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## 20 Earmarking

### Box 20.1 Key messages

- About \$1.5 billion, or one third, of gambling revenues are earmarked for specific purposes.
  - Health services receive the majority of earmarked funds (\$1.1 billion).
  - Problem gambling related services are often funded through earmarking but the amounts are a small proportion of total earmarking (less than two per cent of the total).
- Budget funding is generally preferable to earmarking arrangements, because earmarking makes it more difficult for governments to set and reset funding priorities.
- However, earmarking for problem related gambling services, gambling research and community awareness campaigns is appropriate, since gambling has created the need for such services, which otherwise may not be adequately funded.
- Earmarking for other uses does not appear to have created widespread distortions to budget spending (although there are problems at the margin). However, it offers no particular advantages over budget funding and plays a dubious role in promoting some forms of gambling.

All governments, to varying extents, earmark (or hypothecate) part of gambling taxation to social programs. Earmarking has a long history in Australia and overseas. A number of lotteries were established in Australia in the 1920s and 1930s to provide funds for community projects (as well as to combat illegal gambling). Large-scale projects such as the Sydney Opera House were partly funded from gambling revenue, and funds continue to be earmarked for such purposes.

Of the total gambling revenue (taxes charges and other levies) of \$3.8 billion in 1997-98, nearly \$1.5 billion, or a third, is earmarked for specific purposes. Victoria accounted for over one billion of earmarked revenue in 1997-98 (table 20.1).

Gambling taxes are earmarked for a variety of purposes. All states earmark revenue to fund gambling-related activities, such as problem gambling services and research into the impact of gambling on the community. However, hospitals are the major beneficiaries of earmarked funding, particularly in Western Australia (\$60.5 million in 1997-98) South Australia (over \$80 million) and Victoria (where around

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\$1 billion went to the Hospitals and Charities fund). Other activities that receive earmarked revenue include sports, cultural activities such as the Perth Festival, and a wide range of charity and community-run activities.

Earmarking takes three broad forms, with most states employing more than one model.

- The first model involves gambling revenue being channelled into ‘community benefit funds’. Grants are then made from these funds to projects that are consistent with the funds’ purposes. Although funds are distributed via grants, they often support ongoing activities. Most problem gambling services are funded from community benefit funds, although the revenue is also distributed to a much wider range of activities.
- Hospital funds represent the second type of earmarking and are used in South Australia, Victoria and Western Australia. These funds receive a fixed percentage of revenue from particular gambling activities which is then reappropriated to the hospital sector, as part of normal budget processes.
- The third form of earmarking is through direct grants, such as operate in Western Australia and New South Wales. In Western Australia, the Lotteries Commission administers a program to distribute revenue to community groups. In New South Wales, registered clubs can distribute up to 1.25 per cent of gaming machine revenue to health and community groups, as an offset to the tax they would otherwise have to pay. Generally direct grants are made as one-off payments to community groups, often for relatively small amounts.

In considering the merits of earmarking, a distinction can be drawn between earmarking gambling revenues for problem gambling services and earmarking for other purposes such as health, sport or cultural activities.

**Table 20.1 Community benefit levies on gambling**

| <i>Fund</i>  | <i>Funding</i>  | <i>Expenditure estimates (\$'000)</i><br><i>1997-98 unless indicated</i> |                  |
|--|---|--|------------------|
| <b>New South Wales</b>                               |   |  |                  |
| Casino Community Benefit Fund                        | 2% of casino revenue  | Problem gambling   | 3 729            |
|  |   | Gambling research  | 257              |
|  |   | Gambling programs  | 795              |
|  |   | Health   | 913              |
|  |   | Aged Care  | 115              |
|  |   | Other  | 3 115            |
| Sport and Recreation Fund                            | 28.2% of Sports TAB player loss   |  | 1 429            |
|  | <b>Sub-total</b>  |  | <b>10 353</b>    |
| <b>Victoria</b>                                      |   |  |                  |
| Community Support Fund                               | 8.33% of gross profit from gaming machines in hotels  | Health   | 1 358            |
|  |   | Other  | 84 172           |
| Hospitals and Charities Fund                         | 1% of casino revenue  |  | 8 043            |
|  | 12.5% of keno revenue   |  | 2 590            |
|  | 33% of gaming machine revenue in clubs and hotels   |  | 553 785          |
|  | 28.2% of player loss from TABs  |  | 261 382          |
|  | lottery revenue allocated by treasurer.   |  | 120 560          |
| Mental Hospitals Fund                                | Lottery revenue allocated by treasurer  |  | 62 115           |
| Tourism Victoria                                     | 5 yearly payments of \$1m from the casino   |  | 1 000            |
|  | <b>Sub-total</b>  |  | <b>1 095 005</b> |
| <b>Queensland</b>                                    |   |  |                  |
| Gaming Machine Community Benefit Levy                | 4% of Keno tax and an allocation of 8.5% of gaming machine tax                              | Health   | 1 552            |
| Children's health                                    | Fixed annual sum from Golden Casket revenue   | Other  | 13 967           |
|  |   | (1996-97)  | 1 500            |
| Casino Community Benefit Funds                       | 1% of casino revenue  |  | 4,700            |
| Charities and Rehabilitation Fund                    | A (variable) percentage of gaming machine and keno revenue                                  |  | 26,400           |
| Sports and Recreation Benefit Fund                   | 1% of commission of 25% of Queensland's pool of Footy TAB                                   |  | 43,700           |
|  | <b>Sub-total</b>  |  | <b>134.119</b>   |
| <b>South Australia</b>                               |   |  |                  |
| Hospitals fund                                       | Lotteries revenue and 14% of keno subscriptions   |  | 73 500           |
|  | 45% of TAB surplus  |  | 10 125           |
| Gamblers Rehabilitation Fund                         | Voluntary contributions by the Australian Hotels Association and Licensed Clubs Association |  | 1 500            |
| Community Development Fund                           | Allocation from gaming machine taxation   | Health   | 6 000            |
|  |   | Other  | 13 500           |
| Allocation by the Department of Recreation and Sport | 35% of net soccer pools sales   |  | 93               |
| Racing Industry Development Authority                | 0.5% of net sports betting sales  |  | 4                |
| Recreation and Sports Fund                           | 15-18% of net sports betting sales  |  | 131              |
| (continued)  |   |  |                  |

(continued)

Table 20.1 continued

| <i>Fun'd</i>  | <i>Funding</i>  | <i>Expenditure<sup>a</sup> (\$'000)</i><br><i>1997-98 unless indicated</i> |                  |
|---|---|--|------------------|
| <b>South Australia (cont.)</b>                      |   |  |                  |
| Housing Improvement Fund                            | 1% of casino gaming revenue<br>(administered by SA Housing Trust)   |  | na               |
| Charitable and Social Welfare Fund                  | from gaming machine revenue   |  | 3 000            |
| Sport and Recreation Fund                           | from gaming machine revenue   |  | 2 500            |
|   | <b>Sub-total</b>  |  | <b>110 353</b>   |
| <b>Western Australia</b>                            |   |  |                  |
|   |   |  | (1997)           |
| Hospital Fund                                       | 16% of lottery turnover   |  | 60 500           |
| Lotteries Discretionary Fund                        | Voluntary contributions from the Lotteries Commission of WA, Burswood Resort Casino and WA Totalisator Agency Board |  | 8 309            |
| Lotteries Direct Grants                             | 5% of lottery receipts plus remaining funds after lottery costs   |  | 45 105           |
| Allocation by the Minister for Sport and Recreation | 20-25% of net sports betting sales  |  | 189              |
| Upkeep of Burswood Island                           | 1% of casino gaming revenue   |  | 3 588            |
|   | <b>Sub-total</b>  |  | <b>117 691</b>   |
| <b>Tasmania</b>                                     |   |  |                  |
|   |   |  | (1996-97)        |
| Community Support Levy                              | 2% of gross profit from gaming machines in clubs and 4% of gross profit from gaming machines in hotels.             | Health   | 203              |
|   |   | Other  | 506              |
|   | <b>Sub-total</b>  |  | <b>709</b>       |
| <b>Northern Territory</b>                           |   |  |                  |
| Community Benefit Levy                              | 25% of gross profit from gaming machines in hotels  | Fund balance <sup>a</sup>  | 2 000            |
| <b>Australian Capital Territory</b>                 |   |  |                  |
| Community Services Grants program                   | Derived from a percentage of gambling revenue   | Problem gambling   | 86               |
| Clubs and Racing Development Fund                   | 4% (of the net % of totalisator revenue received by government)   |  | 223              |
| Distributed to Clubs                                | 0.25% of 1.25% of sports betting taxes  |  | not available    |
|   | <b>sub-total</b>  |  | <b>309</b>       |
| <b>Sum of states and territories</b>                |   |  | <b>1 470 539</b> |

<sup>a</sup> In the NT payments to the Community Benefit Fund were suspended in July 1997, pending the Gaming Machine Industry Review, however the balance of the fund is over \$2 million.

Source: Submission 155; Alder (1998) for NT data; the ACT Department of Education and Community Services for ACT Community Grants data; expenditure estimates for health and problem gambling funds from submission 163 and expenditure on sports, recreation and other funds were estimated using data from the Tasmanian Gaming Commission eg. NSW Sport and Recreation fund expenditure was estimated as 28.2% of expenditure on sports betting.

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## 20.1 Earmarking revenue for problem gambling services

Earmarking for problem-gambling services, gambling research and community awareness campaigns currently account for less than two per cent of total earmarked funds. Given that these services are directly related to gambling activity, earmarking for these purposes has been relatively uncontroversial. Indeed, it was generally supported by participants. For instance, the Mental Health foundation stated:

The Foundation endorses the practice adopted by the Victorian and NSW Governments, wherein a specified portion of gambling revenue is channelled directly to fund services that assist gamblers. In Victoria, the Break Even and G-Line problem gambling services were introduced with specific allocations from the Community Support Fund, and did not exist prior to the Fund being established by Government (sub. 51, p. 3).

In addition to a clear community perception that gambling operators should be seen to fund problem gambling services, there are two practical reasons for doing so.

- Firstly, earmarking funds for problem gambling is a form of pre-commitment by government to support these services. This can remove the perception, reasonable or not, that governments may be reluctant to fund these service adequately because of the revenue benefits from gambling.
- Secondly, requiring operators to fund these services may reinforce the link between gambling and the problems it can cause for some people. If the public is aware that gambling taxes fund problem-gambling services it can implicitly act as a form of warning to balance some of the more positive messages that are conveyed by using gambling taxes to fund worthwhile community projects.

**The Commission accordingly supports the earmarking of gambling revenue for problem-gambling, harm minimisation, and community awareness campaigns, and for the funding of problem-gambling related research and data collection.**

However, there are a range of questions about the design of earmarking schemes. A key one is whether *all* gambling activities should fund these services, or just those that contribute most to problem related gambling?

In principle, one benefit of earmarking a percentage of funds to problem gambling is that if gambling increased, funding would automatically become available to handle any increase in the number of problem gamblers. On the other hand, it is not clear that falling gambling levels would immediately lead to less problem gambling, so mechanisms are needed to ensure gambling-related services do not suffer if gambling revenue declines in certain markets. In addition, it is also important to ensure that services funded through earmarking are subject to the same level of accountability as other government funded programs.

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## 20.2 Earmarking for other programs

In contrast to problem gambling services, the merits of earmarking revenue for services that are unrelated to gambling such as core health, sporting or cultural activities are more contentious.

One issue is the role earmarking appears to serve to promote gambling. For instance, the Western Australia Government echoes a common view among researchers that the rationale for earmarking is political, not economic or social:

These forms of revenue hypothecation are often justified on the basis that they increase gambling's acceptability to the community, making it easier for agencies such as the Lotteries Commission to market their products, while at the same time negating opposition from socially concerned groups over gambling's social costs (sub. 82, p. 49).

This view is supported by the Institute of Public Affairs which stated that earmarked funds have been set up 'in order to ameliorate pressure groups opposed to gambling' (sub. 12, p. 8). The Commonwealth Department of Health and Aged Care also considered that:

... there is a risk that this hypothecation is disguising the impact both of the revenue raised and of the gambling activity being promoted (sub. 163, p. v).

Whether the promotional role of earmarking is a cause for concern in itself, depends largely on the activity being promoted, and whether or not it is harmful. For instance, it would obviously be of concern if governments promoted smoking by earmarking smoking taxes to cultural or sporting activities. In the case of gambling, some forms contribute more to problem gambling than others. Lotteries do not contribute significantly to problem gambling, so earmarking their funds to social purposes is unlikely to cause problems. Lottery customers may even derive some additional benefit if they feel they are contributing to charitable causes.

However, to the extent that earmarking promotes gaming machines, casino gambling and wagering — activities which do attract a significant level of problem gambling — its role is questionable.

This issue aside, participants considered earmarking or hypothecation has both advantages and disadvantages compared to budget funding.

### Support for earmarking

The Commonwealth Department of Health and Aged Care recognised that there were potential problems with earmarking, but considered that:

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... earmarking, per se, does not necessarily result in these negative impacts. Rather, it is the way in which hypothecated funds are managed that is critical (sub. 163, p. vi).

The Department considered that earmarking should be regarded as a complementary process to normal government funding processes rather than a replacement — that is, it should serve to increase total funding for earmarked activities. It particularly supported the community-based nature of some earmarking arrangements.

... the pattern of mostly one-off grants established by the States has the capacity to foster self help particularly in the States which require communities to make their own contribution to costs ... At times, communities need ‘a bit extra’ to cope with set-up costs or large maintenance items, but can manage day to day costs (sub. 163, p. viii).

Some participants also suggested that earmarking was as a way of returning gambling taxes to the communities that generated them. This view was strongly put by participants from disadvantaged areas with high concentrations of gaming machines. As the City of Greater Dandenong said:

Due to high density of gaming machines in Greater Dandenong, the community is contributing a substantial and disproportionately high level of taxes and charges ... Council is concerned that Greater Dandenong should receive an appropriate level of benefit and return from these taxes and charges (sub. 82, p. 7).

The Break Even – Western Gambling Service also said:

The distribution of funds should consider the areas of highest gambling usage and hence contribution to taxation ie. Low-income areas. Through our community education services we hear a common request that these funds should be directed back into these communities (sub. 64, p. 1).

One aspect of this argument is that earmarking funds for disadvantaged communities is a response to the regressivity of gambling taxes. The motivations behind this approach are sound, and it would be feasible to make grants of gambling revenue to councils based on the average income of households in the council area.

However, this approach may not effectively target the problem of regressivity, nor address regional inequality comprehensively. The basic drawback is that individuals gamble, not communities. Within any community there are widely differing levels of gambling. Earmarking funds for disadvantaged communities would assist many people who do not gamble, as well as the gamblers who contributed gambling revenue. Such an approach would, therefore, be a blunt instrument for offsetting the regressivity of gambling taxes.

Another aspect of this argument is that gambling causes a drain of resources away from already disadvantaged areas. While the level of economic activity in disadvantaged regions is of concern to policy makers, it is generally more

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appropriate to address this in a holistic sense, rather than devising policies to address the financial impact of individual government policies.

## **Potential problems associated with earmarking and hypothecation**

Hypothecation arrangements are subject to a number of criticisms. These include, lack of budget scrutiny for earmarked programs, uncertainty of funding, and additional administrative costs for recipients. These need to be explored in the case of gambling revenue.

### *Lack of budget scrutiny*

The Western Australian Government summarised the potential problems associated with earmarking as follows:

the hypothecation of State revenues such as these can be criticised on the grounds that it affords a privileged budgetary position to specified functions (ie. these functions are not subject to the scrutiny of the annual budget process). Revenue hypothecation can also reduce budgetary flexibility and may, over time, result in a distortion of priorities and allocation of resources (sub. 76, p. 49).

Ideally, earmarked revenue should be taken into account by Governments when deciding the level at which activities should be funded. Otherwise, budget funds may not be allocated to the highest valued uses in the community. Spending may be biased in favour of earmarked programs.

The extent to which earmarked gambling revenue is taken into account is difficult to determine.

Hospital funding is the 'big ticket' item in hypothecation of gambling revenues. The Department of Health and Aged Care found little evidence that earmarking has had an impact on overall hospital funding. States that earmarked funding to hospitals provided neither higher or lower funding in total than states that did not use earmarked funding (sub. 163, p. 30).

This finding is consistent with the conclusion of Smith (1998, p. 41) who stated that:

The consensus is that earmarking revenue does not severely restrict legislatures flexibility in spending if expenditures can be substituted within the general budget. Earmarking merely reshuffles government spending and revenues rather than increases resources for the funded social programs.

On the other hand, activities that receive earmarked revenue via *grants* appear more likely to escape normal budget scrutiny. For instance, the Western Australian



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Lotteries Commission receives around 2500 applications for funding each year, of which around 90 per cent are successful (sub. 82, p. 55). Such a high success rate suggests that the funding criteria for the program are very broad, which would make it difficult to assess the effectiveness of funding. Although the nature of grant programs to community groups is such that it is often more difficult to assess their effectiveness than for other programs, the Western Australian program appears to be a unique product of earmarking.

In New South Wales, clubs with gaming machine revenue greater than \$1m can make donations of up to 1.5 per cent of their gaming machine revenue toward general community development and support activities, to offset a proportion of the tax they would otherwise pay. Funding must be provided to community groups serving the disadvantaged (at least 0.43 per cent escalating to 0.75 per cent in the third year), or to other community development and support activities, including certain sporting and recreational activities (0.83 per cent decreasing to 0.75 per cent in the third year). This is a form of earmarking that is administered privately by clubs, but which is also required by the enabling legislation to be informed by advice from social welfare agencies.

While this scheme may appear attractive because grants are made in the regions that raise gaming machine taxes, there appears to be minimal scrutiny of the effectiveness of these arrangements by government, and it is difficult to tell whether funding is allocated to the highest priority areas in the community. Certainly, it is almost impossible for the New South Wales Government to take this form of funding into account when deciding other budget allocations. **The Commission considers that this arrangement is unlikely to deliver the level of benefits to the community that would be delivered if the tax were paid into consolidated revenue and allocated as part of normal budget processes.**

### *Uncertainty of funding*

While gambling revenue has in total increased, some newer forms of gambling such as casinos may have increased at the expense of traditional forms, such as racing. If an activity depends on hypothecation of revenue from one form of gambling its funding could be subject to fluctuation as revenue from that activity fluctuates.

The degree of uncertainty associated with government funding will depend upon the extent to which earmarked funding is integrated with budget priority-setting processes. If hypothecation is well integrated with these processes, it is likely that major fluctuations in gambling revenue — either positive or negative — can be handled though adjusting other budget allocations.

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Since earmarking does not appear to affect significantly the level of spending on social activities, the majority of earmarked funding appears to be well integrated with budget processes.

However, there is evidence that for some activities fluctuation in gaming revenue has caused fluctuation in funding. For instance, in its 1996-97 Annual Report, the Western Australian Lotteries Commission reported that:

The Commission's failure to achieve revenue targets this year has had consequences, in particular for our 'statutory funding' recipients, the Health Department, the Ministry of Sport and Recreation and the Department for the Arts, who receive funding based on a percentage of turnover. For these recipients uncertainty in the gaming market makes longer term planning particularly difficult (p. 17).

As a result of the fall in lotteries revenue, it appears that funding for hospitals in Western Australia contracted by \$2 million in 1996-97. It is clearly undesirable for funding to hospitals to be dependent on outcomes in a particular gaming market, rather than being based on an assessment of health priorities against other areas of expenditure.

Even though cases like this may not be widespread, they do illustrate the danger of relying of earmarked revenue for funding rather than normal budget funding.

### *Administrative and accountability issues*

Some participants alleged that there were some administrative problems with the grant processes under some of the 'community benefit funds'. For instance, the Wesley Gambling Counselling Service in New South Wales said that:

Funding needs to be regular and ongoing to these types of services as the time taken in yearly submissions and the angst of waiting to see if your submission is accepted is not a professional way of managing a counselling service (sub. 26, p. 18).

However, this is not a feature of all community benefit funds. Under the Victorian program, funds can be committed for up to a three year period.

Other concerns related to the accountability of earmarking programs. For example, in 1996 the Auditor General in Victoria concluded that:

There is a need for application of a consistent approach to assessment and approval of distributions from the Fund and for participation in the decision-making process by all relevant Ministers (VAGO 1996, p. 3).

He also pointed to the need to develop annual reporting on the funds effectiveness, as a means of reinforcing the Government's accountability for management of the fund (p. 4).

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These concerns relating to individual funds and grant arrangements illustrate that good program design principles — embodying transparent funding criteria and clear accountability measures — need to apply as much to earmarked programs as to any government program. They are thus not a problem inherent with earmarking as a concept, but with its implementation in particular jurisdictions.

However, one potential problem with earmarking, no matter how well administered, is that of agencies having to apply for funding from multiple sources. For instance, the Wesley Gambling Counselling Service receives some funding from the Community Benefit Fund and some from the Department of Community Services. This creates duplication of administrative effort and possibly the need to meet multiple performance criteria. Funding activities entirely from one source would overcome these problems, although this may not be practical in all cases.

## **20.3 Conclusions**

The Commission supports earmarking gambling revenue to fund problem related gambling services, gambling research and community awareness campaigns. Since gambling directly creates the need for these services it is appropriate that gambling revenues explicitly fund them, particularly given potential for them to be under-funded otherwise.

While earmarking revenue to other activities is widespread, there do not appear to be particular advantages of earmarking over budget funding:

- although earmarking need not reduce accountability, distort budget spending or create uncertainty in funding for particular activities, there is a greater chance of these problems occurring than if gambling revenue were directed through consolidated revenue;
- earmarking gambling revenue to disadvantaged communities to offset the regressive effects of gambling taxes could have some benefits, but is unlikely to adequately target those who pay the gambling taxes; and
- earmarking of gaming machine and casino revenue can also serve to promote these activities. Such mechanisms for promotion are questionable in view of the social costs of these gambling forms.