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VLTs — What Are The Odds Of Texas Winning?

By

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About the Author

Chris Patterson is the director of research for the Texas Public Policy Foundation. She is primarily responsible for planning and coordinating the Foundation's research, as well as scholar recruitment.

Chris first came to the Foundation in 1996. She left in 1999 to serve as the Director of Education Policy for The Lone Star Foundation in Austin and Executive Director of Education Connection of Texas in San Antonio. She re-joined the Foundation in March 2001 as Director of Education Research.

She has written numerous studies, research reports and commentaries on public education, published by the Foundation and other entities.

Chris and her husband have two sons that attended public school in San Antonio. Prior to moving to Texas with her family in 1996 from New York, Chris was the Executive Director of the Regional Action Phone, a crisis intervention and suicide prevention hotline. She holds a bachelor's degree in Psychology and Labor Relations Certification from the Cornell University School of Management Studies.

About the Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute guided by the core principles of limited government, free enterprise, private property rights and individual responsibility.

The Foundation's mission is to improve Texas government by generating academically sound research and data on state issues, and by recommending the findings to opinion leaders, policy makers, the media and general public. The work of the Foundation is conducted by academics across Texas and the nation, and is funded by hundreds of individuals, corporations and charitable institutions.

By refusing government funding, the Foundation maintains its independent voice on the issues important to Texas' future.

In 1989, a small group of civic-minded Texans created the Texas Public Policy Foundation to bring independent, market-based thinking to tackle problems facing state government. Through the years, the Foundation has championed solutions to the day's pressing issues, and won support for market-based policies that have made Texas a better place to live and work.

The Foundation's impact on public policy is substantial, and has been noted by lawmakers and opinion leaders alike. The *Dallas Morning News* has said the Foundation is "dubbed the 'official think tank of Texas' by friends and foes."

EXECUTIVE SUMMARY

Legalized gambling provides a lucrative source of revenue for many states today, although it is arguable that this revenue is offset by associated costs. Rising revenues, particularly from video lottery terminals (electronic slot machines that are commonly known as VLTs), tempt many states to expand gambling. In Texas, accelerating costs of Medicaid and school finance prompt some policymakers to consider the legalization of VLTs at racetracks and Indian casinos. This report surveys the economic and policy arguments for and against legalizing VLTs, and examines the economic experience of communities, states, and nations.

The economic impacts of gambling have been examined by a large body of national and international research; however, the research findings are mixed. While there is general agreement that gambling can provide large state revenues and that there are socio-economic costs attached to these revenues, researchers disagree about the dollar value assigned to these costs and whether the net fiscal impact is positive or negative.

To determine whether gambling provides an overall economic benefit, fiscal costs associated with gambling must be subtracted from the fiscal benefits. Benefits associated with gambling, particularly casinos, are identified as: (1) new revenues; (2) job creation; (3) increased tourism; and (4) increased sales revenues from businesses that cater to gamblers.

Costs associated with gambling include: (1) a reduction of approximately 10 percent in state lottery revenues; (2) an investment of approximately 10 percent of revenues in regulatory costs for gambling; (3) criminal justice costs underwriting an 8 to 13 percent increase in crime; (4) lost state and local revenue resulting from diversion of spending from goods and services to gambling; and (5) lost jobs resulting from decreased spending on non-gambling goods and services.

According to some research, the economic impact of gambling is positive – however, most of these studies acknowledge limited or no calculation of costs. For example, Ray Perryman, principal of an economic and financial analysis firm located in Waco, has recently produced a study estimating that casinos and VLTs could generate $2 billion in state revenues, $730 million in local government revenue, $762 million in racetrack profits, and 250,000 new jobs. The February 2005 study, commissioned by the Texas Enhancement Group (businesses favoring the expansion of gambling), claims these financial benefits would be generated without any increase in the gambling related costs currently paid by Texans – but the study does not estimate costs.

Other research, however, indicates the economic costs associated with gambling cancel out the revenues with net-zero financial gains or result in an overall financial loss at the end of the day. For example, research conducted by Florida's Office of Planning and Budgeting concluded in 1994 that Florida would experience a significant deficit if the state expanded gambling; although tax revenues were projected to reach almost $500 million annually, gambling costs were projected to total at least $2 billion annually.

There is limited research available on the economic impact of VLTs in the U.S.; however, studies from Australia and Canada indicate that VLTs are not associated with the same fiscal benefits that are sometimes associated with casino gambling. Unlike casinos, VLTs do not create jobs nor foster businesses that cater to gamblers; as a result, legalization of VLTs has been associated with a net job loss.

The financial costs of gambling are evident in experiences of communities and states:

- 24 out of 57 counties in the U.S. with casinos experienced job losses
- Atlantic City went from 50th in the nation for per-capita crime to first and violent crimes rose by 78 percent, during the first three years of casino gambling
- Sales declined 10 to 20 percent in Natchez, Mississippi after gambling was legalized
- Counties with casinos have a bankruptcy filing rate that is 13.6 percent higher than in counties without casinos throughout the nation
- Delaware reports spending between $1 to $1.5 million annually on gambling-related costs and Wisconsin reports spending $63 million annually

When costs associated with gambling are included in the equation, what would be the overall benefit of legalizing VLTs for Texas? Earl L. Grinols, professor of economics at Baylor University and one of the nation's leading researchers on the economic impacts of gambling, examined this question. He calculates Texas will shoulder an increased annual cost of at least $1.5 to $3 billion dollars if VLTs are legalized – a cost that would be magnified by reductions in state revenue from the diversion of spending on goods and services to gambling (an amount that is difficult to predict).

The cost identified by Dr. Grinols, other research on gambling, and experiences of communities suggest that Texas policymakers should exercise extraordinary caution about legalizing of VLTs. The long and short term impact, direct and indirect impact, and, most importantly, the final net economic result should be determined. Before VLTs are legalized, the question that should be answered is this: Once the costs are subtracted from new state revenues, will the lives of Texans be enriched by VLTs?

INTRODUCTION

Although VLTs are identified as video-based games of chance in which players compete with others for a large central jackpot, it is increasingly difficult to distinguish between VLTs and many other forms of gambling: lotteries, video poker, slot machines, gambling video terminals, electronic slot machines, electronic pull-tab machines, video slot machines, and "racinos." Differences have been largely erased by the rapid evolution of gaming technology and continuing efforts of legislatures to make state law accommodate the technology and terminology.

Over the past several decades, most states have expanded gambling, lured by the staggering sums that can be made by legalizing this activity. Today gambling is legal in all states except Hawaii and Utah. It is a major industry in the United States – realizing profits over $73 billion annually and supplying states with annual revenues of approximately $20 billion. For some states, gambling provides a major source of revenue.

Gambling on state-operated lotteries is the most popular form of gambling in the U.S., generating in excess of $14 billion for state coffers last year. In 2004, the Texas Lottery generated $3.4 billion. However, the popularity of lotteries is being eclipsed by VLTs. Growth of lottery sales slowed to just 3 percent annually in states with legalized VLTS while the revenue from VLTs increased by 16 percent. Throughout the nation and internationally, VLTs represents the fastest growing form of gambling.

Eight states now operate and tax VLTs: Delaware, Iowa, Louisiana, New Mexico, New York, Oregon, Rhode Island, and West Virginia. During fiscal year 2002, VLTs generated $263 million for West Virginia, $195 million for Delaware, and $149 million for Rhode Island.

Although only eight states now have "officially" legalized VLTs, 21 other states (excluding Texas) permit some form of electronic gaming machines that seem very similar to those in the "official" eight states and may be different only by the way state law defines various forms of gambling. These 21 states are: Arizona, California, Colorado, Connecticut, Florida, Illinois, Indiana, Kansas, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, South Dakota, and Wisconsin. Regardless of the name chosen by states, VLTs and other forms of electronic slots serve as extremely effective fundraisers. In West Virginia, VLTs account for 12 percent of state revenue, and in South Dakota, video slot machines serve as the state's second largest source of state revenue.

Huge VLT jackpots seem to present an irresistible seduction to states as a way to solve over-spending and budget shortfalls. In 2004, 29 state legislatures (including Texas) considered the expansion of legalized gambling. Seventeen of the 29 states (including Texas) proposed to legalize or expand some form of VLTs (slots, electronic pull-tab machines, electronic gambling, video poker, or electronic bingo). Now, the 79th Texas Legislature is considering the introduction of VLTs at racetracks and casinos.

GAINS AND LOSSES

The economic research on legalized gambling can largely be divided in two camps – research that identifies the financial benefits for states and research that shows how the financial benefits cancel out the benefits or result in an overall, net financial loss. Most of the research lauding financial benefits neglects the costs associated with gambling and fails to provide a cost-benefit analysis that identifies the net or overall economic impact of gambling.

To determine whether gambling provides an overall economic benefit, fiscal costs associated with gambling must be subtracted from the fiscal benefits. Benefits associated with gambling, particularly casinos, are identified as: (1) new revenues; (2) job creation; (3) increased tourism; and (4) increased sales revenues from businesses that cater to gamblers.

Costs associated with gambling include: (1) reduction of revenues from the state lottery; (2) regulatory costs; (3) criminal justice costs; (4) reduced state and local revenue resulting from diversion of spending from goods and services to gambling; and (5) lost jobs and lower wages resulting from decreased spending on non-gambling goods and services.

A recent report on the potential economic and fiscal impact of casino gambling on the Texas economy offers an example of research that identifies fiscal positives without accounting for negative financial impacts. This report was produced by Ray Perryman, principal of an economic and financial analysis firm located in Waco. The Perryman report, commissioned by a group of businesses favoring expansion of gambling (the Texas Enhancement Group), estimates that VLTs could generate $2 billion in state revenues, $730 million in local government revenue, $762 million in racetrack profits, and 250,000 new jobs. The report purports these financial benefits would be generated without any increase in the gambling-associated costs currently paid by Texans. However, it should be noted that costs associated with gambling were not identified or examined.

Similar economic gains were identified for Illinois by researchers at the University of Illinois. The 2003 report, commissioned by the state's casino association and chamber of commerce, noted that casino spending, jobs, and taxes contribute nearly $5 billion a year to the state economy. However, no cost-benefit analysis was conducted to identify the overall net economic impact for the state (when asked why, the lead author stated that the report was written to represent the casino's perspective).

A few studies do look at costs and attempt to measure the overall economic impact of gambling. For example, a 1999 report prepared for the Gaming Control Board by a group of researchers representing seven state universities finds that gambling produced a net annual benefit of $1,107 million for Louisiana, after subtracting annual costs of $531 million. However, findings of this and similar studies are highly debated because of the various methods used to determine costs.

The methodology for calculating cost-benefits of gambling has become more scientifically sound and useful. Earl L. Grinols, a professor of economics at Baylor University and one of the nation's leading experts on the economics of gambling, constructed a framework for economic analysis that has gained broad recognition nationally and internationally. Over the past 10 years, his independent research shows that gambling fails the cost-benefit test by a ratio of three dollars in cost to one dollar in benefit.

ECONOMICS AND ECONOMIC DEVELOPMENT

There is some evidence that casinos can stimulate economic development by adding jobs, increasing consumption of local goods and services, and raising tax revenues. For example, the Illinois Casino Gaming Association notes it employs more than 11,000 people in the gambling industry in that state and spends more than $184 million on goods and services provided by state vendors.

At the same time, however, there is also evidence that casinos in Texas are unlikely to provide this much economic benefit. Most casinos fail to approach the level of profits required for positive economic activity (such as creating jobs and increasing average personal income) outside of Las Vegas and New Jersey; unless 50 to 75 percent of profits come from gamblers outside the region, economists find casinos do not provide overall economic gains.

While there is evidence that some casinos do stimulate economic development, researchers have not found this same link with VLTs. Unlike casinos, VLTs do not create jobs, nor do they generate state revenues from businesses that cater to gamblers. To the contrary, there is evidence the introduction of VLTs is associated with job loss; two jobs were eliminated for every three VLTs legalized in Australia.

In communities where casinos have added new jobs and created businesses that cater to gamblers, the end result may not represent economic development or net financial gain. There are well-documented costs that are associated with gambling:

- Regulatory activities generally consume about 10 percent of gambling revenues;
- Criminal justice costs increase 8 to 13 percent;
- State lottery revenue decreases approximately 10 percent;
- Revenues from taxes on non-gambling goods and services decline as discretionary spending is redirected to gambling; and
- Jobs are lost in non-gambling businesses.

A broad group of economists, nationally and internationally, conclude that economic costs entirely offset gambling revenues and immediate economic gains associated with gambling. Some economists, including Dr. Grinols, argue that the costs of gambling far exceed the financial benefits. The experiences described below depict the negative economic impact exerted by gambling:

- 27 out of 57 counties with casino gambling in the U.S. experienced job losses;

- Sales declined 10 to 20 percent among local businesses in Natchez, Mississippi after gambling was introduced;
- 50 percent of the city's retail businesses and restaurants closed in Atlantic City within 10 years of the legalization of gambling;
- Violent crime increases up to 13 percent in counties with casinos that are least 4 years old;
- The State of Delaware reports underwriting between $1 to 1.5 million annually on social services related to gambling;
- The State of Wisconsin and local communities spend over $63 million annually on social and criminal justice costs associated with gambling;
- The American Insurance Institute identifies $1.3 billion in annual costs related to gambling and insurance fraud; and
- Bankruptcy rates in U.S. counties with casinos are 18 percent higher than those without casinos.

Economists agree that these costs cannot be fully offset by revenues generated by gambling because a certain amount of gambling revenue, perhaps as much as 75 percent, represents dollars that the state would have captured from taxes on other goods and services (revenue displacement).

Some economists suggest that the best way to measure the efficiency and effectiveness of gambling revenues as a driver for economic development is to look at the fiscal condition of states that generate significant revenues from gambling. They note these states are as likely to be facing budget deficits as states that do not rely on gambling revenues.

DOING THE MATH ON COSTS FOR TEXAS

When the costs associated with gambling are included in the equation, what would be the overall financial benefit of legalizing VLTs for Texas? The Foundation asked Dr. Grinols to provide an estimate. His estimate is based on the proportion of individuals who represent problem and pathological gamblers in the population (a group that is responsible for most of gambling-associated costs) and a taxonomy of costs that are associated with these gamblers (including such things as business and employment costs, crime, and regulatory costs that can be documented).

Based on evidence that the proximity of gambling increases the incidence of problem and pathological gambling, Dr. Grinols predicts the legalization of VLTs will stimulate an increase of 1.7 to 3.5 percentage points or an additional 69,910 to 137,023 adults who are pathological gamblers, and an increase of .5 to 1 percentage points or an additional 230,702 to 468,395 adults who are problem gamblers.

The result of Dr. Grinols' calculation is this: Texas would shoulder an increased cost of $1.5 to $3 billion dollars annually – a cost that would likely not be offset by any net increase in state revenues because of revenue displacement.

STATE TAX REFORM

Some policymakers suggest that VLTs offer Texas a way to raise new and significantly vast sums of state revenue without raising taxes. They argue that taxes on VLTs would exert far less negative economic consequences than a tax on personal income or business payroll because it would be (1) voluntary; (2) a tax on consumption; and (3) affect a limited subpopulation. It is claimed that VLT taxes could improve the horizontal equity of the state tax system because each consumer must pay the same amount of taxes for the games.

Other policymakers argue against expanding state reliance on legalizing gambling. They say that taxing VLTs represents a tax increase whether or not the tax is paid as a voluntary or involuntary tax – or whether the tax is paid by all taxpayers or a select group. They note that gambling taxes, particularly taxes on various forms of slot machines such as VLTs, levy a disproportionately heavy share of the tax burden on the poor. Some express concern that consumer spending will be distorted by the state tax system if VLTs are legalized because states that legalize VLTs either own or operate some aspect of the gambling business and promote consumption of gambling over private sector goods and services. A recent report by the Tax Foundation would seem to concur; it states that dependence on gambling revenues makes "state tax systems more regressive, less transparent, and less economically neutral" (*Lotteries and State Fiscal Policy*, 2004).

CONCLUSION

The National Gambling Impact Study Commission, a bi-partisan commission created to study the social and economic impacts of gambling in the United States, released its report in 1999. Concerned with the socio-economic effects of gambling, the commission offered voluminous recommendations, among which were the following:

- "States should refuse to allow the introduction of casino style gambling [including VLTs] into pari-mutuel facilities;" and
- "States should not authorize any further convenience gambling operations and should cease and roll back existing operations."

Despite these recommendations, most states (including Texas) are expanding legalized gambling. Policymakers increasingly turn to gambling revenues to underwrite the cost of enlarging government programs, and public support for this course appears to be growing. The number of Texans who support legalization of VLTs rose from 45 percent in 2003 to 51 percent in 2005, according to opinion polls.

Research on gambling underscores the urgent need for Texans to carefully examine the economic costs and benefits of expanding gambling and legalizing VLTs. Policymakers would do well to consider an admonition of the National Gambling Impact Study Commission:

> "One of the more damning criticisms of government decision-making in this area [gambling] is the assertion that governments too often have been focused more on a shortsighted pursuit of revenues than on the long-term impact of their decisions on public welfare."

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