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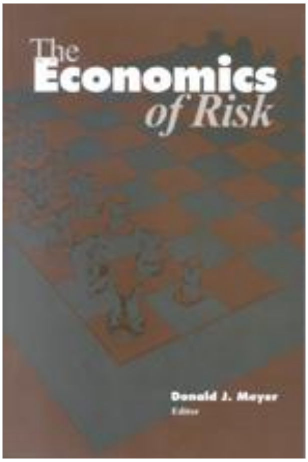

William R. Eadington
University of Nevada, Reno

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Gambling with the Future

Economic and Social Perspectives on Casinos in America

William R. Eadington
University of Nevada, Reno

Commercial gaming became a substantial industry in the United States over the second half of the 20th century, generating revenues in 2001 in excess of $64 billion, and having a legal presence in 48 states. Over half of gaming revenues come from commercial and Indian casinos located in more than 30 states.

From strict prohibitions in most states only a generation ago, laws governing casino-style gambling have been entertained or enacted by state governments interested in new sources of tax revenues, new catalysts for job creation and capital investment, new reasons for attracting tourist spending, and—occasionally—in response to citizens' desires to participate in casino-style gambling for the fun of it. The types of gambling authorized include Nevada-style casinos, slot machines at race tracks, and video poker, video lottery terminals, and other electronic gaming devices in bars and taverns. Besides state-authorized gaming, nearly 200 Indian tribes have opened tribal casinos and gaming centers throughout the country, under the general guidance of the Indian Gaming Regulatory Act of 1988.

This chapter examines the major political, social, and economic dynamics that have resulted in the rapid proliferation of permitted gambling—especially casinos and casino-style gambling—in the United States over the past quarter century. This process of legalization and deregulation has created gaming industries of increasing size, sophistication, and presence, which have become—or are quickly becoming—part of the modern mainstream of commercial entertainment, leisure, and tourism industries in various parts of the country.

Economic benefits notwithstanding, permitted casino-style gaming remains a highly charged political issue. Casino gaming is still considered by some to be an essentially unhealthy activity that has not lost its previous status as a pernicious vice. States that have authorized casino gaming have often done so under conditions of limited competition or by using regional monopoly structures. This approach creates economic rents or monopoly profits that become the objective of ongoing rent-seeking behavior by various special interests in their efforts to capture the rents. Such designed market structures are typically a by-product of desires at the legislative level to control gaming's social impacts through regulatory constraints, geographic isolation, or planned undersupply. Nonetheless, pressures to expand the scope of permitted gaming are found in many jurisdictions, especially when needs for tax revenue generation or job creation are substantial.

It is difficult to make an unambiguous case either in favor of or in opposition to permitting casino-style gaming into any community that previously did not have such activities. Nonetheless, in the first years of the 21st century, it appears that gaming industries will continue to expand in new and diverse ways in many jurisdictions. At minimum, expanding permitted casino-style gaming is now actively on the agenda in many state legislatures, and it is likely to remain so for some time to come.

TRENDS IN GAMING IN THE UNITED STATES

Events of recent years are a continuation of processes toward legalization and a greater presence of permitted gaming that began with Nevada's casino legislation in 1931 and New Hampshire's lottery legalization in 1963. However, the main spread of legal commercial casinos occurred in the first half of the 1990s. Prior to 1988, casinos had been authorized only in Nevada and in Atlantic City, New Jersey. Atlantic City itself was a relatively new addition, with its casinos opening their doors for the first time in 1978. Between 1988 and 1996, a total of nine states[1] authorized new casino industries, some as riverboat casinos, some as limited-wager casinos in former mining towns, and some as urban casinos. Indian tribal casinos were effectively legalized by a Supreme Court decision in 1987[2] and were provided a statutory framework with the passage of the Indian Gaming Regulatory Act in 1988.[3] Indian casinos spread to nearly 30 states by the early 21st century, with the most significant tribal casinos found in such states as Connecticut, Minnesota, Michigan, New York, and California.

The proliferation of permitted commercial casinos in the United States slowed down after 1993, coinciding with the improvements in performance of the national economy. However, another trend soon emerged: the authorization of gaming devices at race tracks in various states, purportedly to provide the racing industry with a "level playing field" against newly authorized forms of gaming, and a competitive edge over tracks in other states in attracting purses and high-quality race horses. The effect of this development was to create a number of "racinos," where the presence of slot machines would transform race tracks into *de facto* casinos, and typically lead to a high proportion of total revenues for such operations being generated by the gaming devices rather than wagering on racing. Such race track casinos have developed in Iowa, Delaware, West Virginia, New Mexico, Rhode Island, and Louisiana in the 1990s.

Changing economic circumstances, especially recession and substantial fiscal shortfalls at the state level, contribute to the casino debate. In 2003, the United States went through another round of discussion of whether to legalize and expand casinos and casino-style gaming. Economic circumstances in the early years of the first decade of the 21st century parallel the period from 1989 to 1993, when the national economy slowed and then moved into recession, and when many states found themselves financially strapped and desperate for job-creating strategies. With the economic slowdown and recession of 2000–2003, an increasing number of jurisdictions in the United States found themselves in financial difficulty. As such slowdowns occurred, commercial gaming was often one of the strategies put forth for raising government revenues and stimulating local and regional economies. Thus, in 2002 and 2003, debates on casinos, slot machines at race tracks, and even slot machines in bars and taverns took place in legislatures and among political leaders in Hawaii, Kentucky, Maryland, Pennsylvania, New Hampshire, Rhode Island, Wisconsin, and Minnesota, as well as in other states.

Other events can also have impacts on the debates of whether or not to expand the presence of casinos. In October 2001, shortly after the September 11 terrorist attacks, the State of New York authorized six new tribal casinos and slot machine gaming at eight race tracks. This was motivated in no small measure by the need to close the gap against large impending state deficits, related both to the economic slowdown and to the anticipated economic consequences of the terrorist actions and the subsequent war on terrorism. The debate was hastened by the reality that by 2001, New York was surrounded by successful casino gaming operations in Atlantic City, Eastern Connecticut, and Ontario, Canada.

COMMERCIAL GAMING AND CONTROVERSY

Between 1982 and 2001, total gaming revenues of commercial gaming industries in the United States grew from $10.2 billion to $65.8 billion, with more than half of the 2001 total coming from commercial and tribal casinos. Lotteries, pari-mutuel wagering on racing, and charitable gambling, including bingo, all lost market share as casinos and electronic gaming devices increased their presence and popularity over the past two decades.

However, in spite of rapid economic expansions, general attitudes toward the acceptance of permitted casinos remained at best lukewarm in most jurisdictions. There is growing sentiment in a number of states that—at least in some situations—governments have authorized too much gaming. In such locales, there are pressures to reverse some of the trends that have characterized commercial gaming industries in the past three decades.

In some situations, substantial commercial gaming industries have seen their legal statuses revoked. This occurred when authorization for video poker machines in South Carolina was allowed to expire in 2000, eliminating an industry that was generating gross gaming revenues in excess of $500 million per annum. In 1996, local elections reversed the legal status of video poker machines in 34 of the 66 parishes in Louisiana.

The issue of when gambling overextends its political welcome can be seen in recent events abroad. Such developments might provide insights into what may lie ahead for American jurisdictions wanting to fully exploit the economic rents from casino-style gambling. Following publication of a 1999 Productivity Commission Report on Gambling (Australian Productivity Commission Report 1999), Australia adopted a number of restrictions on electronic gaming devices after declaring problem gambling to be a public health issue, under a declared strategy of "harm minimization." This followed a decade where the number of electronic gaming devices in Australia expanded from about 70,000 to approximately 190,000, 90 percent of which were located outside of casinos (Monaghan 2001). The Productivity Commission Report claimed, among other findings, that the 2.1 percent of adult Australians who were problem gamblers made up 10 percent of regular players on gaming machines, and generated 42 percent of spending on gaming machines in Australia.

New technological developments in the gaming industries have also become part of the political controversy surrounding gambling. Perhaps the most dramatic of these is Internet gambling, whose legal status has been actively debated in many countries throughout the world, with no clear resolution in the early 21st century in general trends and directions. Internet gambling has a very large potential market and has the capability to bring highly sophisticated gaming products into households everywhere. Based on the spotty evidence that exists on this still largely "gray area" activity, the size of the global Internet gambling market is already measured in the billions of dollars (see, for example, Cabot 2000).

On the other hand, Internet gambling raises social concerns about the potential adverse impacts such ubiquitous gaming opportunities might bring about, especially in the areas of underage gambling and problem and pathological gambling. The activity also poses interesting challenges for jurisdictions on how to regulate and tax the activity, creating a dilemma for governments that are tolerant of permitted gaming primarily because of their ability to extract economic rents from excise taxes on the activity. Because Internet gambling operates with little concern for national borders, and because some jurisdictions have decided to encourage Internet gaming sites to locate within their borders through offering low tax rates, other jurisdictions will have to match or come close to those tax rates to remain competitive. Furthermore, the United States, at both the congressional level and in various states, has demonstrated little desire to move forward to fully exploit the economic opportunities of Internet gambling.

It is possible that Internet gambling is just the tip of the technological iceberg. Interactive television betting and the use of various handheld computer devices for playing games and making wagers are perhaps the next major gambling developments. However, they will continue to be politically controversial because of the difficulties in exercising social controls over the activities where they take place, and because of the ability of new technologies to outstrip legislative attempts to constrain the presence or availability of gambling in general. A by-product of the new world of Internet and other low-cost and virtually instantaneous communications is likely to be the inability to significantly constrain gambling activities that take place through those media, regardless of the wishes and desires of legislative and parliamentary bodies.

A FRAMEWORK FOR EVALUATING THE BENEFITS AND COSTS OF EXPANDED GAMBLING

One aspect of legalizing new forms of permitted gambling is that such actions create benefits that impact economies—especially local or regional economies—in ways that are generally tangible, measurable, and economic. But an expanded presence of permitted gambling also generates social costs that affect individuals and households in ways that are far less tangible, measurable, and visible. It is extremely challenging to policymakers and social scientists to conceptualize, identify, and measure the social costs that accompany gambling in any meaningful way (see, for example, Walker and Barnett 1999 and Eadington 2003). Furthermore, because of the relative lack of attention to the costs and benefits of gambling prior to the mid 1990s, little serious effort was undertaken to address these issues.[4] It is likely that these dimensions of benefits and costs associated with gambling will remain at the heart of the debate over the wisdom of expanding or contracting the availability of permitted gambling for some time to come.

Nonetheless, a number of observations can be made about the benefits and costs of permitted gambling in comparison to reasonable alternative states of nature. For those jurisdictions that are still debating the status of gaming within their control, such observations should prove useful.

First, it should be noted that the primary benefit associated with permitted gambling is the creation of *consumer surplus*, the incremental value to consumers from being able to participate in an activity that was previously prohibited. Consumer surplus is generally defined as the difference between what consumers would be willing and able to pay for an activity versus what they actually have to pay for that activity. Such gains accrue predominantly to the consumers of gambling services rather than to producers or the governments who authorize the activity.

However, when permitted gambling is authorized in a manner that prevents the market from expanding to its demand potential, or when the market structure is designed to result in monopoly or otherwise restricted competition, then the price of the activity increases. As a result, a portion of potential consumer surplus is diverted away from consumers and becomes value for someone else. The diverted consumer surplus can be referred to as *economic rents*. Economic rents can be captured by government through the implementation of excise taxes on the activity, or by outright ownership of the gaming franchise. Other economic rents might be captured by companies or organizations that offer gambling services through exclusive or limited franchises. Only when the market is allowed to expand to its demand potential, or when competition from related substitute activities bid down the price of the primary activity to competitive levels, are the economic rents bid away.[5]

As with other activities, most of the costs and benefits associated with permitted gambling are internal to the consumers and producers of the gambling activities. Under the assumption of rational economic actors, consumers choose to spend money on gambling because they derive greater value from participation than the expected or realized cost. Producers provide gambling services because it provides a greater return on their resources than the next best alternatives. As private benefits and costs, there is little reason for public policy considerations to affect the decision processes that generate these allocations.

Public policy intervention is typically justified when negative externalities are associated with the activity.[6] With gambling, the primary negative externalities are linked to problem and pathological gambling. Generally speaking, there have been two major driving forces that have influenced societal decisions to liberalize gambling laws and regulations: 1) a desire on the part of governments to capture economic rents through permitting a previously prohibited activity; and 2) a desire to mitigate the negative side effects (real or perceived negative externalities) associated with the activity by constraining it in ways that would allow for greater control of the adverse side effects.

The combination of these two somewhat conflicting forces has led to a variety of eccentric laws passed in various jurisdictions throughout the world. In the United States, riverboat gambling with mandatory sailing, or mining town casinos with loss limits and restrictions to historic buildings only, reflect states' efforts to capture economic rents while providing protections against people who might overindulge in gambling activities. Voter ratification of Indian gaming, as in the State of California in 1998 and 2000, was a validation of the distribution of economic rents to tribes and tribal members; California's legislature and voters have been reluctant to bestow similar economic rents on other rent seekers, such as the card club industry or the racing industry.

As with other vices such as tobacco, alcohol, illicit drugs, and commercial sex, gambling is perceived as an activity that has a strong realized and latent demand that emanates from a portion of the population. As with the other vices, it also possesses a variety of negative side effects—perceived or real—that are viewed as immoral or otherwise socially damaging by (typically) another subset of the population. Such side effects have served as the impetus for constraints on the permitted offerings of gambling services. As with the other vices, there is no clear consensus on the best approach to regulating and constraining the availability of gambling, and as a result, there has not been much stability on the manner in which legal gambling has been permitted and constrained from one political jurisdiction to another.

The extent of demand for gambling that is realized—as opposed to remaining latent—is partly a function of gambling's legal status. If casino gaming, through the process of legalization or deregulation, is made more attractive and available to a society's population centers, then the demand for gambling in general, and the total amount of income spent on gambling, will increase. The greater the availability of gambling, and the fewer the constraints that are applied to gaming activities, the larger the realized demand will be. Furthermore, the more that permitted gambling is offered in a competitive market context, the more that demand for gambling will increase. Increased competition will result in lower realized prices to consumers for gambling, and competition will enhance the price and availability of complementary nongaming activities as well. The recent experience of competitive venues such as Las Vegas and Mississippi—in comparison to more supply constrained or monopolistic jurisdictions such as the urban casinos in Detroit and New Orleans, or riverboat jurisdictions in Illinois, Indiana, or Louisiana—clearly demonstrate these effects.

When trying to evaluate social benefits and costs associated with gambling, it is important to evaluate the alternatives to the status of permitted gambling under consideration. If a jurisdiction currently prohibits gambling but has a substantial amount of illegal gambling taking place within its borders, removal of the prohibitions will likely diminish the adverse economic impacts of the illegal industry, and quite possibly will diminish the severity of some of the social costs associated with such illegal activities.

It is also useful to look at the general locational structure under which casino and casino-style gambling is offered, in terms of its potential for delivering benefits and costs. Though it is argued elsewhere that benefits and costs of permitted gambling should be done at the national level (Grinols and Mustard 2001), most policy analysis concentrates on local and regional economic benefits associated with permitted casinos and casino-style gaming. Using that as a starting point, one can create the following categories of casinos and near-casinos:

- Destination resort casinos located away from population centers (such as Las Vegas, Reno, and Lake Tahoe, Nevada; Biloxi, Mississippi; or Atlantic City, New Jersey).
- Rural casinos, located away from population centers (such as Foxwood's in Connecticut and most tribal casinos in the United

States; and the casinos in Deadwood, South Dakota; and in Central City, Blackhawk, and Cripple Creek, Colorado).

- Urban or suburban casinos located in or near major metropolitan areas (such as those found in Detroit, or in and around St. Louis, Kansas City, and Cincinnati), as well as most race track casinos ("racinos").
- Neighborhood casino-style gaming (such as video poker machines, video lottery terminals, and other gaming devices found in bars and taverns in such states as Nevada, Montana, Oregon, and South Dakota). This is sometimes referred to as *convenience gambling.*

If we compute benefits and costs for gambling in the traditional manner, and discount the importance of consumer surplus,[7] we find that jurisdictions that export gambling to citizens of other jurisdictions tend to capture a substantial amount of economic benefit in the form of economic rents and value added by producers and owners of local resources (i.e., the benefits of increased local employment), whereas the social costs associated with problem gambling in particular tend to get exported to the jurisdictions where the gambling consumers reside. In such cases, the ratio of benefits to costs within the jurisdiction is relatively high.

In a similar fashion, benefit/cost ratios for rural casinos are also fairly high, especially if the region for which the impacts are being evaluated includes only the rural area. This is often the case with Indian tribal casinos, where the primary group of interest is the tribe itself, and most of the casino customers are not tribal members.

On the other hand, if urban or suburban casinos are evaluated in this manner, the benefit/cost ratio is considerably lower. Most of the gaming activities provided by such casinos cater to demand in the local market. In such a case, spending on gambling does not stimulate the local economy in the same manner it would if gambling activities were exported. Furthermore, social costs typically remain within the community where the gaming facilities are located. Thus, measured benefits will be lower and social costs will be higher than in either of the first two cases. Nonetheless, such urban/suburban casinos can create significant regional investment and might serve as efficient mechanisms for tax revenue generation. Furthermore, they might bring about considerable *import substitution* behavior, encouraging local residents who otherwise might travel out of the region to pursue gambling activities to spend their gambling budgets in local casinos instead.

If we consider the situation of convenience gambling—gaming devices in bars and taverns located in neighborhoods—the general tendency is for benefits to be lower and social costs to be higher than in any of the previous situations. Since such facilities generate little in the way of new investment or job creation associated with the gambling activities, economic benefits tend to be lower.[8] Because casino-style gaming is offered in more accessible surroundings than is typical for site-specific casinos, there might be a greater incidence of impulsive gambling and, as a result, of problem and pathological gambling.

The ratio of benefits to costs for a region or jurisdiction is a bellwether to the extent of controversy associated with the various types of permitted gambling. In light of this framework, especially when consumer surplus is given relatively little standing, it is not surprising to see convenience gambling as the most politically vulnerable of the alternatives considered. This thesis is consistent with the recent experiences in Australia noted previously, as well as jurisdictions such as South Carolina and Louisiana, where convenience gambling was eliminated or threatened with elimination because of the political backlashes associated with it.

This framework also carries implications for the new forms of gambling. Unless consumer surplus is given greater standing, Internet gambling and interactive television gambling, for example, will likely prove to be very low on perceived economic benefits and very high on social costs. Furthermore, the competitive and global dimensions of Internet gambling make it very difficult for governments to capture economic rents, especially in the form of taxes on gross gaming revenues. Also, the regulatory challenges of permitted gambling in the home, especially gambling by youth or by those prone to overindulge, imply that the social costs associated with such activities are going to be both socially dangerous and very hard to control without violating other dimensions of personal privacy. Thus, these newest forms of gambling might prove to be the most controversial of all.

CONCLUSION

In summary, the ongoing dynamics of the economic and social impacts of gambling and of permitted gaming industries point out a number of important dimensions characteristic of the activity, the industry, and of public policy processes regarding gambling. Most important of these are:

- Gambling is one of the largest industries whose fundamental economic characteristics are substantially determined by political decisions.
- Political decisions regarding gambling are largely influenced by the ability of competing special interests—including state governments—to capture economic rents associated with liberalizing permitted gaming activities. This is often countered by perceived or real social costs associated with problem and pathological gambling and with an increased availability of gambling in society.
- There is a strong latent demand for casino-style gaming (including gaming within casinos and with electronic gaming devices located outside of casinos), which is manifested when the legal status of gambling is liberalized.
- Technologies have developed over the past two decades that have broadened the appeal of, and the market for, commercial gaming. The same technologies have raised concerns over some adverse social impacts that such an increased presence of gambling in society might bring about. Many of these adverse social impacts are related to problem and pathological gambling behavior.
- Benefit/cost analysis applied to permitted gaming activities is still a relatively primitive science, primarily because of the difficulties in conceptualizing, observing, and measuring social costs. Because of its lingering status as a vice, consumer surplus associated with gambling consumption is often discounted in policy discussions.
- Some types of permitted gambling raise greater social concerns over their impacts than do others. Some categories of venues for

> casinos and casino-style gambling are more vulnerable to political controversy and possibly reversal of liberalization of permitted activities than are others. The forms of gambling with the greatest potential for controversy include convenience gambling, Internet gambling, and interactive television gambling.

The debate over the proper role of permitted gambling in society is far from over, though there are some clear long-term trends—visible for much of the past half-century—that have supported increased legalization and deregulation in many jurisdictions. In many respects, these trends reflect society's increased acceptance of gambling as a proper form of (adult) leisure and entertainment.

However, as has been demonstrated in various situations, public attitudes toward gambling can be fickle. Should significant problems arise—such as corruption scandals, the presence of organized crime, or even sensational incidents involving pathological gamblers—gambling might once again come under fire. If the perceptions of social costs associated with gambling become substantial relative to the economic benefits that it is creating, then the political winds can quickly shift harshly against its permitted status. Unless and until respect for gambling as a consumption activity achieves a level comparable with other consumption activities, newer types of permitted gambling will continue to raise public policy debates and remain at the center of political controversies.

Notes

1. The states were South Dakota, Iowa, Illinois, Colorado, Louisiana, Mississippi, Missouri, and Indiana. Only Michigan, where voters authorized three casinos in Detroit in 1996, was added to this list between 1994 and 2001.
2. *California et al. v. Cabazon Band of Mission Indians et al.*, No 85-1708, February 25, 1987; reprinted in Eadington (1990).
3. P.L. 100-497 (1988), 100th Congress; reprinted in Eadington (1990).
4. Until casinos spread beyond Nevada and Atlantic City in the United States, there was little in the way of institutionally funded research on gambling. Similar circumstances prevailed in other countries. Since the 1990s, there have been a number of major national studies undertaken in various countries, including the *Final Report* (National Gambling Impact Study Commission 1999) in the United States, the *Gambling Review Report* (Department for Culture, Media and Sport 2001) in

the United Kingdom, and *Australia's Gambling Industries* (Productivity Commission 1999) in Australia.

5. It should also be noted that the idea of consumer surplus has seldom been an important factor in deliberations regarding legalizing or deregulating gambling. This is probably because of long-standing prejudices that gambling is a tainted activity, and people who participate in gambling are themselves exercising poor judgment in their consumption choices, and should therefore not be given much consideration in deliberations. As a result, most policy deliberation relies primarily on the magnitude and distribution of the economic rents.
6. Negative externalities arise when the market transactions between two parties create costs for third parties who are not involved in the transactions. Without policy intervention, this shifting of costs results in overproduction of the activity that creates negative externalities.
7. See note 6.
8. It should be noted, however, that such gaming devices might be extremely efficient tax collectors.

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Donald J. Meyer
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