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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 draw 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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Social costs from the spread of casinos nationwide easily would exceed $200 billion over a decade...

not because their motivation for gambling is not recreation

- Because of its need to be regulated and the above-normal profits to casino owners this often implies, licensing casino gambling creates a perpetual entrenchment 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 nearly told 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[1] 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.[2]

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 1995 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

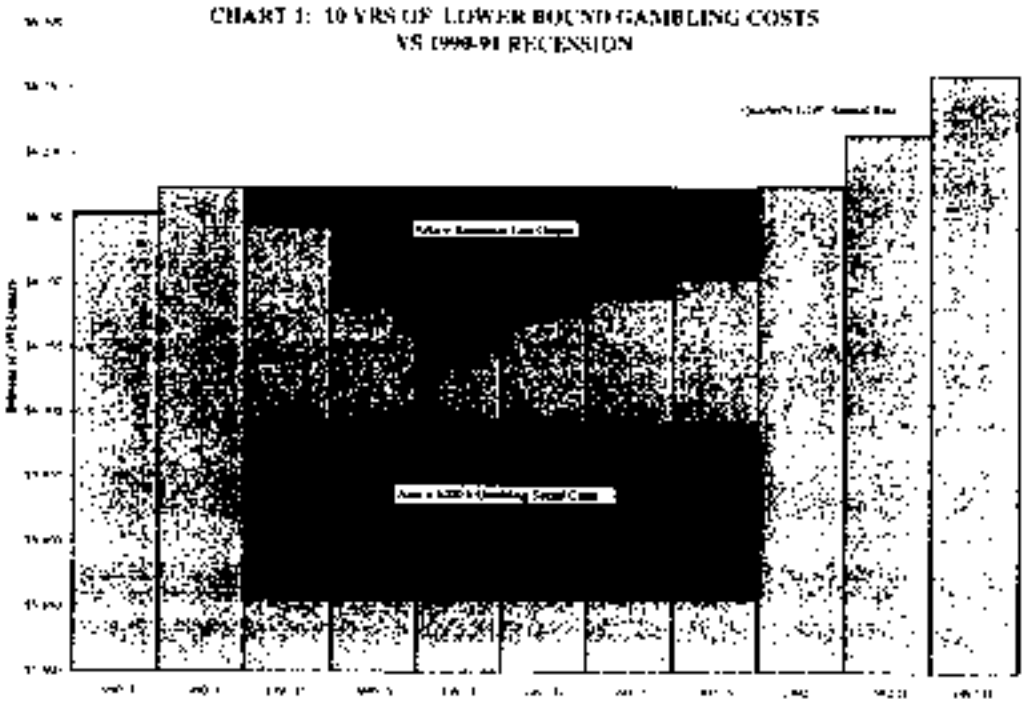
TABLE 1
PREVALENCE RATES OF P&P GAMBLING
Percent

Year	State	Problem	Pathological	Total
1986	New York	2.8	1.4	4.2
1986	California	2.9	1.2	4.1
1988	New Jersey	2.8	1.4	4.2
1988	Maryland	2.4	1.5	3.9
1989	Massachusetts	2.1	2.3	4.4
1989	Iowa	1.6	0.1	1.7
1995	Iowa	2.3	1.0	3.3
	Average	[illegible]	1.3	3.7

[illegible]

Thirty-five to fifty percent of long run casino revenues come from problem and pathological gamblers.

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.[1] 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

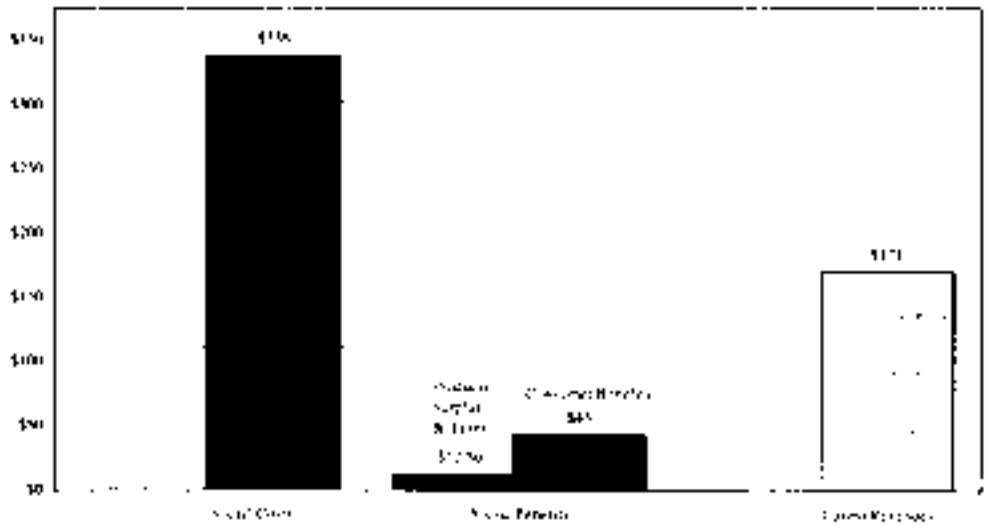
Three-fifths of pathological gamblers in treatment report that they committed crimes in response to their addiction. These crimes tend to be property crime rather than violent crime, though incidence of both types of crime increases when casino gambling is present. When one to four percent of the population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

We know that legalized gambling also increases the amount of illegal gambling.

...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



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 raise 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 passers-by and lead to their harm, even when the harm requires the choice of the passer-by. 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.

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 28 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

[illegible]

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 which research indicates are between $112 and $338 per adult annually. 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

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

1. Gazel, Ricardo, Dan Rickman, and William Thompson, "The Social costs of Gambling in Wisconsin," Wisconsin Policy Research Institute Report, July 1996.
2. Grinols, Earl, "Development or Dreamtield Delusions: Assessing Casino Gambling's Costs and Benefits," University of Illinois, September 1996.
3. Grinols, Earl and J. Omorov, "Who Loses When Casinos Win?" *Illinois Business Review*, Spring 1996, 53:1, pp. 7–11.
4. Reported in *St. Louis Post-Dispatch*, October 15, 1996.
5. *Minneapolis Star Tribune*, December 10, 1995, p. A20. ■