Gambling Economics: A Primer

Editors' Introduction

Professor Grinols’ interest in gambling began in 1990 with the newspaper announcement that an offtrack betting parlor (OTB) was slated for his town. Knowing that OTBs generally drew 90 percent of their clients from nearby residents; that their profit rates were 19 percent including racing industry payments; and that owners would be out-of-city investors, he was surprised to read that supporters believed it would bring 125 jobs to the city. A net export multiplier model would show the opposite—a drain on community revenues and reduction in jobs. Rebuffed by city officials in his offer to volunteer time with city staff to produce an economic impact study, he published a newspaper commentary providing data on the OTB’s impact instead. Through the University of Illinois news bureau this led to commentaries in major newspapers, one of which Senator Simon of Illinois read into the Senate record.

Professor Grinols’ phone began to ring off the hook with people asking about the effects of gambling expansion in areas from coast to coast. Seeing that existing numbers implied astonishingly large social costs, he decided that the issue was worthy of a portion of at least one economist’s professional time, and feels that if even a small fraction of the net social damage of casino expansion can be avoided by education and good advice, the time will have been well spent.

Gambling, especially casino gambling, is a social issue, rather than a purely private matter of personal freedom of preference, because its presence in society is associated with high social costs. How much gambling to allow is properly a government regulatory matter because gambling’s social costs are paid by those who do not gamble as well as by those who do. Over the past half dozen years, the nation’s experience with casino gambling and other forms of gambling outside the confines of Atlantic City and Nevada has grown sufficiently that the parameters of the debate can be succinctly summarized by responses to four statements:
1. Casinos lead to eventual social costs that are in the range of $2-$6 for every dollar of direct benefits.
2. Casinos are not economic development tools.
3. Casino gambling leads to lost national income and is directly unproductive activity for a significant number of those who engage

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in it because their motivation for gambling is not recreation.
4. Because of its need to be regulated and the above-normal profits to casino owners this often implies, licensing casino gambling creates a perpetual enticement to influence-buying and governmental malfeasance.

Elaboration of these points is provided below.

**Dimensions of the Problem**
Gambling's social costs result primarily from problem and pathological gamblers (P&P gamblers), the approximately two to five percent of those exposed to gambling who become "addicted" to it. Out of a typical 100 adults, one or two might become pathological gamblers if exposed to casinos. Another two or three would become problem gamblers, suffering many of the same addiction-like symptoms of the pathological gambler, but not to the extent of the pathological gambler. Table 1 presents data about the prevalence of problem and pathological gambling from a sampling of surveys. As shown there, P&P gamblers range from 1.7 percent of the population in Iowa before the introduction of casinos to 4.4 percent, with the average around 3.7 percent.

The social costs of casino gambling are comparable to the effects of other harmful addictions including drugs and alcohol. Consequences of gambling addiction include lost productivity, personnel costs to employers, fraud, embezzlement, family decay, suicide, and even murder. The acts of the few are paid for by the many, including those who do not gamble. Exposing more people to casinos, including those who never had cheap access to one before, can only increase the social costs. For example, in Iowa the number of pathological gamblers rose tenfold after the introduction of casinos—from a tenth of one percent of the population to one percent—in the space of several years in a comparison of before and after field surveys done with identical test methodology. The introduction of casino gambling is also associated with a many fold increase in gambler hotline calls and gamblers anonymous groups, with increases of three hundred and four hundred percent more usual than unusual.

A study by Gazel, Rickman, and Thompson found that the average problem gambler in Wisconsin cost society $10,113 each year. Applying this figure to the 1.6 percentage point increase in P&P gamblers observed in Iowa, for example, implies additional social costs when spread over the entire population of $162 per adult annually. This falls within the range of earlier estimates that project the additional social costs of gambling expansion to be between $112 and $338 per adult annually.

For those accustomed to measuring various kinds of social costs, these figures are astonishing. For example, on a national basis they imply yearly costs which summed over a decade easily exceed the value of lost output of the 1990-91 recession. Chart 1 compares lost real output from the 1990-91 recession of $126 billion in 1992 dollars or just over $140 billion when expressed in 1996 dollars to gambling's costs. Social costs from the spread of casinos nationwide easily would exceed $200 billion over a decade, with figures well over twice that possible.

**Economic Development**
States like Illinois have found that casinos do not behave as tourist attractions because in the usual case they represent convenience gambling for those nearby, most from less than 35-50 miles. Few individuals plan trips or vacations to gamble in expansion casinos of the type that have appeared since 1990.

The rare exceptions to the characterization that casinos have not brought economic development typically involve circumstances where the region containing the casino is not populated enough to support it. In these cases, a large population base from which the casino draws usually exists nearby. For example, Central City, Colorado is not large enough to
TABLE 1
PREVALENCE RATES OF P&P GAMBLING
Percent

<table>
<thead>
<tr>
<th>Year</th>
<th>State</th>
<th>Problem</th>
<th>Pathological</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>New York</td>
<td>2.8</td>
<td>1.4</td>
<td>4.2</td>
</tr>
<tr>
<td>1990</td>
<td>California</td>
<td>2.9</td>
<td>1.2</td>
<td>4.1</td>
</tr>
<tr>
<td>1988</td>
<td>New Jersey</td>
<td>2.8</td>
<td>1.4</td>
<td>4.2</td>
</tr>
<tr>
<td>1988</td>
<td>Maryland</td>
<td>2.4</td>
<td>1.5</td>
<td>3.9</td>
</tr>
<tr>
<td>1989</td>
<td>Massachusetts</td>
<td>2.1</td>
<td>2.3</td>
<td>4.4</td>
</tr>
<tr>
<td>1989</td>
<td>Iowa</td>
<td>1.6</td>
<td>0.1</td>
<td>1.7</td>
</tr>
<tr>
<td>1995</td>
<td>Iowa</td>
<td>2.3</td>
<td>1.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td>1.3</td>
<td>3.7</td>
</tr>
</tbody>
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support the casinos it contains. It draws its revenues primarily from Denver, Colorado gamblers not far away. Similarly, Tunica, Mississippi takes money from Memphis, Tennessee across the border. Frequently, casinos are intentionally sited to conduct “border raids” against a neighboring state’s population. The Trump casino in Gary, Indiana, for example, is located very near the eastern boundary of the 4.9 million adult Chicago, Illinois market.

Another reason that casinos have not created economic development for their host regions is that casino owners earn high profits that they remove from the local economy to fund other projects located elsewhere and repay investors. Research indicates that Illinois has lost money, on balance, due to its casinos. Industry funded studies of the impact of casinos have not usually drawn much attention, if any, to the way in which owner profits might drain a state or region.

Source of Revenues
Casinos draw money from the “wrong” sources to be economic development tools. Instead of serving recreational tourist gamblers, research indicates that 35 to 50 percent of long run casino revenues come from problem and pathological gamblers. Further, data from Illinois indicates that 75 percent of revenues come from residents within 35 miles of the casino, and that another 10 to 20 percent come from those 35 to 50 miles away. Increases in casino revenues can also be identified with reductions in business revenues within 10 miles of the casino that are on the order of $460 for every $1,000 of additional casino revenue, coming from losses in general merchandise, miscellaneous retail and wholesale trade, food, and eating and drinking sales. The true loss is larger than the estimate because the loss to eating and drinking sales includes the gains to casino eating and drinking establishments that could not be separated from the total. Losses to business 10 to 30 miles away also would add to the total.

In spite of the above findings, the absence of net job creation remains a tricky thing to convey to casual observers. Casinos certainly create jobs within the confines of the casino, and thus they certainly create jobs in a small enough geographic vicinity of the casino itself. A U.S. News and World Report study of 55 counties that opened casinos between 1990 and 1992 found that the 4 percent increase in new businesses in these counties...
When one to four percent of the population become P&P gamblers... the damage caused can be substantial.

matched that for the rest of the country. Studies of Illinois counties with casinos similarly found that job creation was not different because of the presence of casinos. On the county level the absence of increased jobs means that jobs near the casino come at the expense of other employment nearby, as economic theory would predict.

Crime

Three-fifths of pathological gamblers in treatment report that they committed crimes in response to their addiction. These crimes tend to be property crime rather than violent crime, though incidence of both types of crime increases when casino gambling is present. When one to four percent of the population become P&P gamblers, therefore, the damage caused can be substantial.

Police chiefs do not collect data on gambling-related crime. Even when prosecuted, crimes caused by gambling are not currently classified under a gambling category. Data on street crime, which is often not affected by a casino, depending on the size of the casino presence, degree of nearby police presence and so on, is not a good measure of the crime-related costs of casino gambling. Crimes committed by pathological gamblers often are hidden, such as embezzling, insurance scams, and credit card fraud. They become known only when they need prosecution. An in depth study by the Minneapolis Star and Tribune of the effects of gambling in Minnesota, including estimates of the direct cost to the state of a gambling-related embezzling case, led the paper to take an editorial position that said in part, "The price of Minnesota's love affair with gambling is turning out to be every bit as high as opponents had said it would be—not only for those who get caught directly in its web, but for everyone else as well." The gambling industry has spent millions of dollars on media campaigns in recent years, losing its battle to promote gambling as a "responsible" way to raise money. We know that legalized gambling also increases the amount of illegal gambling,
but we do not have good measures. In one area where measurements have been done, it is well documented that illegal gambling by underage teens and children increases with increased legalized gambling.

**Directly Unproductive Activity**

Many gamblers describe their motivation for gambling in non-recreational terms. When an individual devotes time to an activity that does not result in a product or have direct value as recreation, it reduces national income because the time and resources are diverted from producing output of tangible value. While an individual might rightly conclude that he can make money from poker playing, his social output is reduced if it diverts him from productive output. Such directly unproductive profit seeking activity is socially costly. Unfortunately, at present this is perhaps the least studied and least quantified social cost of gambling.

**Government Malfeasance**

The legal profession recognizes the concept of liability for creating an attractive nuisance on one’s property that might entice passersby and lead to their harm, even when the harm requires the choice of the passerby. Casino gambling has historically been the vehicle for fraud and abuse. Few individuals take the laissez faire view that casinos could safely be allowed to establish in whatever locations they choose without restriction or license. Government licensing, on the other hand, implies some degree of market power granted to the licensee. The desire to reap the resulting above-normal returns by currying favor with elected officials is an attractive nuisance to rent seeking and influence buying of the type described. The already long list of governmental abuses, indictments, and convictions of elected officials in various states and parts of the country over incidents related to gambling speak to the results. As long as the attractive nuisance is present, the inducement to malfeasance will have its eventual effect.

*...individuals in the gambling industry have an incentive to say whatever is necessary to attain or retain access to their flow of revenues.*

* Chart 2: Gambling Social Costs & Benefits

Annual Dollars per Adult

- Social Costs: $338
- Social Benefits: $12.50
- Consumer Benefits: $43
- Casino Revenues: $171
A simple cost benefit comparison of prohibition versus casino gambling shows that the social costs of gambling exceed the benefits.

Gambling Industry Positions
Much of the gambling industry’s responses to the above issues are naturally driven by the facts that casino owners and others in the leadership of the industry are making enormous amounts of money through casino gambling. For example, the nine individuals who provided the original $7 million investment for the Joliet casino near Chicago nearly tripled their money in the first six months of operation. In the first 18 months they earned $87 million on revenues of $185 million—a 47 percent gross profit rate!—and in the past several years have each been receiving individually as dividends from their casino holdings over $900,000 per month. These earnings cannot primarily be attributed to superior business skill or product, but do have a great deal to do with the regional monopoly the nine investors’ license grants them.

With this type of money at stake it is not surprising that individuals in the gambling industry have an incentive to say whatever is necessary to attain or retain access to their flow of revenues. Furthermore, they often have a great deal more money at their disposal to use in their cause than those whose opposition to gambling derives from knowledge of its eventual social costs and a personal notion of civic duty or good government.

One debating technique is to deny all statements made by the opposition. Gambling industry representatives often deny that introducing casinos to a region will result in an increase in gambling or that this will result in more P&P gamblers; they often claim that their support for treatment of gambling addiction will deal with whatever problem of P&P gamblers currently exists; and they claim that casinos will bring economic development. They have mounted large public relations campaigns to present their message, and in several cases such as the state of Missouri, have been able to get re-votes on the ballot within six to nine months of a vote that went against their interests. They have also been willing to pay large sums of money to fund studies that, not surprisingly, reach the conclusion that casinos will bring economic gains to the proposed region. These studies are generally flawed because:

1. They do not describe casino owners’ profit and where these profits will be taken, out of state or spent locally.
2. They do not treat long term social costs research indicates are between $112 and $338 per annual. Casino gross revenues, in comparison, coming primarily from nearby state residents, are generally between $150-$200 annually per adult.
3. They do not consider that casinos will increase the prospect of neighboring states adopting them, or that not adopting will decrease the likelihood. Wisconsin, Missouri, and Indiana all expanded casinos, to Illinois’ harm, after Illinois introduced them in imitation of Iowa, for example.
4. Finally, they are based on a layering of assumptions about how much individuals at different distances will gamble at the facility in question, chosen within the range of uncertainty, but selected with the effect that they produce one-sided conclusions.

Policy Options
American experience with gambling was bad enough in the late 1800s that many states passed constitutional bans on gambling while others passed legislation against it. By 1910 no lotteries or gambling were allowed anywhere in the nation except for horse racing in three states, and one of these states later banned horse racing. The national unwritten social compact was that for mutual gain each community would ban gambling if the others did the same. When one breaks the compact, however, it leads to an escalation inducing others to break the compact. The end result is that when every region has
casinos, they all cannot gain at the others’ expense, though all will pay the increased social costs.

With this in mind, the country has three options: at one extreme is prohibition; at the other extreme is unrestricted licensing; a middle alternative would allow gambling but neutralize social costs either by “sanitizing” gambling (preventing it from creating P&P gamblers) or by paying for the social costs through taxes on casino revenues or by other general taxes willingly paid by citizens.

It is questionable whether the middle alternative exists. There is no available technique or evidence to suggest that gambling, especially casino gambling, can be allowed without having P&P gamblers. Further, as Chart 2 shows, tax rates on casino gross revenues would have to start well above 50 percent and it is possible that taxing 100 percent of casino revenues might still be insufficient to cover the social costs. A simple cost benefit comparison of prohibition versus casino gambling shows that the social costs of gambling exceed the benefits.

The National Commission

How do we proceed from here? Large ships with radar can peer ahead for trouble, adjusting through rudders when course corrections are needed. A small but competent national commission investigating the impact of casino gambling can serve as both radar and rudder for the nation. Given the pressure to open more casinos, and the way casinos are being used for border raids on the revenues of neighboring states, many of whom do not themselves choose to allow casinos, Congress wisely decided the evidence on gambling was sufficient to warrant a careful look at its consequences. In spite of opposition by the gambling industry, which offered to fund its own studies, the National Gambling Impact Study Commission Act was signed into law on August 3, 1996.

From its inception, the commission will be required to go against the tide in setting its own agenda, inaugurating its work, and following through to the completion and implementation of its conclusions. If gambling costs are not high, as the industry claims, then competent individuals on the commission will find this out. On the other hand, if they are high, the right individuals gathering and making available this information can result in a national course correction regarding gambling. Avoiding the costs equivalent to just one recession would pay for their service many times over.

There is concern that pressure for political accommodation will result in commission positions being given to individuals having ties to the gambling industry. At the time of writing, four members have been named. Among these, House Speaker Gingrich announced the appointment of J. Terrence Lanni, Chairman of the Board and CEO of MGM Grand, Inc., a Las Vegas-headquartered gambling firm. This is unfortunate both because of personal financial interests working against objectivity and the setting of the commission agenda, but also because industry backing has the potential to seriously imbalance the information gathering of the commission. The only certain losers from failure to push forward a serious study would be the American people.

Conclusions

We know that gambling is not an economic development tool except in certain circumstances. We also know that current evidence indicates the social costs of gambling outweigh its benefits by a margin between $2 to 1 and $6 to 1. Nationwide casino gambling has the potential to be as socially costly as an additional 1990 recession every decade, and is comparable to alcoholism or drug addiction in its effects. Nevertheless, the pressures to expand gambling in other regions, once it is introduced in one region, are great. A national commission conducting serious research on the effects of gambling would be the first step to
setting a new national policy. Ultimately, better information and a better informed populace will be the routes by which a new social compact is chosen.

ENDNOTES


4 Reported in St. Louis Post-Dispatch, October 15, 1996.