



# Gambling and the National Accounts

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#### Expectation?







#### Reality

#### System of National Accounts 2008



International Accounting Standards Board<sup>®</sup>







#### "This isn't betting. This is bookmaking. And that's where our Trading team comes in. A big day on the trading floor creates an atmosphere to rival any stock exchange in the world."

Recruitment advert for UK bookmaker Ladbrokes.





## This paper

- How should we think about gambling within the System of National Accounts (SNA)?
  - Wagers are like financial derivatives
  - New wagers (and thus new derivatives) are 'purely speculative' and should not be counted as output





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(in my opinion)





## Types of wagers

Fixed-odds wagers	Casino wagers	Spread-betting wagers	Pool wagers
Initial stake paid by	Initial stake paid by	No initial stake paid by	Initial stake paid by
consumer.	consumer.	consumer.	consumer.
No explicit service charge.	No explicit service charge.	No explicit service charge.	Often an explicit service
			charge or a proportion of
			each stake is withheld as
			an explicit service charge.
Creditor and debtor	Creditor and debtor	Creditor and debtor can	Individual creditor
position can change in	position can change in	change in both magnitude	positions can change in
magnitude but not	magnitude but not	and direction.	magnitude but not
direction.	direction.		direction. However total
			debtor position remains
			fixed at total staked.
Outcome determined by	Outcome determined by	Outcome determined by	Outcome determined by
uncertain future event.	uncertain future event.	uncertain future event.	uncertain future event.
Total cash pay-out can	Total cash pay-out can	Total cash pay-out can be	Total cash pay-out cannot
exceed total staked.	exceed total staked.	unlimited.	exceed total staked.

#### Labour leadership odds

Jeremy Corbyn	1/9
Owen Smith	<u>11/2</u>







#### Current SNA treatment

- Focuses on lotteries (pool wagers)
  - Price of tickets = service charge + transfer of income to the winner
  - Either explicit service charge, or
  - Implicit service charge = gross gambling yield =  $\Sigma$ wagers Σpayout
  - Lottery as intermediary between participants





#### Questions

- Is the current SNA treatment comprehensive and sensible?
  - Are wagers financial instruments?
    - If so, which?
    - Is it sensible to treat all wagers like pool wagers?
  - How sensible is it to view service charges as output?





# Wagers are financial instruments

- International Accounting Standards (IAS) 32:
  - A financial instrument is "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity", and
  - "the ability to exercise a contractual right may be contingent on the occurrence of a future event"
- Similar language in SNA (2.29, 3.33 & 3.35)





# Specifically: a financial derivative

#### A financial derivative:

IAS 39	SNA (11.11 & 11.12)			
Require no (or little)	Requires no principal and			
investment	no income accrues			
Value depends on an underlying item				
Settled at a later date				

All wagers fit all three criteria





# What type of derivative?

	Forward	Option
Premium paid?	No	Yes
Value at inception?	Zero	Positive
Position variability?	Magnitude & direction	Magnitude
Obligation for transaction?	Yes	No

Spread-bet wager?  $\Rightarrow$  forward-type contract

Fixed-odds/Casino wager?  $\Rightarrow$  options contract Pool wager?  $\Rightarrow$  options contract, but capped in magnitude





### Derivative or insurance?

- Accounting standards: gambling cannot be seen as insurance
  - IASB: gambling creates a risk, insurance transfers a risk
  - SNA: insurance covers against a loss, a wager does not cover against a loss
- Economic distinction is less clear-cut





## Wagers: output or not?

- Explicit service charges: always output
- SNA: explicit + implicit service charges (i.e. gross gambling yield)
- Haynes: Wagers and creation of financial derivatives should be treated the same way





# Output related to derivatives

- SNA chapter 17, part 4:
  - Options: use the premium or (if the financial institution acts as market maker), the bid/offer margin. (cf. 17.289)
  - Forwards: zero value at inception, so (effectively) no output associated with these.

# Should there be output?

- Haynes: only if a service is provided
- Gambling and financial derivatives are 'purely speculative'
  - Contrast to FISIM: resolving asymmetric information
  - Derivatives/wagers create a financial risk, rather than transfer a financial risk, as in insurance
  - With symmetric partners (e.g. a forward), who provides a service to whom?
- *Conclusion:* no implicit service charge, accept negative value added





#### Not so fast!

- Inklaar: the term 'purely speculative' is not a clear, unambiguous concept
  - Derivatives: typically a way of *hedging* risks, i.e.
    transferring existing risk rather than creating a new risk for the fun/heck/profit of it
  - Bank is either a market maker or an intermediary





## Pool & casino wagers

- Pool wager: explicit service charge  $\Rightarrow$  output
- Casino (or fixed-odd) wager:



Example: Bet €1 on every number 1–36 Expected return:  $\left[ \begin{pmatrix} 36 \\ \overline{37} \end{pmatrix} \times €36 \right] - €36 = -€0.027$ 





## Pool & casino wagers

#### • Casino (or fixed-odd) wager:



Slot machines have a preprogrammed pay-out rate of <100%





## Pool & casino wagers

- Casino (or fixed-odd) wager:
- More in general: see e.g. Nevada's 'Gaming Revenue Information' (<u>http://gaming.nv.gov/index.aspx?page=149</u>):
  - Average win percentage on Games & Tables:
    13.35% (June 2016)
  - Average win percentage on slot machines: 6.92% (June 2016)
- If a negative expected return is not an implicit service charge for entertainment services, what is it?
  - Compare FISIM on deposits





## Spread betting

- Spread-betting wagers: "no explicit service charge"
  - Not necessarily: bookmaker can charge a commission (explicit charge); also common for FX trades (and thus forwards)
- Or charge implicitly through a bid-offer spread





#### Derivatives

- Option premium > initial value (potentially)
- FX forward: commission or bid/offer spread
- These would be hard to measure, but may be quite important
- New derivatives can be economically indistinguishable from an insurance contract  $\Rightarrow$  there should be output associated with this





# Summing up

- Thorough discussion of an under-explored area
  - Strong on accounting rules
- Provocative argument for zero output from wagers
  - But symmetry argument (implicit vs. explicit charges) holds greater sway for me