoroughbred Industry initiative to integrate local race clubs into regional 'Racing Clusters' is an example of these initiatives.

[7] The race wagering product can be defined in a number of ways e.g. the code (thoroughbred, harness, greyhound; both local and overseas), the types of wager offered (win/place, double, trifecta, etc), race mix (prize money, horse quality, etc) and the racing calendar (number of meetings, day of week, etc)

[8] The channels are the different ways in which customers wager with the TAB and include branches (the traditional TAB outlet, owned by the TAB), agencies (operate under contract to the TAB but are accountable for profit and loss), socials (TAB outlets in recreational settings such as hotels and clubs), telephone betting (both operator and touch phone), the Internet, and interactive TV

Figure 6.1: Examples of Performance Improvement At NZRB, Code And Club Level

Major Initiative	Support Initiatives
Cost efficiencies	• Address compressible costs • Move to lower cost channels • Enhanced use of technologies • Remove administrative duplication and inefficiency
Product enhancement	• Wagering product development, including simplification and education • Race mix review • Increase starters per race • More effective brand development and positioning
Channel strategies	• Upgrade retail • Review portfolio of social outlets • Continue to develop new channel technologies • Enhanced customer relationship management
Enhanced industry performance	• Increased sponsorship • Advertising and promotion • Increased sharing of industry facilities • Improve industry processes and management standards • Training and upskilling of industry participants • Increase sources of other income • Enhanced industry calendar and funding arrangements • Performance benchmarking of racing clubs

Enhanced Entertainment Proposition

The focus here is improving the entertainment proposition by providing and promoting a clearer and more attractive consumer offering; driving at increased attendance, primarily at Carnivals and Picnic meetings; and delivering a consistently high standard of facilities and services.

To compete more effectively in the entertainment sector, racing has significant potential to enhance its presentation to its target segment. For example, market research has shown that 800,000 New Zealanders 19 years or older (34 per cent of existing non-NZRB customers) think that racing is enjoyable and exciting. Similarly, customer perception studies indicated that six times as many customers and non-customers said they would prefer to own a share of a racehorse than own it outright, showing that there are many people interested in some form of participation. Similar opportunities have been identified by like international surveys.

Finally, the research indicated that racegoers are generally satisfied with much of the horseracing product but have major issues with the quality and value-for-money of the food and beverage offered and the facilities in which it is served.

This and other extensive research has led to a number of opportunities for improvement in the quality of the entertainment proposition as outlined in Figure 6.2.

Initiatives in this area have already commenced with several new features introduced at the recent highly successful Hawkes Bay Racing Spring Carnival and the revamping of Trackside. Planning is also underway on all other initiatives.

Figure 6.2: Examples Of Enhanced Entertainment Proposition

Major Initiative	Support Initiatives
Clearer consumer proposition	• Carnival, picnic event promotions • Focus on creating events • Increased wagering education • Strengthened problem gambling disciplines • Trackside TV revamp
Enhanced participation	• Programmes to attract people on course • Ownership drives • Club 'frequent flyer' schemes
Better facilities and services	• Selected facilities upgrade • National food, beverage standards • Mobile facilities, ie marquees, big TV screens

Steps To Internationalise The Product

Further internationalisation of the racing product includes increasing New Zealand's international participation as a Tier 1 racing country through product (races and animals) import and export, and co-mingling of wagering pools with Australia.

Section 7 below and Appendix A discuss the competitiveness of the New Zealand industry in a global context and highlight the internationalisation of racing and wagering and the increased competition with other first-tier racing nations. New Zealand must participate in this wider market to ensure its animals and races continue to have international significance. This is especially true given the ever-increasing strength of Asian racing and the emergence of China as a major thoroughbred racing nation.

To this end, the New Zealand TAB buys race rights from overseas to allow wagering on them and is looking further afield to import races that have relevant New Zealand interest and/or are world-class events. At the same time New Zealand races are being broadcast to Australia. This again reflects the 'Trans-Tasman nature' of the business from an owner's perspective with racing schedules often being mapped out for both horses and dogs to include races on both sides of the Tasman.

To enhance the attractiveness of such events to particularly New Zealand punters, the New Zealand TAB is entering into co-mingling agreements with offshore totalisator operators. Co-mingling of pools is the process where one totalisator organisation combines its betting pool with one or more other operators and thereby aligns the take-out rates with the 'host' system.

The most significant impact for New Zealand punters (and international punters wagering on New Zealand races) is the larger pool size that results from co-mingling. This reduces the volatility of the pool, giving increased confidence to the more sophisticated or larger punters that their bet will have less impact on the final dividend[9]. As a result, part of the incentive to place bets offshore will be removed and the initiative also places NZRB in a more favourable position to export New Zealand racing product to other jurisdictions by establishing instant 'liquidity' in the offshore jurisdictions.

An Irish Comparator. It is interesting to note that the combination of initiatives outlined by the NZRB are broadly consistent with similar initiatives adopted by other first-tier racing countries, for example Ireland (Figure 6.3).

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[9] Under the pari-mutuel system where all bets on a race of the same type are placed in a common pool, if that pool is small, then making a large wager will significantly reduce the odds for the outcome wagered on

Figure 6.3: Horse Racing Ireland's Goals

	Example
1. FUNDING	**• Sponsorship up 5% • Other revenue up 20% • Costs of administration– best practice**
2. RACECOURSES	**• Attendance up 15% (including Leopardstown/Nawan targets) • Racegoers' database • Oncourse better • New owners up 1,000/year**
3. INTEGRITY	**• Improved Bookmakers Code**
4. PRODUCT DEVELOPMENT	**• Prize increase to€60m • Owners' entry fees down • Set percentage of black type races**
5. TOTE	**• Multiple tote - Turnover, profit, new channels up - Client accounts up - Expenses reduced from 13.5% to 10% of turnover**
6. BREEDING	**• Foal levy maintained • New markets; but keep foal population static**
7. INFORMATION TECHNOLOGY/ MEDIA	**• Data licensing • Satellite TV**

Implications

The net result for successful execution of these short-term improvements in the next three to five years is in the order of $20 to $35 million, thereby increasing industry returns by approximately 33 per cent and so delivering net industry payments greater than $100 million.

(a) *Improvements To NZRB Performance: Years 3-5 Impact*

Source Of Value	Incremental Contribution ($m)
Enhance product mix	3-4
Channel growth	5-8
Cost efficiencies	2-3
	10-15

(b) Industry Initiatives: Years 3-5 Impact

Initiatives	Outcome	Incremental Contribution ($m)
On course = entertainment Ownership/participation	Increased participation	
	• Thoroughbreds	6-10
	• Other codes	2-4
Performance benchmarking Venue Review	Industry efficiencies and revenue enhancement	2-4
		10-18

It is worth noting that since the formation of the NZRB, improvement programmes have commenced at NZRB, code and club level. Examples of these include:

At the NZRB level:

- Implementing professional business disciplines and practices
- Financial and operating improvements that have reduced costs and improved payout
- Product and channel improvements including Trackside, co-mingling and restricting the growth of imported product
- Strategies to revitalise the race industry.

At code and club level:

- Enhanced business plans, ‘breakout’ consumer research and vision exercises
- A continuous drive for increased sponsorship and cost efficiencies
- Enhanced carnival marketing leading to record attendances at Hawkes Bay and Christchurch carnival weeks through combined marketing

- Ongoing initiatives to develop regional clusters — e.g. the Thoroughbred Racing Action Consortium (TRAC) in the Central North Island and the Northern Harness Grouping based on Alexandra Park — which are the racing equivalent of Rugby's 'Super 12'.

Finally, two important observations can be made on the projected improvements:

(i) First, given the need to turn the racing industry organisation around from what has been three years of 'interim' management, investments will exceed returns in year one and improvements will not flow to the bottom line until year two and beyond. To assist in accelerating these initiatives the NZRB is looking to inject $10 million from reserves into those industry initiatives with the greatest impact

(ii) Second, the lower range of the estimates above is more likely to be achieved as annual improved operating performance at the end of year three, with the upper range being a more realistic target for year four to five.

Conclusion

The two key conclusions from the industry improvement initiatives are:

(1) Industry initiatives are substantial (approx model, 50% of the estimated funding gap) but alone will not be sufficient to deliver the quantum of improvement required to build a sustainable industry

(2) The industry initiatives require time to gain momentum and there is the risk of the window of opportunity closing too fast.

7 New Zealand's Competitiveness In Global Wagering

It can be seen from the previous discussion on industry initiatives that no large increase in the profits from wagering is expected. The emphasis in these plans is foremost on stopping the loss of market share to other forms of gaming in New Zealand and to prevent further losses of wagering to offshore operators. The threats posed by the growth in cross-border wagering and the proposed actions to be taken by the NZRB in response are outlined here, drawing on a detailed discussion in the attached report by Applied Industry Analysis.

Worldwide, wagering on racing has traditionally been tightly regulated and highly taxed. Most countries organised (and still do) their race wagering on the pari-mutuel system and governments usually granted monopoly rights to the totalisator operator. Wagering occurred within national or state borders, and was clearly not part of the tradeables sector.

The rise of offshore betting and interactive wagering[10] has completely changed the competitive situation. Cross-border wagering is now common and is driven largely by different rates of betting duty and also the contributions that wagering operators make to the racing industry.

Evolution Of The Threat

Offshore betting began in the late 1980s and largely exploited differences among countries in the tax treatment of wagering. Bookmakers in some countries with low or no betting duties offered telephone betting to customers in countries with high betting duties, on races in the customers' country.

Offshore betting remained a relatively small market until the take-off of the Internet in the mid-1990s. The Internet is an ideal medium for wagering on racing. There is a large

[10] Interactive wagering on horse races encompasses betting by telephone (operator, touch tone and voice activated), Internet, interactive TV and 'wireless hand-held devices'

amount of intellectual property in the public domain (handicapping, race form, betting odds, race coverage) and the Internet allows the information to be easily accessed by an unlimited audience, and in real time when that matters.

More recently websites have emerged that compare the competitive odds of alternative wagering sites and lead the bettor to the best option. The growth in broadband further increases the attractiveness of the Internet for wagering, particularly for delivering race coverage. The Internet also facilitates wagering transactions against pre-established accounts and the efficient transfer of funds to and from accounts, including across borders.

What has given online wagering most credibility with bettors, is totalisator agencies and main-street bookmakers in first-tier racing countries, adding the Internet as another domestic channel through which to wager. Great Britain, Ireland and most states in Australia, also allow foreigners to bet on their websites. They also host wagering on races in other countries, including Australian TABs and corporate bookmakers offering Internet wagering on major New Zealand races.

Also, the Internet has allowed new forms of wagering to emerge, most notably betting exchanges. A betting exchange is a means by which individuals can wager on whether a particular event will occur or not. A horse race comprises a set of events, namely whether each horse wins or loses. The betting exchange assumes no risk: it is simply an intermediary whose income is a commission on the amount won, typically starting at 5 per cent and decreasing to as low as 2 per cent depending on the volume of betting. Betting exchanges are highly contentious in that they entail wagering on horses or competitors losing, not just winning, and that is seen as a threat to the integrity of the racing industry and participation in sports competition.

The current situation faced by the New Zealand TAB is that its customers are able to:

(i) Bet through an overseas agency or bookmaker on leading New Zealand races, a number of whom target the New Zealand TAB odds (i.e. guarantee their odds will always be better than the TAB's)

(ii) Wager on many of the overseas races carried by the New Zealand TAB, through an alternative operator

(iii) Wager on many overseas races not carried by the New Zealand TAB

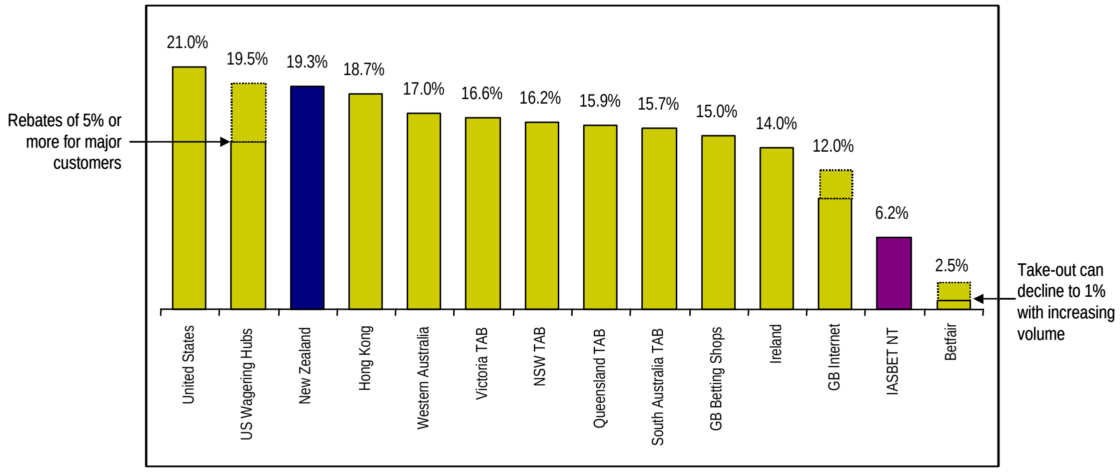
(iv) Bet on a large range of other gaming activities that are not available on New Zealand-hosted websites.

International Competitiveness

The growth of interactive gambling and the globalisation of wagering are major issues for racing authorities in all racing countries. There are numerous efforts to disrupt cross-border wagering but it has still grown rapidly. The traditional monopoly of race wagering in most jurisdictions no longer holds and the close integration of racing and wagering is breaking down. Take-out rates, the distribution of take-out, and cost structures, now have to be assessed in an international context.

The take-out rate (the amount lost by wagerers expressed as a proportion of the total amount wagered) is the price of betting in aggregate. For the serious and often large wagerer, it is the leading determinant of the attractiveness of different wagering jurisdictions or channels.

Figure 7.1: Cross-Jurisdiction And -Channel Comparison Of Take-Out Rates



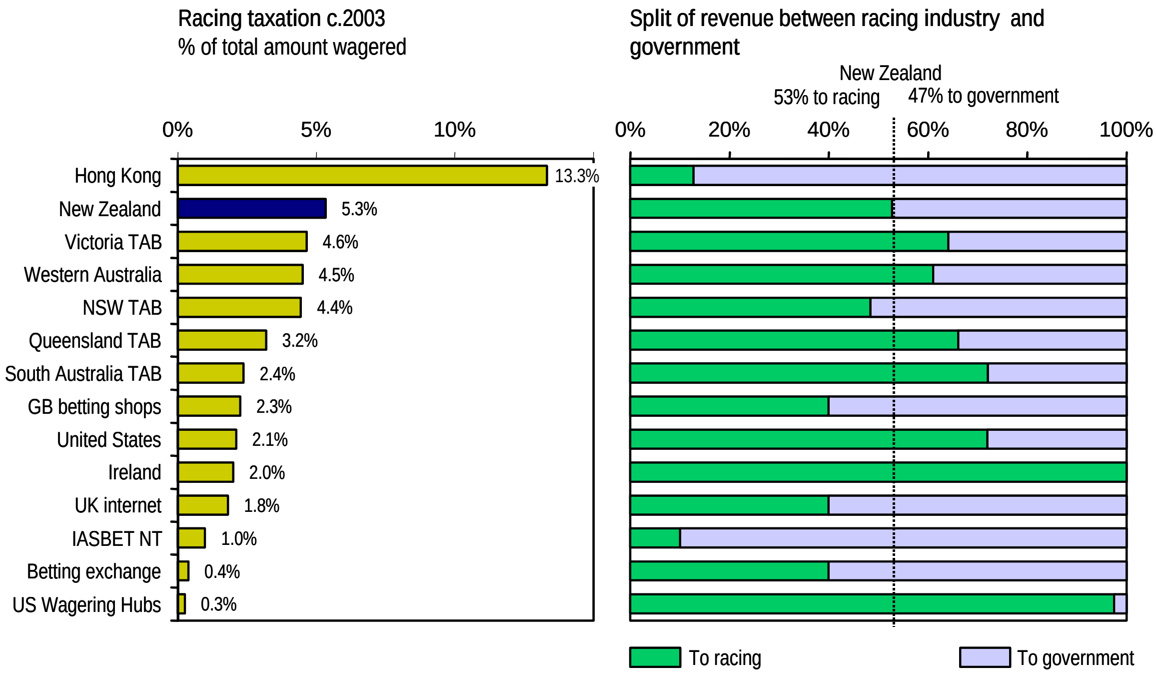
Source: Industry publications; Annual Reports

Among those racing jurisdictions and channels of particular relevance and/or interest to the New Zealand situation — TABs and corporate bookmakers in Australia; bookmakers in Great Britain and Ireland, both via retail outlets and the Internet; the UK's Betfair, the largest betting exchange; US race tracks and US wagering hubs; and the Hong Kong Racing Club — New Zealand is unfavourably positioned close to the top in terms of the take-out rate (Figure 7.1). From the wagerer's perspective, New Zealand is relatively expensive.

The take-out from race wagering is distributed among: (i) government, (ii) the wagering operator (TAB or bookmaker or betting exchange), and (iii) the racing clubs or racetracks and the horse owners. The tax paid on wagering is an important factor determining both the overall level of take-out and the level of funding available to the racing industry. Changes to the taxation of race wagering are commonly used in other countries in support of the competitiveness of racing.

Across 14 different jurisdictions/channels (Figure 7.2), New Zealand has the second highest taxation rate (as a proportion of the total amount wagered) after Hong Kong whose situation is unique because racing taxation there is the source of about one-tenth of the Government's revenues. In terms of the split between revenues going to the racing industry and to government (excluding any income tax), New Zealand has a smaller share than most other countries with a similar racing industry structure.

Figure 7.2: Cross-Jurisdiction And -Channel Comparison Of Take-Out Rates



Implications

Information on the growth in interactive wagering and the leakage of money from traditional wagering channels has to be pieced together but the picture presented in the Applied Analysis report attached, suggests that the amounts are substantial. New Zealand punters now have choices on how they wager on racing in New Zealand and on overseas races, whether the overseas races are broadcast in New Zealand or not. The close ties of New Zealand racing to Australia with its rapidly growing corporate bookmakers, the proclivity of New Zealanders to look overseas, and New Zealanders' high comfort levels with the Internet, all suggest that New Zealand may be among the leaders rather than the laggards in cross-border wagering. What is clear is the very rapid pace with which cross-border wagering is growing globally and the need to anticipate it and move proactively.

The Racing Board has agreed on a series of initiatives in response to the threat of cross-border wagering. These are:

(1) The NZRB cannot and will not compete directly with unlicensed wagering operators and offshore betting sites who generally provide no product payments to support the racing industry and operate in low-tax jurisdictions. New Zealand can achieve a premium over such operators and can develop and promote wagering products that they will have difficulty copying. However, this premium will never be sufficient to change the behaviour of the largest punters who will always follow the highest odds.

(2) The NZRB will continue to support regulatory responses that seek to control cross-border wagering, for example through active participation in the Asian Racing Federation and the International Federation of Horseracing Authorities. New Zealand is a signatory to the Asian Racing Federation's 'Good Neighbour Policy'.

(3) The TAB is looking to provide co-mingling of wagering pools with Australian TABs, to allow New Zealand-based punters the opportunity to participate in larger pools and enjoy the take-out rates available in Australia. The benefits of wagering through the New Zealand TAB to support the local racing industry will be actively promoted.

(4) Take-out rates for the remaining (i.e. those that are not co-mingled) domestic win & place, quinella and sports betting will be reduced to provide parity with other first-tier racing nations, particularly Australia. These moves will also improve product competitiveness with other forms of domestic gaming.

Conclusion

The rise of offshore betting and interactive wagering has completely changed the competitive situation. Cross-border wagering is now common and is driven largely by different rates of betting duty and also the contributions that wagering operators make to the racing industry.

The net impact of these industry initiatives outlined is not estimated to be a significant increase in wagering but more a stopping, or at least reducing, of the flow of wagering funds offshore. These offshore flows do nothing to contribute to the domestic racing industry or provide any taxation contribution to the Government.

8 Impact Of Increased Industry Competitiveness And Lower Taxation

The difficult situation facing New Zealand racing is – or has been – encountered by other leading racing countries with which we are increasingly competing. Australian states, Great Britain, Ireland, the United States and Hong Kong, for example, have either undertaken or are proposing the implementation of plans to improve the offering of their product and the tax regime within which their industry operates. There is a strong international trend towards the lower taxation of race wagering and in some instances, revenue from taxation is recycled back into racing.

In comparison with the above countries, New Zealand currently has the second highest taxation rate (as a proportion of total wagering turnover) behind Hong Kong, which has unique circumstances. In addition the New Zealand racing industry receives a smaller share of the revenue split than most other countries with a similar industry structure. Accordingly, it is very apparent in the view of the Taskforce that unless both of these issues are addressed, the additional funding needed to create a sustainable domestic industry and international competitiveness of the racing product, will be unattainable.

As outlined in Section 4, the tax treatment of New Zealand race wagering also places it at a disadvantage relative to other gaming activities in New Zealand. Measuring the tax burden of each gaming sector as a proportion of net (of operating costs and winnings paid to bettors) profit in order to provide a standard base, KPMG concluded that racing in New Zealand is overtaxed by comparison with other gaming sectors.

The NZRB Taskforce firmly believes an integral part of the pathway to enhanced performance, domestically and internationally, is a reduction in the taxation of race wagering in New Zealand.

Economic Modelling

As noted in Section 5, NZIER was engaged to assist the Board in assessing if a reduction in taxation, strategically applied, could produce an enhanced result for both the industry and the economy. The model and results are more fully developed in their attached report, *The Racing Industry — Growth and Taxation* but in summary, the approach used was to quantitatively examine the consequences of a reduction in the current tax rate applying to wagering on racing, for:

- The racing industry – numbers of animals running, employment, and value added
- Other wagering and gaming industries in New Zealand
- The level of economic activity in New Zealand as a whole
- The profitability of the TAB and of the racing clubs
- The Government's total tax take from gaming duty on all wagering and gaming and from additional industry sources of production, ownership and training.

The timeframe chosen for the modelling is a 'notional' five years because this is long enough for most of the likely impacts to have emerged, and short enough to be manageable and not require too many other changes to be modelled explicitly. It also assumed that the duty on race wagering was reduced by an amount currently equivalent to $30 million, being the difference between the current race wagering rate and the casino rate.

The model allows the following policy decisions to be analysed:

- Reductions in the tax rates on racing, lotteries, casinos, gaming machines, and sports in New Zealand and overseas
- Reductions in the TAB's take-out rates on racing and sports betting
- The allocation of reductions in local tax and take-out rates between:
  - improved odds (i.e. prices) for wagerers
  - increased marketing spending
  - increased prize money for horses and dogs raced, thereby influencing returns to owners and the number and quality of starters per race.

The calculations in the model require the following parameters to be set:

- Own- and cross-price elasticities for various forms of wagering and gambling
- The income elasticities for the various forms of wagering and gambling
- The elasticity of expenditure on various forms of wagering and gambling with respect to marketing expenditure
- The responsiveness of the numbers of runners to the level of prize money
- The responsiveness of the level of wagering to the numbers of runners.

Model dynamics. A drop in, for example, the gaming duty on racing allows the NZRB to determine how it could allocate the change in net revenue among the following alternatives:

- Improving the returns to punters i.e. lower prices
- Increasing prize money for animals raced
- Increasing expenditure on marketing
- Spending on enhanced infrastructure and amenities for patrons.

First Five Scenarios. The report considers five main scenarios (with variants on each) for comparison:

- Scenario 1A-B: The tax on wagering on racing is reduced and 100% of the reduction is returned to bettors in the form of improved payouts. In Scenario 1A the reduction in the tax is 100%, in 1B it is 48%, the reduction required to make the combined GST and Gaming Duty tax rate on racing equivalent to the combined tax rate on casinos.

- Scenario 2A-B: The tax on wagering on racing is reduced and 100% of the reduction is applied to increasing prize money for runners. In Scenario 2A the reduction in the tax is 100%, in 2B it is 48%, the reduction required to make the combined GST and Gaming Duty tax rate on racing equivalent to the combined tax rate on casinos.

- Scenario 3A: The tax rate on wagering on racing is reduced to the level of the combined GST and Gaming Duty tax rate on casinos and 100% of the reduction in taxation is applied to increasing expenditure on marketing.

- Scenario 4A-C: The combined GST and Gaming Duty tax rate on wagering on racing is reduced to the level of the combined tax rate on casinos and the reduction is applied in part to increasing the return to bettors and in part to increasing prize money. In Scenario 4A the split between increased returns to bettors and increased prize money is 20%:80%; in Scenario 4B it is 50%:50%; and in Scenario 4C it is 80%:20%.

- Scenario 5A-C: The tax on wagering on racing is left unchanged but the level of wagering and gambling rises because of the effect of a 5 per cent a year nominal increase in GDP over the five years. In Scenario 5A the income elasticity of wagering on racing is assumed to be 0.96, the short-term elasticity NZIER found in their econometric study. In Scenario 5B the income elasticity is 0.39, the long-term elasticity from the NZIER study, and in Scenario 5C it is 0.20.

Within the model, there are some conservative assumptions regarding factors that will influence the final performance of the industry. For example:

- The existing fixed-variable cost ratios of race clubs are used without account of enhancements through industry, code and club strategies

- A very low estimate of the amount of funds currently wagered offshore by New Zealanders

- The assumption of more races for the forecast increased number of animals could also be addressed by more animals per race and increased quality of animals available for racing

- The averaged assumptions with respect to marketing expenditure versus a well-segmented marketing approach

- The difficulty of modelling enhancements to racecourse and community assets.

These types of performance levers, when properly managed by the industry, will improve the results further. However, they do not detract from the clear conclusions from the NZIER report as presented.

Table 8.1: Racing, Economy-Wide And Taxation Impacts From Tax Reduction

Output	Variable	Scenario Outputs (Changes from base case)				
		2A	2B	4A	4B	4C
Racing Industry Impacts	Output ($m)	127.9	61.0	48.8	30.5	12.2
	Employment (FTEs)	1,200	570	460	290	110
	Value Added ($m)	41.5	19.8	15.8	9.9	3.9
Economy Wide Impacts	Output ($m)	509.4	243.0	194.4	121.5	48.6
	Employment (FTEs)	3,380	1,610	1,290	810	320
	Value Added ($m)	180.5	86.1	68.9	43.0	17.2
Impact on Total Tax Revenue	Direct Tax Loss ($m)	62.0[11]	28.6	28.7	28.9	29.0
	Value Added ($m)	180.5	86.1	68.9	43.0	17.2
	Indirect Tax Gain ($m)	59.6	28.4	22.8	14.2	5.7
	Net Tax (Loss) ($m)	(2.5)	(0.2)	(6.0)	(14.7)	(23.4)

Source: NZIER. 2004. *The Racing Industry — Growth and Taxation*

The key outputs of the report are summarised in Table 8.1 above, the implications of which can be summarised as:

- To increase the economic contribution of the racing industry and the New Zealand economy while maintaining the viability of the clubs and TAB, the model indicates the appropriate strategy is to use any reduction in tax to both increase prize money and improve the returns to bettors

- When the funds from a reduced taxation regime are applied strategically to the industry, the Government would see a healthier and more competitive industry and a similar level of taxation revenue as today. This is because the model estimates tax effects beyond the direct taxation of race wagering, also capturing the tax that flows from the greater contribution to the economy.

[11] Loss of gaming duty of $37.3m and GST of $24.8m; for the other scenarios no GST revenue is lost.

A full description of the models, scenarios and output are provided in the attached report.

However, we have argued strongly that the industry needs both industry and taxation initiatives to best position itself domestically and internationally. To this end we have modelled two additional scenarios where the amount reinvested in the racing industry is greater than the amount just from the reduced taxation rates.

Two Additional Scenarios: Tax Reduction and Enhanced NZRB Funding. Both of these additional scenarios are developed from scenario 4B and include reinvestment of both the tax reduction and the NZRB returns from enhanced TAB and industry performance.

Scenario 6A:

- Tax reduction equivalent to rate for casinos
- 50% of this amount applied to increasing the return to bettors
- 150% applied to increased prize money (i.e. includes enhanced returns from the industry)

Scenario 6B:

- Tax reduction equivalent to rate for casinos
- 30% of this amount applied to increasing the return to bettors
- 150% applied to increased prize money
- 20% applied to community facilities, marketing and industry development.

As can be seen, the dollars invested in the industry (represented by the increased percentages) are greater than the tax return, given investment from industry performance improvement initiatives.

The results from these further scenarios are outlined in Table 8.2 below:

Table 8.2: Racing, Economy-Wide And Taxation Impacts From Reallocation Of Tax Reduction And Industry Initiatives

Output	Variable	Scenario Outputs (Changes from base case)		
		4B	6A	6B
Racing Industry Impacts	Output ($m)	30.5	45.8	64.0
	Employment (FTEs)	290	430	600
	Value Added ($m)	9.9	14.9	20.8
Economy Wide Impacts	Output ($m)	121.5	182.2	255.1
	Employment (FTEs)	810	1,210	1,690
	Value Added ($m)	43.0	64.6	90.4
Impact on Total Tax Revenue	Direct Tax Loss ($m)	28.9	28.8	28.6
	Value Added ($m)	43.0	64.6	90.4
	Indirect Tax Gain ($m)	14.2	21.3	29.8
	Net Tax (Loss) ($m)	(14.7)	(7.5)	1.1

Source: NZIER. 2004. *The Racing Industry — Growth and Taxation*

Implications

The NZRB is implementing changes to the racing industry and seeking reforms to racing taxation that correspond most closely to Scenarios 6A and 6B summarised in Table 8.2. In these preferred options, the enhanced returns from the initiatives (set out in Section 6) that the racing industry is taking are reinvested in the industry, as are the additional funds available from a reduction in betting duty.

The NZIER findings also demonstrate that when funds from both industry improvements and tax reductions are applied to enhanced prize money and better returns to wagering — coupled with NZRB initiatives in marketing and targeted facilities upgrade — the result is improved industry performance and a comparable taxation take by the government from broader sources within the industry.

9 A Recommended Package To Transform Industry Performance

As developed in the previous chapters, the NZRB Taxation Taskforce firmly believes a balanced position can be reached between industry needs for enhanced funding and the potential funds available i.e.:

- Funding needs are estimated as:

– Improve payout for wagerers	$7-8m
– Increase in prize money	$28-38m
– Capital investments & facilities upkeep	$10-15m
	$45-61m

- Sources of increased funding are:

– NZRB improvements	$10-15m
– Other industry initiatives[12]	$5-9m
– Reduced wagering taxation[13]	Up to $34m
	Up to $49-58m

To achieve this result requires a partnership between industry and the Government. In particular the Government must be convinced that the industry improvements will be delivered and that a healthier, stronger industry, with increased contribution to the economy will result. However, there is a window of opportunity that will pass unless some form of increased funding is available in the near future.

To achieve a pathway forward, the NZRB Taskforce requests of the Government:

[12] 50% taken here as balance will go towards restoring club profitability
[13] Based on the current rate of duty applied to casinos

(i) A reduction in wagering duty to allow $25 million to be injected into the industry now, being year 1 of the improvement programme. An additional $5 million is assumed to be available from industry initiatives in the first year. This rises to upwards of $25 million as industry improvement programmes are implemented and deliver results.

(ii) That this reduced tax payment be applied, along with the projected improvements by the industry, to:

-	Increase in prize money	$17m
-	Improved payout for wagerers	$6m
-	Critical industry capital enhancements	$7m
	Total:	$30m

(iii) That NZRB and Government then work to a three year programme that, subject to positive performance on key industry parameters, allows the total package of industry initiatives and reduced wagering duty to be put in place i.e. the combined $50 million plus.

We believe that this quantum of additional funds, applied strategically and monitored as outlined in the following section, will provide the catalyst to set the racing industry on the pathway to enhanced performance.

The basis of allocating the funds and the monitoring mechanisms to deliver an effective application of the funds, are outlined in Section 10.

Allocation Of Funds And Monitoring Performance

As mentioned previously, betting duty on New Zealand racing was last changed in 1995, with the change taking effect in January 1996. The reduction was all passed through to the wagerer in higher dividends and the impact in the following year was approximately a $100 million increase in the total amount wagered. However, in the following years, the very large increases in casino and gaming machine opportunities limited further growth and the industry has had to run as hard as it could, just to stand still.

Therefore, it is an imperative for the Government and the industry that the new initiatives have a more significant and long-lasting impact. Three factors will determine the result and have to be managed as effectively as possible. These are the competitive market place; the allocation of funds; and the alignment of strategies across the industry. Each of these is discussed below.

The Competitive Environment. The competitive environment was different in 1996 than it is today. On the positive side there will not be the same explosion of domestic wagering alternatives given the stage of industry development and the restrictions laid out in the Gambling Act 2003. However, the challenges from wagering moving offshore are far greater today than in the past. Accordingly, it is important that the wagering customer in New Zealand is fully informed of the improved opportunities of race wagering in New Zealand (as per the TAB's plan) and the need to and benefits of, supporting the local racing industry.

The Allocation Of The Increased Funding. It is recommended that the increased funding goes into three areas — increased returns to horse owners, better returns to wagering, and capital enhancement programmes — and that this expenditure supplements the existing Board and industry programmes. Each of these areas of focus makes very good sense but it is important to ensure that within each of them, the increased funding is used as effectively as possible, i.e.:

- Increase Returns To Horse Owners
  - Means:

        - Implementing a prize money policy which balances between average returns to owners and percentage of profitable owners
        - Alignment with the codes' *Pattern of Racing* plans which are looking to build the competitiveness and entertainment value of New Zealand racing products
        - Aligning as far as is feasible, racing club, code, TAB and owner returns e.g. better horses and increased number of stakes; imported and exported product considerations
        - Considering prize money bonus schemes, which are proving very successful in Australia, and circuits versus across-the-board increases
    - Does not mean
        - Six $1 million races, or doubling the stakes for maiden races or similar extremes
        - Each sector of the industry working independently
        - Merely increasing the number of races.

- Better Returns To Wagering
    - Means
        - Reductions in take-out targeted to where we are competitively exposed
        - Application of the increased returns in a way that creates wagerer interest and is difficult for offshore bookmakers to match or exceed
        - Excitement in the message of communication
    - Does not mean
        - A diluted and virtually invisible reduction across the board,

- Attacking Critical Capital Works
  - Means
    - Prioritising a portfolio of opportunities i.e. alignment with regional clusters and the overall strategic imperatives of the racing facility
    - Balancing customer with industry needs
  - Does not mean
    - Equal distribution for all racing clubs/tracks.

Aligning The Industry. The new Act and its accompanying arrangements place the racing industry in a better position today to ensure alignment and therefore enhanced efficiencies of strategies and their funding.

The NZRB and the racing codes have agreed to work together in a collective process that will lead to coordinated code plans for the efficient allocation of increased funding by 1 April 2005 that will be based on having:

- Agreed the principles of increased stakes to meet the industry's objectives and the racing calendar that delivers the product
- Agreed capital programme priorities
- Agreed and prioritised other ongoing initiatives.

In turn the codes would work with the racing clubs to:

- Ensure best practice is transferred and adopted
- Quality assurance is enforced on meeting industry standards of product presentation and the prerequisites of increased participation
- Industry efficiencies and learnings are extracted.

The new Act does give the NZRB the power to ensure effective alignment of the initiatives through:

- Providing funding only to agreed and approved code plans
- Issuing racing dates.

While this power would be used if required, the renewed sense of purpose in the industry strongly suggests progress will be made without resorting to these measures. The industry is more united and integrated than prior to the new legislation and has a far greater chance of success than at almost anytime.

Finally, both the industry and the Government will be looking for clear evidence of the positive impact of the strategies. A preliminary list of measures by which to track progress are:

Indicator	Apparent In (Year)
Wagering turnover	More NZ-based wagering (2005/06)
Wagering turnover per race	More NZ-based wagering (2005/06)
Participation (on-course)	Attendances at key carnivals, picnic meetings (2005/06)
Participation (ownership)	Number of animal owners (2006/07)
Enhanced breeding statistics	Newborns (2007/08+)
Stronger fields	Number of runners per season (2006/07)
Increased industry margin	NZRB and industry costs and income (2005/06)
Improved asset efficiency	Further progress on clusters (2005/06/07)

A more comprehensive set will be developed by the end of March 2005. The NZRB will monitor and report these on a six monthly basis to the industry, and the Government, beginning 31 July 2005 and using the period to 31 July 2004 as the base case.

Finally, as outlined in the previous sections, the Taskforce believes that the Government is approximately tax neutral and avoids future tax losses from racing industry decline. In addition there are enhanced benefits to the broader New Zealand economy.

Conclusions

The NZRB is in no doubt that the situation is urgent and that the new Act will allow strategic and effective allocation of the monies. There is total agreement from the code Chairman on the need for a disciplined approach, facilitated by the NZRB, aimed at lifting the overall economic performance of the sector, an objective shared by racing industry leaders and in the interests of all New Zealanders.

11 Summary Of Recommendations

The NZRB Taskforce (in conjunction with the racing codes) recognises the need to boost the strength of the racing industry in New Zealand, to allow it to deliver on its domestic potential and realise its international competitiveness.

The industry has commenced improvement plans and believes they can have a significant impact. However, the plans will take time to come to fruition and will only deliver roughly half of the additional funds required to realise the full industry potential.

To achieve the full potential we believe we need to work in partnership with the Government, whereby Government reduces the duty rate for race wagering by the equivalent of $30 million a year. This would mean that the rate of betting duty for racing approximates that currently applied to casinos.

The NZRB strongly believes that there is a window of opportunity if we act now, while recognising the need for Government to ensure that additional funds injected into the industry are used to good effect. To this end the NZRB Taskforce requests the Government to consider a progressive reduction of the betting duty rate, beginning with an infusion of $25 million per annum into the industry as soon as is practical. This will be supplemented by industry funds and focused strategically to secure improvements in the areas of increased returns to animal owners, improved returns to wagerers, and critical capital programmes.

The Taskforce further believes that the new industry arrangements and powers will ensure this money is wisely spent and the result monitored and reported to Government. Given successful implementation of the initial programmes, the Taskforce requests that the Government, in year 3, would finalise the taxation position. This finalisation, along with projected additional industry returns, will put New Zealand racing on a strong footing to deliver on its potential both locally and internationally.

GLOSSARY

Bloodstock industry	Breeding of thoroughbred horses.
Bookmaker	An individual or company licensed to take fixed-odds bets on races, sports events, or a major event.
Expenditure	Total amount wagered less the amount returned as winnings i.e. bettor losses; equal to gross profits or take-out.
First-tier racing countries	Australia, France, Great Britain, Hong Kong, Ireland, Japan, New Zealand, Singapore, United States.
Fixed-odds betting	Bettors wage against the operator who assumes risk; the odds do not normally change in the course of betting on an event.
Gaming	A game of chance.
Gambling	The combination of wagering and gaming.
Gross profit	See Expenditure.
Multi-products	A single wager that crosses multiple events
NZRB	New Zealand Racing Board
Pari-mutuel betting	Where all wagers of the same type are placed in a pool from which dividends are paid, after an amount is taken out to cover costs; the odds offered continually change in the course of betting on an event
Percentage betting	A bettor pays a percentage of the price of a Trifecta, Treble, Pick6 or Six Pack in return for an equivalent percentage of the dividend; reduces the amount required to be wagered.
Prize money	The money paid to finishers in a race.
Racing codes	New Zealand Thoroughbred Racing (gallops), New Zealand Harness Racing Association (trotting), New Zealand Greyhound Racing Association.
TAB	The brand name of NZRB used for all betting activities.
Take-out	The percentage taken from the totalisator pool.
Turnover	Total amount wagered or bet
Wagering	A game of skill.