



Creating a Commercially Viable Casino Industry

Several observers have noted that casinos are proliferating via a "domino effect," the same way lotteries proliferated in the 1960s and 1970s. New casino states are learning from adjacent states and are creating casino industries that generate more economic development, more jobs, and more tax revenue than laws permit in adjacent states. An offshoot of this so-called "war among the states" is that casino operators -- particularly cruising riverboat operators, whose businesses are necessarily mobile -- might migrate to states where the best climates for business exist. Even if the casinos themselves can't move, the capital that finances their development and operation may be deployed in any of a number of jurisdictions.

A spotlight on the midwestern U.S. illustrates this point. Iowa's pioneering riverboat gaming legislation included strict loss and wager limits and permitted relatively little on-board space to be devoted to casino operations. These restrictions excluded a significant number of recreational casino customers and hampered the casinos' overall profitability. As long as Iowa maintained its regional monopoly on riverboat gaming, however, these restrictions did not appear overly burdensome. But neighboring Illinois subsequently passed legislation absent any restrictions on wagers or losses. Moreover, passage of the Illinois law meant that new casinos would open that were more conveniently located for Illinois-based customers who had been crossing the Mississippi River into Iowa to experience riverboat gaming. Coupled with the inexperience of several of Iowa's casino operators, these factors proved detrimental to the Iowa riverboat gaming industry. Three of Iowa's original boats have, in fact, left the state. In April 1994, Iowa finally repealed the wager and loss limits and several other restrictive elements of its riverboat gaming statute.

Policy-makers with responsibility over casino gaming should realize that the intensity of the "war among the states" will only increase as additional states legalize casino gaming. But that certainty does not mean that unlimited gaming with unlimited licenses in unlimited locations is the only way a state can proceed. It means only that legislation be mindful about the realities of inter- and intra-state competition for casino gaming. Here are some specific suggestions to create a commercially viable casino industry:

- **Avoid setting wager and loss limits.** These limits place states at a competitive disadvantage by reducing the entertainment desirability of casino facilities from the customer's perspective. In just about every market, and especially where casino gaming is designed to attract tourists, there is a customer segment that can afford to wager more and spend more than the average customer (the average customer spends between \$50 and \$75 visiting a riverboat casino). There is no reason to discourage this customer segment from visiting your casinos. Customers budget their money when they visit casinos, so the absence of wager or loss limits will not entice lower-stakes players to become higher-stakes players.
- **Recognize the relationship between gaming tax rates and the permitted number of operator licenses.** Some states have authorized unlimited casinos and have permitted market forces to sort out weak competitors from strong competitors. In other states, legislation authorizes a specific number of casino licenses, and may specify site-specific casino locations. In general, jurisdictions with extremely high gaming tax rates (20 percent or more) can host successful casinos only if they permit monopolies or oligopolies to exist in major markets. Keep in mind, too, that a single market can include more than one casino jurisdiction. Several failures of casinos in Colorado during 1993 were a result of too many casinos (no limit on the number of

operators) competing for too little revenue (small market size; change from a three-tiered sliding tax scale with a maximum rate of 15 percent to a two-tiered scale with a maximum rate of 20 percent). Indiana's current 20 percent casino tax is considered reasonable because of the genuine profitability of the Indiana market and the availability of only 11 licenses.

On the other hand, jurisdictions can host relatively large numbers of casinos if the tax rate is moderate (12 percent or less). For example, Atlantic City casinos are taxed at 8 percent and most choose to purchase bonds for redevelopment equivalent in value to 1.25 percent of gaming revenues (as opposed to paying an additional 2.5 percent tax on gaming revenues), with a resulting effective tax rate of 9.25 percent. Mississippi casinos are taxed at 8 percent (although local option taxes and fees may also be assessed), while Nevada casinos are taxed at 6.25 percent.

The trend in North America is toward states or provinces permitting limited numbers of casinos in specified locations, either fully land-based or "dockside" riverboat casinos which do not cruise and hence function as if they were land-based casinos. Even in the U.S. casino jurisdictions where the number of licenses is unlimited by statute, gaming regulatory authorities have frequently used their discretionary powers to control proliferation by refusing to issue new licenses. The Iowa Racing and Gaming Commission, for example, denied a riverboat license to a company seeking to operate a boat on an Iowa lake in part because of concerns related to market saturation. Missouri and Indiana officials have also voiced a concern about maintaining equilibrium between supply and demand. These examples show that where the public purpose of permitting casinos is to target and deliver particular levels of economic benefits to specific communities, legislators and regulators sometimes do not permit the invisible hand of the market to sort out winners and losers. To put it bluntly, few places in America want to be the "next Las Vegas" or the "next Atlantic City."

For better or worse, managing the supply of casino facilities is an increasingly important role for gaming policy-makers in North America. The recent wave of casino growth in the U.S. revolutionized how casinos are taxed. The object is to extract as much revenue as prudent from gaming operators, up to that limit in which such extraction becomes a barrier to market entry. Simply put, government wants more of the profit in exchange for the right to operate a casino. The industry can and will pay more under certain conditions -- under monopoly conditions, of course, states can extract maximum fees. This is particularly true of prospective operators who perceive high profit potential in the marketplace.

The ideal number of gaming licenses in any state depends on the size, proximity, and gaming preferences of both local and tourist populations. Illinois has authorized ten commercial casino licenses. Indiana has authorized eleven, and Louisiana has authorized sixteen (15 riverboats and the land-based casino in New Orleans). Only the larger urban areas or tourist destinations in the U.S. are capable of supporting in excess of 100,000 square feet of casino space.

- **Establish minimum-size requirements for all casinos.** While there are no hard and fast rules here, policy-makers should appreciate the rule of thumb that a smaller number of medium to large casinos is, all other things (including total square footage of casino space) being equal, preferable to a larger number of small casinos. Larger facilities operate more efficiently, provide better customer entertainment experiences, and incur lower regulatory costs than smaller facilities. A related dictum is:
- **Place explicit geographic constraints on casino development.** Specify the exact waterways where riverboat casinos are to be permitted. Specify counties and cities where casinos are to be located. Assign limited stakes casinos and land-based casinos particular districts where they may be located.

The idea here is to ensure that the casino industry you get is the casino industry you want. By failing to circumscribe a particular area where casinos could locate, the law permitting casino

gaming in Deadwood, South Dakota transformed the city's entire commercial core into a de facto casino district. In Cripple Creek, Colorado, the town's only grocery store was converted into a casino. Many local residents were understandably displeased by these events. And it's only a slight bit of hyperbole to state that, until recently in Mississippi, no one was quite sure whether a few gallons of standing water in a ditch miles from the nearest navigable stream qualified as a dockside casino site.

In many jurisdictions there is a pent-up demand for legal casino gaming, and if poorly planned, casinos might transform the character of entire towns and cities and critically stress the local infrastructure. Cities and states desiring simply to increase the attractiveness of a locale as a tourist destination and provide communities with an additional entertainment option must insist that gaming legislation specify locations where casinos are to be permitted.