Eastern Economic Journal, Volume XIII, No. 2, April–June 1987

A Parimutuel Principle

Donn R. Pescatrice*

The parimutuel horseracing industry of New York State consists of active racetrack operations in coordination with an off-track betting system (OTB). The OTB mechanism is simply an extension of the racetrack parimutuel system; through a network of betting parlors, OTB offers the patron the opportunity to wager without having at attend the racetrack. OTB provides a wagering convenience.

The horseracing industry is broadly defined to include racetrack owners, horse owners, breeders, trainers, jockeys, etc. The racing industry and state and local governments share (albeit unequally) in the revenue generated from by wagering, both on and off-track. The parimutuel revenues accruing to both of these sectors have been declining in recent years (not only in New York, but nationally). The traditional explanations offered for this revenue decline is, of course, escalating operating costs. However, horseracing in New York is subject to increased competition for the wagered dollar. The recent introduction of casino gambling in Atlantic City, the popular New York Lottery, and the modern Meadowlands Racetrack in nearby New Jersey have severely eroded the New York horseracing market.

In an effort to compete more actively for the gambling dollar, innovative wagering mechanisms have been suggested for the integrated racetrack and OTB system of New York. The foremost possibility is simulcasting. Simulcasting provides a visual component to the OTB system by televising the live race into the parlor. Currently, only a radio call of the race is permitted except in a few parlors where simulcasting is operating on an experimental basis. Special forms of simulcasting involving elaborate teletheaters with dining facilities are also under consideration. Some enthusiasts also envision a mechanism of cable television coupled with telephone wagering as the ultimate medium for the marketing of horseracing.

Since the racing industry receives the greatest portion of each dollar wagered at the racetrack, these innovative wagering forms are vigorously opposed by leaders of the racing industry. Their argument is that all the new betting schemes critically involve the OTB system which is the source of the government portion of race track revenues. The contention of the racing industry is that the introduction of new wagering forms will severely dampen racetrack patronization and its associated revenues, and ultimately cripple it.

The prolonged and heated debate has fostered a Legislative Task Force charged with studying the problems inherent in the racetrack and OTB system. Its final report strongly recommends that all segments of the racing industry and OTB unite in partnership with the state legislature to mount a coordinated and concerted effort to revitalize the beleaguered horseracing industry in New York. It is argued that the continual pursuit of the self-serving goals of the particular individual sectors may serve as the deathblow to the overall industry. The relevant question is how it is possible for the racing industry to form a constructive alliance with government in a parimutuel structure where the major revenues of each "partner" are derived from directly competing sources? It seems unlikely that a truly cohesive effort by the racing industry and government can be the system in which state and local governments are major

*Iona College, New Rochelle, NY 10801

benefactors of the OTB structure while the racing industry is best served by the racetrack operations.

A solution is offered below which removes the direct competition for the wagered dollar by the OTB system and the racetracks without disadvantaging either the racing industry or government. A modification of the existing parimutuel tax and distribution scheme is the key ingredient which provides a framework from which a true partnership between the racing industry and government can be formed. Lifesaving new wagering mechanisms can then be actively pursued and promoted by both sectors, since it would be to their mutual advantage to promote wagering in any form.

The alternative scheme embodies a principle of parimutuel tax and distribution where both the racing industry and government are indifferent to whether the patron wagers at the racetrack or with the OTB system. This parimutuel principle may provide direction and focus to subsequent reforms in the parimutuel tax law. It may also serve as guideline for other states and racing industries attempting to buoy government revenues while reversing the financial plight of the local horseracing industry.

AN OVERVIEW OF THE EXISTING MODEL

The OTB system allows the racing patron the opportunity to wager without having to attend the racetrack. The racetrack and OTB system offer the same type of betting choices. The options include regular win, place, and show wagering, as well as multiple wagers involving two horses, and exotic wagers involving three or more horses. Each type of wager is subject to a particular parimutuel tax or takeout percentage. The remaining money is returned to patrons holding winning tickets. All monies wagered with OTB are combined with the racetrack wager, theoretically resulting in a common set of payouts to winning ticketholders. However, an additional 5 percent surcharge is imposed on OTB payouts to winning ticketholders, so that OTB payoffs are smaller than those at the racetrack. The surcharge is generally considered as a cost of the off-track service analogous to an admission fee charged at the track. Leaving aside the allowance for the surcharge, the horseracing patron is indifferent to the potential monetary rewards of wagering at the racetrack or with OTB. Of course, there is no spectacle nor aesthetics associated with OTB play, a deficiency that causes many fans to prefer the racetrack.

The patron's monetary indifference as to where the wager is made does not carry over to the racing industry and government. The racing industry contends that OTB does not cultivate future racetrack patrons. The convenience and negligible expense involved with OTB play is a key attraction of the OTB system, dampening the patron's desire to attend the live races. Hence, the racing industry believes that OTB infringes on its market, and that the racetracks are not properly compensated for the negative impact of OTB. The argument is that a former racetrack patron now playing with OTB results in a net revenue loss to the racing industry. The industry is certainly not indifferent to where the patron plays.

The disparity in wagering revenue accruing to the racing industry and government depending on where the patron wagers is reflected in the following model of the current integrated racetrack and OTB system. Upon subsequent analysis, it will be apparent from a purely revenue standpoint, that government much prefers the patron to wager with OTB and the racetracks and horseman benefit most from actual racetrack patronization. The competing revenue objectives have resulted in intense competition between the tracks and OTB for the wagered dollar.

Although the heated competition between OTB and the racetracks is not the sole source of the problems confronting the horseracing system of New York, it has impeded innovative wagering mechanisms and marketing techniques which might combat the market erosion stemming from the escalating competition of the new gambling opportunities offered in nearby New Jersey. The suggested alternative model embodying the principle of indifference diffuses this senseless competition.

The New York racing program consists of seven harness racetracks and four thoroughbred racetracks. The parimutuel tax, or takeout, and the distribution of this takeout for both on and off-track is legislated for each type of race. The tax and distribution scheme for the thoroughbred tracks is essentially the same for all of these tracks (certain tax allowances are occasionally made to bolster some of the weaker racetrack operations). The tax and distribution scheme is also uniform for all the harness tracks. Furthermore, there is only a minor difference in the schemes between these two types of racetracks. In addition, both thoroughbred and harness racetracks offer the same wagering choices (i.e., regular, exotic, multiple) which have the same relative appeal to patrons. Hence, a meaningful analysis is facilitated by employing the takeout and distribution scheme of a representable racetrack, since all other tracks have either an identical or comparable tax structure. The racetrack employed in the analysis which follows is the harness track of Roosevelt Raceway. However, the adjusted distribution of takeout based on its specifics can be applied in principle to all the racetracks comprising the New York system. For Roosevelt Raceway the configuration of the total wager both at the racetrack and with the OTB system, the associated distribution of the takeout (parimutuel tax) at each facility, and the resulting parimutuel revenues accruing to each sector are displayed in Tables 1, 2, and 3 below. This wagering pattern is typical of the New York racetracks. Some fine-tuning of the results presented here may be required in situations where wagering behavior deviates significantly from that employed in this model.

The competition for the wagered dollar between government (particularly local governments) and the racing industry (essentially tracks and horse owners) is readily apparent in Table 2. Local governments are obvious beneficiaries of wagers placed on the OTB system—they receive nothing from on-track wagers but receive a healthy percentage racing from 11.3 to 14.3 of the OTB play. In contrast, the tracks and horse owners are best served by wagers placed at the racetrack—they lose anywhere from 3.25 to 5.5 percent when a wager is placed at OTB rather than at the racetrack. The existing parimutuel tax distribution scheme clearly places the racing industry in competition with government for the wagered dollar.

The total parimutuel revenues accruing to each sector as a result of the existing parimutuel tax and distribution scheme both on and off-track are reflected in Table 3. Table 3 is generated by appropriately multiplying Table 1 through Table 2.

The conflict of interest inherent in the current tax and distribution scheme pervades the

TABLE 1
Total Wager by Type of Bet ($000 omitted)

Type of Bet	On-Track	Off-Track	Total
Regular	$129,673	$ 40,501	$170,174
Multiple	72,281	60,600	132,281
Exotic	41,906	53,895	95,801
Total	$243,860	$154,998	$399,256

TABLE 2
Distribution of Takeout Percentage

	On-Track			Off-Track		
	Regular	Multiple	Exotic	Regular	Multiple	Exotic
Tracks	7.0	7.5	8.5	2.0	2.0	3.5
Owners	5.25	5.75	6.75	2.0	2.0	3.5
Breeders	0.5	0.5	0.5	0.5	0.5	0.5
State	4.25	5.25	9.25	1.2	1.2	3.2
Local	-0-	-0-	-0-	11.3	13.3	14.3
Total Takeout	17.0	19.0	25.0	17.0	19.0	25.0

entire integrated racetrack and OTB system, and has fostered a needless and potentially destructive competition for customers by the racetracks and the OTB system. As a result, nearly all of the innovative and provocative new wagering mechanisms, which critically involve the OTB system and are designed to stimulate fan participation and combat escalating competition from other gambling sources, have been stalled as a consequence of racing industry opposition. This does nothing but accentuate the plight of the horseracing system of New York.

The following model may provide a guideline for an improved integrated racetrack and OTB system in a climate of cooperative mutually beneficial to both the racing industry and government.

THE INDIFFERENCE PRINCIPLE

The revenues accruing to each sector as displayed in Table 3 include the respective operating expenses. The operating expenses incurred by the racetrack are approximately 4.0 percent of the total wager at the racetrack, and the analogous expenses incurred by the government in the operation of the OTB system are approximately 9.0 percent of the total OTB wager. These expense percentages are based on current conditions. Likewise, the total revenues accruing to these sectors as a result of the modified distribution scheme will also encompass the inherent operational expenses.

Since both the government and racing industry are aware they must bear the cost of providing wagering opportunities, each can be truly indifferent as to where the patron wagers only if the respective net revenues are essentially the same regardless of where wagers are

TABLE 3
Distribution of Total Revenue
($000 omitted)

	Total Revenue
Tracks	21,968
Owners	17,701
Breeders	1,990
State	16,119
Local	20,344

TABLE 4
Distribution of Takeout Indifference Principle

	On-Track			Off-Track		
	Regular	Multiple	Exotic	Regular	Multiple	Exotic
Tracks*	(6.5)	(7.0)	(8.0)	2.5	3.0	4.0
Owners	3.5	4.0	7.0	3.5	4.0	7.0
Breeders	.5	.5	.5	.5	.5	.5
State	5.5	5.5	7.5	.5	.5	2.5
				(10.0)	(11.0)	(11.0)
Local*	1.0	2.0	2.0	1.0	2.0	2.0
Total Takeout	17.0	10.0	25.0	17.0	19.0	25.0

*Tax in parenthesis is total tax. The figure below is net of approximate operating expenses.

placed in the integrated system. Hence, in constructing the proposed modification of the takeout distribution scheme, the takeout percentages net of operating expenses are key considerations. Indifference with respect to net takeout percentages will imply indifference with respect to net revenues derived from wagering.

The alteration of the existing parimutuel tax distribution scheme embodying the principle of indifference is revealed in Table 4. In essence, the current overall parimutuel takeout as displayed in the last row of Table 2 is redistributed. That is, the proposed modification of the takeout scheme is merely a reapportionment of the overall current parimutuel tax. For the tracks and local governments the gross takeout percentage is in parentheses above the takeout percentage net of approximate operating expenses. Table 5 is the result of appropriately multiplying the patron wagering patterns of Table 1 through the altered distribution scheme displayed in Table 4.

Notice, in particular, that both the racetrack and horsemen receive the same takeout percentage net of operating expenses from wagers placed anywhere in the system: tracks 2.5, 3.0 and 4.0, owners 3.5, 4.0, 7.0, and breeders .5 everywhere. Similarly, local governments receive the same net takeout percentage regardless of where the patron plays—1.0, 2.0, and 2.0 respectively. The aspect of indifference with respect to net takeout and hence net revenue differs dramatically from the current situation. The model reflected in Tables 4 and 5 alters the current tax distribution scheme such that *all sectors'* current revenues are safeguarded, yet

TABLE 5**
Distribution of Revenue ($000 omitted)

	On-Track			Off-Track			
	Regular	Multiple	Exotic	Regular	Multiple	Exotic	Total*
Tracks	8,428	5,060	3,352	1,012	1,818	2,155	21,825
Owners	4,538	2,891	2,933	1,417	2,424	3,772	17,975
Breeders	648	361	209	202	303	269	1,992
State	7,132	3,975	3,142	202	303	1,347	16,101
Local	1,296	1,445	838	4,050	6,666	5,928	20,223

*The revenues to each sector are essentially the *same* as the current revenues reported in Table 3.
**Table 5 is constructed by multiplying Table 1 through Table 4.

each sector is *indifferent* to *where* a wager is placed or *what* type of wager is made. The incentive for the senseless competition for the wagered dollar is removed. All that is important and mutually beneficial to all sharing parties is that the patron participates in the parimutuel system in some manner.

The revenues of each sector are safeguarded by the indifference principle. However, it is obvious that even though state government's revenues are maintained, it is only sector which is not indifferent with respect to where the wager is placed. The state's best interest is served by racetrack patronization. But, this is a positive attribute of the distribution scheme since it provides some assurance that racetracks do not become hollow structures where races are viewed solely by camera crews and videotape machines.

Many variations to the tax and distribution scheme suggested here are possible. Fine tuning some derivative of the indifference principle may best serve the interests of everyone involved in the parimutuel horseracing industry. The principle of indifference is of central importance if the revitalization of the New York parimutuel industry takes the form of new innovative wagering mechanisms. If all participants are indifferent to where the patron wagers, then a truly concerted effort to introduce and promote provocative wagering mechanisms can begin—regardless of where they are based. Given that simulcasting—the live telecast of races in OTB parlors—appears on the horizon, it seems that the implementation of some form of the indifference principle should serve as a necessary prerequisite to the introduction of any new wagering mechanism. Then both the racing industry and government can truly form a partnership to promote the overall sport of horseracing.