THE HOUSE OF CARDS IS FALLING: WHY STATES SHOULD COOPERATE ON LEGAL GAMBLING

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Introduction

Across the United States today, legalized gambling[1] is on the rise, in terms of both dollars wagered and geographical prevalence. Gambling exists in many forms, including lotteries, brick-and-mortar casinos featuring slot machines and table games, sport and race wagers, and Internet gambling. From 1970 to 2010, the number of states in which at least one form of gambling is legal increased from a handful to forty-eight.[2] Of all non-lottery forms of gambling, commercial casinos are the most significant in terms of wagers and revenues.[3] Overall consumer spending on gambling exceeds the amount spent on tickets for sports events, theater, concerts, and movies combined.[4] The growth and geographical spread of gambling has made gambling policy a salient issue in many states, where policymakers must deal with mounting costs and benefits as well as competition from neighboring states. This Note focuses on the causes and effects of interstate competition for the growing casino gambling market.[5]

As of December 2011, twenty-one states[6] have non-tribal slot machine gambling in commercial casinos or "racinos,"[7] with Ohio and

1. The terms "gambling" and "gaming" are often used interchangeably. I use "gambling" because it is less ambiguous.

2. Of the seven states without a lottery, only Utah and Hawaii do not have another form of gambling. *See* Am. Gaming Ass'n, State of the States 2010 4 (2010), *available at* http://www.americangaming.org/files/aga/uploads/docs/sos/aga-sos-2010.pdf; N. Am. Ass'n of State & Provincial Lotteries, Member Lotteries, *available at* http://www.naspl.org/Contacts/index.cfm (last visited Apr. 26, 2011).

3. *See* Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 13–19.

4. *Id.* at 8.

5. "Tribal casinos" are casinos owned by American Indian tribes. They are distinct from commercial casinos, which are owned by individuals or corporations. This Note focuses primarily on non-tribal commercial casino gambling, but tribal casinos are also principal players in the overall expansion of gambling due to their increasing market share and their unique relationships with states. For more discussion, see *infra* Part I.A.

Poker and forms of pari-mutuel betting such as race betting and sport betting are mostly excluded from analysis because of their different character (player against player, rather than player against house), wider traditional acceptance, and lesser significance in overall gambling activity.

Internet gambling, primarily in the form of poker, is still a relatively small market and its legality is controversial. *See generally* Nate Silver, *After 'Black Friday,' American Poker Faces Uncertain Future*, FiveThirtyEight Blog (Apr. 20, 2011), http://fivethirtyeight.blogs.nytimes.com/2011/04/20/after-black-friday-american-poker-faces-cloudy-future/ (describing recent history of online poker, its legal status, and the federal prosecutions of several online operators). Nevertheless, its existence and growth have some relevance to the casino gambling market because the difficulty of regulation and taxation may motivate states to advance in-person gaming.

6. Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 4.

7. "Racino" is a portmanteau of "racetrack" and "casino." Racinos are facilities that have horse or dog tracks and are also permitted to have other forms of gaming,

Massachusetts to join the list pending casino construction.[8] The expansion of gambling in the past several decades represents a major shift in social and legal attitudes towards the activity. Overarching most discussions on the subject is an intense debate regarding the overall economic and social costs and benefits of gambling.[9] This Note does not probe questions about morality or the general economic and social impacts of gambling. Rather, this Note examines how interstate competition for gambling revenues may *reduce* economic benefits and cause undemocratic outcomes in some cases. A significant body of evidence suggests that as more states legalize gambling, the likelihood that gambling will provide economic benefits decreases and the chance that casinos will appear in places where a majority of residents do not want them increases.

When a state legalizes gambling in the absence of a popular legalization movement, something else must be influencing decision-makers. This Note posits that interstate competition is a major factor contributing to gambling's expansion. To that end, this Note explores the following theories: (1) there is a "race to the bottom" which pushes states to legalize as a response to decisions made by neighboring states; (2) the race and its negative effects are exacerbated by the desire of states to defend against spillovers from neighboring jurisdictions; (3) there are shortcomings in the public choice processes leading to legalization; and (4) decision-makers are miscalculating the overall costs and benefits of gambling.

If states are indeed influenced by these factors, the result may be gambling policies that create higher social and economic costs than necessary, thereby shortchanging residents and taxpayers. Traditional federalism theories suggest that states usually achieve the best outcomes for themselves when they make their own decisions, but there is evidence that with respect to gambling, states are engaging in questionable policymaking. Once states enter the competitive arena, they

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primarily slot machines, on the premises. *Id.* at 39. In many cases, the inside of a racino is indistinguishable from a commercial casino, and the racetrack does not always exist before the casino.

8. Ohio legalized gambling in 2009, and its four casinos are expected to open in 2012 and 2013. Susan Glaser, *Ohio's Four Casinos: What You'll Find When They Open*, CLEVELAND PLAIN DEALER (Dec. 4, 2011), http://www.cleveland.com/travel/index.ssf/2011/12/ohios_four_casinos_what_youll.html. Massachusetts legalized casino gambling in late 2011, but casino construction plans have not been established as of this writing. Noah Bierman, *Patrick Vows Speed as Casino Era Begins*, BOSTON GLOBE (Nov. 23, 2011), http://www.bostonglobe.com/metro/2011/11/23/patrick-vows-speed-casino-era-begins/4h7D0DAs7CWzHQFySNJRoK/story.html.

9. *See generally* ROBERT GOODMAN, THE LUCK BUSINESS (1995) (taking an extremely critical position against the spread of gambling).

may be inclined to take regulatory steps to improve revenues while disregarding the costs that come with increases in gambling activity. This Note argues that these problems can only be addressed through significant interstate cooperation or, more controversially, centralization of gaming control through federal intervention.

Research devoted exclusively to gambling is a relatively new field, though certain aspects, such as the economic costs and benefits of gambling and the phenomenon of problem gambling, have been extensively covered. At least three articles have theorized that the use of gambling as an economic growth generator can lead states into a collective action problem,[10] and the use of interstate compacts on gambling has been proposed before.[11] This Note links those theories to recent legalizations, and goes further by fully describing the processes of legalization, reviewing the possible market failures caused by regulatory competition, identifying the many symptoms of this competition, and finally suggesting solutions which may alleviate the negative symptoms. Part I provides a history of legalization with a focus on recent developments and describes the positioning of gambling law within the federalist structure of the United States. Part II explores how market failures may be affecting state decision-making. Part III presents evidence of regulatory competition, and describes the negative consequences of that competition. Part IV proposes strategies, chiefly the creation of interstate compacts, for mitigating unwanted effects attributable to competition for gambling dollars.

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10. *See generally* John D. Donahue, *Tiebout? Or Not Tiebout? The Market Metaphor and America's Devolution Debate*, 11 J. ECON. PERSPECT. 73 (1997) (hypothesizing that interstate competition leads to more liberal gambling laws than the average citizen would prefer); Daniel Felsenstein et al., *Casino Gambling as Local Growth Generation: Playing the Economic Development Game in Reverse?*, 21 J. URB. AFF. 409 (1999) (evaluating gambling as a reversal of roles seen in typical economic development initiatives); William N. Thompson & Ricardo Gazel, *The Last Resort Revisited: The Spread of Casino Gambling as a "Prisoner's Dilemma"*, *in* GAMBLING: PUBLIC POLICIES AND THE SOCIAL SCIENCES 183 (William R. Eadington & Judy A. Cornelius eds., 1997) (using Illinois and Indiana to model an iteration of the prisoner's dilemma and predicting that gambling may spread with negative economic consequences).

11. *See* Christopher B. McNeil, *Interstate Compacts and the Gaming Industry: An Ohio Application*, 9 GAMING L. REV. 449 (2005) (suggesting the use of compacts to reduce regulatory costs); Dave McKinney, *Illinois Governor Seeks Midwest Compact On Gambling*, STATELINE (Sept. 7, 1999), http://www.stateline.org/live/printable/story?contentId=13779.

I.
Background

In the United States, the legalization and regulation of gambling is largely within the regulatory realm of states. At present, the federal government plays a role only in the regulation of Indian tribal gambling, gambling facilitated by the use of wires (including the Internet), and sports betting. To provide sufficient background for analyzing competition between states, this Part briefly describes how states typically legalize and regulate gambling, outlines the development of gambling in the United States, and ends by describing how federalism facilitates competition among the states.

A. How States Legalize Gambling

The decision to legalize gambling requires the creation of a framework of laws and new government bodies. Below is an outline of the three phases of the typical process: initialization, transition, and operation.

At the outset, legal casino gambling is typically proposed by lawmakers or advocacy groups supported by the casino industry. A debate begins within the state, and the key decision-makers step forward and deliberate. Upon an affirmative vote, the state legalizes gambling through constitutional amendment, referendum, legislation or some combination thereof.[12] The decision is then effectuated in statutes or amendments that outline, to varying degrees of specificity, the character of gambling that will be permitted.

The second phase is one of transition and preparation. The state builds a regulatory administration to devise and enforce regulations. The leadership of the administration is typically a board of appointed officials who make top-level decisions such as regulation modifications, discipline for code violations, licensing issues, and management of agency personnel. The bulk of the administration is comprised of compliance officers who conduct audits, investigations, and on-site inspections of casinos. With the governmental systems in place, licenses are apportioned and the construction of casinos begins.

The final phase—operation—extends perpetually as long as gambling is legal. Crucially, once operations begin, the state collects and monitors tax revenues. As time goes by, the state may make adjustments to its constitution, statutes, or regulations as the perceived need arises.

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12. Some states allow for local option votes on casino placement, but many states do not. This issue is developed in more detail in Part III.C.

Throughout this process, which usually takes several years from initialization to operation, numerous interested groups are in tension: aspiring casino owners, job seekers, gambling consumers, potential tax beneficiaries, the general public of the state, neighboring states, and politicians at multiple levels. Within any of these groups, there may be multiple divisions with opposing interests.[13] The legalizing state must make the following decisions, all of which have significant implications for the interested parties: what types of gambling will be allowed, how many operators will be licensed, how revenues will be taxed, and where casinos may be located. Additionally, the state must create and enforce more detailed regulations, such as permissible hours of operation, wagering limits, the availability of credit within a casino, specific game rules, how food, alcohol, and complimentary goods and services offered by casinos are treated, and restrictions on advertising.

Debates regarding legalization are typically lengthy, vigorous, and bitter. People support or oppose legal gambling for many reasons, some of which are intractably tied to their belief systems. It goes without saying that the financial stakes are also high; commercial casinos are already a billion-dollar (or more) industry in each of ten states, employing over 300,000 people nationally.[14] Potential tax revenues have apparent implications for politicians, taxpayers, and any possible recipients of subsidies. Gambling's inevitable negative effects also loom large. The presence of gambling facilities can have ruinous consequences for problem gamblers and their families. Host communities frequently experience dramatic changes, oftentimes for the worse in the eyes of locals.

B. Early History

The legal status of casino gambling across the United States has fluctuated throughout the nation's existence. Gambling in all its forms was outlawed almost everywhere in the early twentieth century, but what some experts call the "third wave" of legalization has been steadily underway since the Great Depression.[15] The current process of casino proliferation resembles in many ways the spread of lotteries in the

13. Casino corporations, for instance, may have the same position on legalization but will square off to compete for licenses. Politicians may unite on the legalization issue only to disagree over details later.

14. Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 7.

15. Prolific gambling scholar I. Nelson Rose coined this term. *See* I. Nelson Rose, *The Rise and Fall of the Third Wave: Gambling Will be Outlawed in Forty Years*, *in* Gambling and Public Policy: International Perspectives 65 (William R. Eadington & Judy A. Cornelius eds., 1991).

latter half of the twentieth century. Lotteries were illegal throughout the United States in 1900, labeled a "pestilence" by the Supreme Court in 1903, and remained a staple operation of organized crime throughout the Prohibition era.[16] Beginning with Connecticut in 1964, legalization of lotteries spread to forty-eight states.[17] Since then, lotteries have been the primary form of gambling in the country.[18]

Nevada was the only state with legal casinos from 1931 until 1976, when New Jersey authorized casino gambling in Atlantic City.[19] A period of stasis followed, but the 1980s featured major changes in another arena: Indian tribe casino operations. The Oneida Tribe of New York began operating bingo parlors in 1975, and the Seminole Tribe of Florida opened high-stakes bingo games in 1979.[20] The states tried to shut down these operations, but they failed after courts, including the Supreme Court in *California v. Cabazon Band of Mission Indians*, concluded that states have a limited ability to interfere with tribal sovereignty in gambling matters.[21]

After the *Cabazon* decision, in 1988 Congress passed the Indian Gambling Regulatory Act (IGRA), giving states the power to negotiate gambling arrangements with tribes.[22] The IGRA recognized three classes of gambling[23] and required compacts to be made between states and tribes before tribes could engage in Class III gaming, which includes slots and typical casino table games.[24] For states, the major benefits of the IGRA were that it allowed them to prevent tribal gambling if the state otherwise prohibited gambling, and it allowed them to use their compact bargaining ability to secure tax contributions

16. Champion v. Ames, 188 U.S. 321, 356 (1903) (quoting Phalen v. Virginia, 49 U.S. (8 How.) 163, 168 (1850)).

17. John Dombrink & Daniel Hillyard, Sin No More 33 (2007).

18. *Id*.

19. Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 18; *see also id.* at 13–24 (showing legalization dates among the states).

20. Kevin J. Worthen & Wayne R. Farnsworth, *Who Will Control the Future of Indian Gaming?*, 1996 BYU L. Rev. 407, 434 (1996).

21. California v. Cabazon Band of Mission Indians, 480 U.S. 202 (1987). The Court concluded that existing federal law permitted a state to prohibit tribal gambling only if the forms of gambling were illegal as a matter of state criminal law and public policy. The court held that California's regime did not meet that standard. *Id.* at 211–13.

22. 25 U.S.C. §§ 2701–2721 (2006).

23. Class I is defined as "social games solely for prizes of minimal value or traditional forms of Indian gaming engaged in by individuals as a part of, or in connection with, tribal ceremonies or celebrations." Class II includes bingo, pull-tab games, and certain types of card games, excluding "banking" card games such as baccarat and blackjack. Class III includes slot machine gambling, banking card games, and any form of gambling not included in Class I or II. § 2703(6)–(8).

24. § 2710(d).

from tribes involved in gambling.[25] After the passage of the IGRA, tribal gambling exploded, notably in California and Connecticut. By 1997, Indian tribes collected more than 13% of nationwide gambling revenues, including lotteries and pari-mutuel betting.[26] Tribal gambling revenues increased from $5.4 billion in 1995 to $26.7 billion in 2008.[27] Since the IGRA, some states have been able to greatly increase revenue sharing; for example, several compacts negotiated by the governor of California, Arnold Schwarzenegger, in 2004 required that 25% of tribal gaming revenues go to the state, similar to the deals made between Connecticut and two tribes.[28]

In the wake of the *Cabazon* decision and the IGRA, states with Indian tribes were less able to control gambling within their borders because they were forced to negotiate "in good faith."[29] In part due to this loss of control, many more states legalized gambling during the 1990s, and this trend continues unabated through 2012.[30] Once restricted to deserts, coastlines, riverboats, and reservations, casino gambling is now a presence in major metropolitan areas like New York City, Chicago, Philadelphia, and Detroit.

Due to its large population, location, and tradition of social conservatism, Pennsylvania is a noteworthy banner state for the latest wave of legalization. After many decades of prohibition, Pennsylvania legalized horseracing in 1963.[31] The Pennsylvania State Lottery was

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25. *See* § 2710(d)(3).

26. William R. Eadington, *The Economics of Casino Gambling*, 13 J. ECON. PERSP. 173, 174 (1999).

27. *See* NAT'L INDIAN GAMING COMM'N, GAMING REVENUE REPORTS, *available at* http://www.nigc.gov/Gaming_Revenue_Reports.aspx (listing several year-to-year comparison reports).

28. Dan Morain, *California on Path to Become Nation's Gambling Capital*, L.A. TIMES, Aug. 25, 2004, at A1; *Gaming Division – Frequently Asked Questions*, STATE OF CONN. DEP'T OF CONSUMER PROT., http://www.ct.gov/dcp/cwp/view.asp?a=4107&q=482854 (last visited Dec. 7, 2011) ("The state receives twenty-five percent (25%) of each casino's slot "win.").

29. § 2710(d)(7)(A)(i).

30. Commercial casinos and racinos were legalized in Nevada in 1931; New Jersey in 1976; Iowa and South Dakota in 1989; Colorado, Illinois, and Mississippi in 1990; Louisiana in 1991; Rhode Island in 1992; Indiana and Missouri in 1993; Delaware and West Virginia in 1994; Michigan in 1996; New Mexico in 1997; New York in 2001; Oklahoma and Pennsylvania in 2004; Maine in 2005; Florida in 2006; Kansas in 2007; and Ohio in 2009. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 13–24; *see also* James Nash, *Ohio OKs Casinos*, COLUMBUS DISPATCH (Nov. 4, 2009), http://www.dispatch.com/content/stories/local/2009/11/04/ISSUE_3.ART_ART_11-04-09_A1_O9FILBO.html.

31. Louis Effrat, *Betting to Begin in Pennsylvania*, N.Y. TIMES, June 7, 1963, at 54.

created in 1971, and off-track betting emerged in the early 1990s.[32] After his election in 2002, then-governor of Pennsylvania Ed Rendell began a campaign for legalization, culminating in the July 2004 authorization of slot machines at up to fourteen locations statewide.[33] Because Pennsylvania has no federally or state-recognized Indian tribes,[34] internal competition with tribal casinos was not a concern. Instead of legalizing to draw gamblers away from reservations, legislators in Pennsylvania were openly taking direct aim at their neighbor: New Jersey.

For several million Pennsylvanians, the commute to Atlantic City takes less than two hours. Atlantic City offers multiple resort-style casinos with luxurious accommodations, entertainment, high-end retail, and other attractive features such as beaches and its famous boardwalk. It is still the largest gambling city in the eastern United States, second nationally only to Las Vegas in gambling revenues and number of casinos.[35] Pennsylvania politicians were extremely cognizant of the capital outflow caused by Atlantic City casinos and repeatedly went on record to claim that legalization was needed to stop it.[36] The state achieved rapid results once casinos started opening. Annual gambling revenues in Pennsylvania exceeded $2 billion just four years after legal gambling operations began.[37] Due to a higher-than-average gambling tax rate, Pennsylvania collected more taxes from commer-

32. *History*, Meadows Racetrack & Casino, http://www.meadowsgaming.com/racetrack/ot_new_castle.php (last visited Nov. 18, 2011).

33. 2004 Pa. Laws 572, 601.

34. Nat'l Conf. of State Leg., Fed. and State Recognized Tribes, http://www.ncsl.org/?tabid=13278 (last visited Apr. 20, 2011).

35. Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 8.

36. Commw. of Pa., S. Legis. J., No. 45, 2d Sess., at 1950 (July 1, 2004) (Statement of Sen. Tomlinson: "But, when you weigh in the balance the good that I think we produced here, and the very fact that people in Pennsylvania are already gaming, people in Pennsylvania by the millions leave our State every day, thousands of trips and millions of people spending billions and billions of dollars, Pennsylvanians spend four billion dollars out of State right now, today, that is money that we could keep here in this Commonwealth and put to good use . . . .").

On the day Pennsylvania legalized casinos, state senator Vincent Fumo, a leading Democrat who pushed the legalization bill through the Senate, said:

> I have said many, many times before, if this were 20 or 30 years ago and the only place you could gamble was Las Vegas, the last thing I would be doing is advocating legalized slot machines in Pennsylvania . . . . We are faced with competition, we are faced with gambling on our borders, we are faced with a demand for this product, if you call it that, from our very own citizens.

Id. at 1990.

37. Pa. Gaming Control Bd., Revenue Fiscal Year 2009/2010, *available at* http://www.pgcb.state.pa.us/files/revenue/Gaming_Revenue_Monthly_FY20092010.pdf.

cial casinos than any other state in 2009, including Nevada, despite taking sixth place in gross revenues.[38] Pennsylvania is also currently the nation's leader in racino revenues,[39] and some analysts predict that it will overtake New Jersey as the second largest casino market in the very near future.[40]

Finding itself surrounded by legal gambling in Indiana, Michigan, Pennsylvania, and West Virginia, Ohio followed the trend of casino legalization in November 2009. Ohio legalized gambling by amending its state constitution through referendum, writing provisions directly into the constitution for four casinos, one in each of Ohio's four largest cities: Cincinnati, Cleveland, Columbus, and Toledo.[41] This contrasted with a more common method that had been utilized in Delaware, Pennsylvania, Illinois, Indiana, New Mexico, New York, and Rhode Island: legalization by statute alone, with no direct voter input.[42] Historically, direct voter approval of casino gambling requires multiple attempts. The Ohio legalization took place following the fifth vote on the issue, after four previous rejections by voters.[43] Florida and many other states also experienced repeated referendum failures in the early 1990s, though Florida eventually legalized slot machine gambling in 2004.[44]

38. *Compare* AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 6 (showing Pennsylvania as the leader in 2009 gambling tax revenues), *with id.* at 5 (listing Pennsylvania's 2009 gross consumer spending on gambling as $1.965 billion, which was sixth highest nationally).

39. *Id.* at 10.

40. Donald Wittkowski, *Pennsylvania Set to Overtake Atlantic City in Casino Revenue, Analysts Say*, PRESS OF ATLANTIC CITY (Mar. 23, 2011), http://www.pressofatlanticcity.com/communities/atlantic-city_pleasantville_brigantine/pennsylvania-set-to-overtake-atlantic-city-in-casino-revenue-analysts/article_0101dad2-54a6-11e0-82d6-001cc4c002e0.html.

41. The provision, titled "Issue 3," included the cities where casinos would be built, the tax rate and specific distributions, an upfront license fee, authorization of twenty-four-hour gambling, and creation of the regulatory body. Interestingly, the amendment authorizes any type of gambling that is legal or legalized in the future in Indiana, Pennsylvania, Michigan, and West Virginia. *See* OHIO SEC'Y OF STATE, PROPOSED CONSTITUTIONAL AMENDMENT, *available at* http://www.sos.state.oh.us/sos/upload/ballotboard/2009/3-final_language.pdf (last visited Apr. 28, 2011). The vote was 53% in favor, 47% opposed. OHIO SEC'Y OF STATE, STATE ISSUE 3: NOVEMBER 3, 2009—OFFICIAL RESULTS, *available at* http://www.sos.state.oh.us/SOS/elections/electResultsMain/2009ElectionResults/20091103issue3.aspx.

42. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 13–14.

43. Jilie Carr Smyth, *Economy Hovers Over Ohio Casino Vote*, WDTN (Nov. 3, 2009), http://www.wdtn.com/dpp/news/politics/WDTN_Economy_hovers_over_Ohio_casino_vote.

44. ROBERT GOODMAN, THE LUCK BUSINESS 6 (1995); Mary Ellen Klas, *A Timeline of Gambling in Florida*, ST. PETERSBURG TIMES (Nov. 29, 2009), http://www.tampabay.com/news/perspective/article1054345.ece.

The geographic diversity of the leading markets reflects the significant changes of the past twenty years. The top ten gambling markets in the United States in 2009 were the Las Vegas Strip; Atlantic City; "Chicagoland;"[45] Connecticut; Detroit, Michigan; St. Louis, Missouri; Tunica and Lula, Mississippi; Biloxi, Mississippi; Shreveport, Louisiana; and Boulder Strip, Nevada.[46] Notably, out of those ten markets, only Las Vegas, Atlantic City, and Boulder Strip had legal gambling before 1990.[47]

C. How Taxes Are Distributed

States choose to spend gambling tax revenues in a variety of ways, such as adding them directly to the state's general fund, relieving other types of taxpayers (by using the money for education and reducing property taxes, for example), creating economic development funds in specified or to-be-determined areas, or paying for specific projects, education, senior citizens, subsidizing for horse racing or other industries, and countering the social costs of gambling.[48] Because states can use gambling taxes to redistribute a fraction of gamblers' losses to benefit specific interests, the process of determining recipients of gambling funds is often as contentious as the process of legalization itself. When funds are allocated to relieve property taxes or subsidize particular businesses, gambling taxes may be more controversial because they appear to be regressive, and they transfer wealth from lower-income to higher-income segments of the population.[49]

D. Federalism and Decision-Making

Federalism is a core feature of the political structure of the United States. The U.S. Constitution explicitly grants certain powers to the federal government and grants or denies certain powers to the states. The federalist structure is reinforced by the Tenth Amendment, which reserves powers unmentioned in the Constitution to the states or

45. Including segments of both Illinois and Indiana.
46. AM. GAMING ASS'N, TOP 20 U.S. CASINO MARKETS BY ANNUAL REVENUE (2011), *available at* http://www.americangaming.org/industry-resources/research/fact-sheets/top-20-us-casino-markets-annual-revenue.
47. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 14–19.
48. *Id.* at 13–24; William N. Thompson, *Gambling Taxes: The Philosophy, the Constitution and Horizontal Equity*, 17 VILL. SPORTS & ENT. L.J. 389, 405 (2010).
49. Alicia Hansen, *Gambling with Tax Policy: States' Growing Reliance on Lottery Tax Revenue*, TAX FOUND., July 2010, at 25–28, *available at* http://www.taxfoundation.org/files/bp54.pdf.

to the people.[50] Gambling is not directly addressed in the Constitution. A state's authority to prohibit or regulate non-tribal gambling is typically premised on its police power. In states where the government's authority to legalize and regulate gambling is unclear, state constitutions may be amended, as was done in Ohio.

In the past, the federal government has regulated some forms of gambling under a presumption of constitutional authority. The IGRA derives authority from the Commerce Clause,[51] as does the Unlawful Internet Gambling Enforcement Act of 2006.[52] The Professional and Amateur Sports Protection Act of 1992, which prohibits sports betting in all but a few states, may also derive authority from the Commerce Clause.[53]

With limited federal oversight, states have been mostly free to create gambling systems of any character they choose. This freedom results in regulatory competition, because each state will treat gambling in a way that it believes improves its own welfare to the greatest extent possible. In other contexts, such as corporate chartering law and environmental law, there has been significant academic debate as to whether or not this type of competition is so problematic as to require federal intervention.[54] However, governmental competition may also serve as an important check on official powers, and may generate in-

50. U.S. Const. amend. X. ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.").

51. U.S. Const. art. I, § 8 ("The Congress shall have the power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.").

52. 31 U.S.C. §§ 5361–5367 (2006).

53. The statute itself makes no reference to constitutional authority. *See* 28 U.S.C. §§ 3701–3704 (2006). It has been criticized as an abuse of the commerce power for its disparate treatment of states. *See* Thomas B. Colby, *Revitalizing the Forgotten Conformity Restraint on the Commerce Power*, 91 Va. L. Rev. 249, 253 (2005) ("[I]t is in fact quite a radical thing to suggest, based on nothing more than a superficial textual analysis, that the Commerce Clause empowers Congress to discriminate between the states. That suggestion does not, I submit, stand up to more searching scrutiny."). A recent challenge to the statute, joined by two New Jersey state senators, was dismissed for lack of standing. Interactive Media Entm't & Gaming Ass'n v. Holder, No. 09-1301, 2011 U.S. Dist. LEXIS 23383 (D.N.J. Mar. 7, 2011).

54. *Compare* Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race to the Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. Rev. 1210 (1992) (the "race to the bottom" argument, by itself, is insufficient to justify federal environmental regulation), *with* Kirsten H. Engel, *State Environmental Standard-Setting: Is There a "Race" and Is It "To the Bottom?"*, 48 Hastings L.J. 271 (1997) (arguing that there is an empirical foundation for the existence of a "race to the bottom," supporting the retention of federal environmental standards).

novation.[55] Justice Brandeis pointed to these advantages of competitive federalism when he wrote, "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[56]

The remainder of this Note argues that unfettered regulatory competition in the gambling context will have significant negative implications; specifically, reduction of efficiency through policies skewed in favor of casino owners, leading to casino saturation, and usurping local preferences. State governments should therefore devise methods of cooperation to avoid such outcomes.

II.
Models of Competition

Dozens of jurisdictions that did not permit gambling in 1980 or 1990 now permit gambling, or may be on the verge of doing so. This dramatic change to the legal position of so many states warrants investigation into the causes of the shift. As more states legalize gambling, the results of interstate competition are becoming more apparent. This Part argues that states are engaged in a type of race to the bottom, and then details the role played by gambling externalities in leading states to legalization.

Competition between states for gambling revenues is without question a complex set of behaviors to analyze. This Note uses basic game theory models to demonstrate one possible cause of the spread of gambling and present problems that follow. Undoubtedly, many other factors contribute to the spread of gambling: increased social acceptance and demand, state budget difficulties combined with the political ease of instituting an essentially voluntary tax, and the availability of gambling from nontaxable providers such as Indian tribes or Internet sites.[57] While these are all relevant driving factors, the role of interstate competition is worthy of study on its own because it becomes more important with every newly adopting state.

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55. Donahue, *supra* note 10, at 74–75.

56. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

57. *See* Peter T. Calcagano et al., *Determinants of the Probability and Timing of Commercial Casino Legalization in the United States*, 142 Pub. Choice 69 (2010) (evaluating factors that may lead to legalization); *see also* Eadington, *supra* note 26, at 176 (suggesting that greater public acceptance and cross-border effects are responsible). Of the other contributory factors, all have been present for decades or longer except the increase in tribal and Internet gaming, and states now have strong protections from those sources through federal laws.

Because this Note focuses on the competition between states for gamblers and gambling revenues, several assumptions are necessary to keep the analysis simple. Unlike interstate competition for a major sports team or a manufacturing plant, it can be assumed for now that there is no relevant limit of firms willing to provide gambling as long as certain conditions are met in a jurisdiction.[58] Another assumption is that the key conditions for enacting legislation are tax rates and gambling rules that can lead to long-term profitability for a private operator. This assumption is realistic because the search by states for casino operators is not currently a zero-sum game,[59] and once gambling is legalized and revenue targets are set, the state will inevitably cater its rules to entice a sufficient number of private owners to open in authorized locations. If decision-makers were unwilling to create conditions necessary for gambling operations to come to fruition, the act of legalization would be an empty gesture. Even if private firms appear unwilling to enter a market, states have the option of owning casinos themselves, as they typically do with lotteries.[60] Therefore, the only

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58. The large number of untapped markets will ensure that there will not be a shortage of eager firms in the foreseeable future, as long as the conditions are sufficient. Most new casino licenses receive multiple bids. In Pennsylvania, twenty-five bids were received for fourteen licenses. Seventeen applications were made for five Category II licenses. The less lucrative Category I licenses received only six bids, however. *See* Press Release, Pa. Gaming Control Bd., Pa. Gaming Control Board Receives 25 Application Submissions for Operator Licenses (Jan. 9, 2005), http://www.pgcb.state.pa.us/?pr=124.

59. It is not a zero-sum game because there is a scarcity of licenses, not a scarcity of firms. The opening of a casino in one jurisdiction does not mean that no firms remain to build a casino in another. The historic illegality of gaming kept corporations out of the business until the second half of the twentieth century, but now dozens of potential operators compete for licenses. Early casinos in Nevada were financed by organized crime syndicates and corporations were forbidden from holding licenses until 1969. Afterwards, hotel chains were some of the first corporations to operate casinos. Today, many gambling-centric corporations are publicly owned and traded on major stock markets. Eadington, *supra* note 26, at 175.

60. As of this writing, there is only one "state-owned" casino in the United States: the Boot Hill Casino & Resort in Dodge City, Kansas. The state of Kansas formally owns the casino because its constitution forbids private ownership of lotteries or gambling facilities, not because private firms were unwilling to enter the market. Stephanie Simon, *(State) House Rules in Kansas Casino*, WALL ST. J. (Feb. 4, 2010), http://online.wsj.com/article/SB10001424052748703338504575041433293903748.html.

In fact, the state "owns" the building and the gaming devices, but the facility is operated by Butler National Corporation. In the fiscal quarter ending January 31, 2011, the casino had gross revenues of ten and a half million dollars, yielding for Butler National net revenues of six million dollars and a profit of seventy-three thousand dollars. Press Release, Butler Nat'l Corp. (Mar. 15, 2011), http://www.butlernational.com/pr031511.pdf. Interestingly, the total tax/public share for the "state owned" casino is 27%, significantly lower than the 55% in Pennsylvania where casinos are privately owned. *Compare* KAN. RACING & GAMING COMM'N, BOOT HILL CASINO &

apparent upper bounds on the number of casinos in this country are the size of the market for gambling and the number of licenses a state is willing to issue.

The purpose of the analysis is to determine whether states are creating policies that are counter to public preference or economically suboptimal. It is normally expected that the laws of a jurisdiction reflect the preferences of its residents and improve the general welfare. If the behavior of a state leads its neighbors to take policy positions that they would not reach if they were isolated, then something other than basic demand for gambling is influencing them. Therefore, the key question that emerges is whether gambling is spreading simply because more and more Americans prefer casinos in their states, or whether another reason, such as that its legality in one jurisdiction tends to cause its legalization in another, is responsible. If the latter is the case, the next questions are whether the spread of gambling is avoidable, and whether states are doing enough to maximize benefits and limit costs.

Gambling has costs and benefits for participants as well as for the communities where it is permitted.[61] The easily identifiable benefits are new tax revenues, employment opportunities, and increased consumer utility; these benefits are mostly enjoyed by the host region and state.[62] These benefits are highly visible and easy to quantify. The costs of gambling are less salient, not necessarily restricted to the locations where gambling takes place, and much harder to calculate.[63] Social costs, often related to "pathological" or "problem" gambling,[64] may include increases in crime,[65] bankruptcy, divorce, and child neg-

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RESORT REVENUE REPORT (Mar. 31, 2011), *available at* http://krgc.ks.gov/images/stories/pdf/Gaming_Revenue_Reports/2011-03_bhcr_revenue_report.pdf *with* PA. GAMING CONTROL BD., SLOT MACHINE GAMING REVENUE REPORT (Apr. 3, 2011), *available at* http://www.pgcb.state.pa.us/files/revenue/Gaming_Revenue_Weekly_20110403.pdf.

61. The actual per capita economic impact of legal gambling is a difficult figure to calculate. Revenues, taxes, and wages are easily obtainable, but cost figures are more evasive.

62. *See* NAT'L GAMBLING IMPACT STUDY COMM'N, FINAL REPORT 7-11 (1999) [hereinafter NGISC, FINAL REPORT], *available at* http://govinfo.library.unt.edu/ngisc/reports/finrpt.html.

63. *Id.* at 7-12 ("The NRC study stated that pervasive methodological problems in almost all existing studies prevent firm conclusions about the social and economic effects of gambling on individuals, families, businesses, and communities, generally.").

64. The phenomenon of pathological gambling has been confirmed, but is still not well understood. *See id.* at 4-1 to 4-19.

65. Much like other issues of gambling economics, the effect of casinos on crime incidents and rates is hotly debated. *Compare* Earl L. Grinols & David L. Mustard, *Casinos, Crime, and Community Costs*, 88 REV. ECON. & STAT. 28 (2006) (conclud-

lect rates.[66] Economic costs may include displacement of demand for other goods, decreases in productivity, and public resources required to support gambling (infrastructure, administration, etc.). The liberty and consumer utility justifications are often made, but because only 25%–30% of people of legal age to gamble in the United States ever actually do so, those benefits are only experienced by a minority of citizens.[67] Focusing on costs and benefits for taxpaying non-gamblers, the only question is whether communal economic gains can offset the communal economic losses and social costs of gambling. As described below, a state's interaction with neighboring states can significantly influence the outcome that the state achieves.

A. The Prisoner's Dilemma and the Race to the Bottom

The prisoner's dilemma is a classic problem in game theory which describes a situation where actors make apparently rational decisions for their own good, but which actually decrease their overall welfare.[68] The basic model is that when two criminal conspirators are captured by authorities, they are isolated and given two choices: they may defect against the other or remain silent (cooperate). If one defects and the other does not, the defector is rewarded with freedom while the cooperator receives a lengthy prison sentence. If both cooperate, they both receive light sentences (the best possible combined outcome). If both defect, they both receive moderate sentences, but the combined years are longer than the lengthy term received by a lone cooperator. The dilemma stems from the ex ante rationality in defecting (a chance at the best individual outcome while protecting against the worst possible individual outcome) and the ex post realization that they receive the suboptimal result if they do so. Since neither knows what the other will do, cooperation poses the greatest ex ante risk to each individual.

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ing that casinos cause increases in all crimes except murder in their host counties, imposing an average social cost of seventy-five dollars per adult in those counties), *with* Douglas M. Walker, *Evaluating Crime Attributable to Casinos in the U.S.: A Closer Look at Grinols and Mustard's "Casinos, Crime, and Community Costs"*, 2 J. GAMBLING & ECON. 23 (2008) (agreeing that the absolute number of crimes in an area will increase when a casino is added, but criticizing the methodology of the Grinols & Mustard study and questioning whether non-gambling tourism would have the same effect).

66. For general discussion of these potential social costs of gambling, see NGISC, FINAL REPORT, *supra* note 62 at 7-18 to 7-28.

67. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 29.

68. This dilemma is frequently discussed in academic literature, but this version is extrapolated from two sources. *See* Thompson & Gazel, *supra* note 10, at 196; Revesz, *supra* note 54, at 1217–18.

Applicability of the model is limited because, in reality, many more variables exist and the system is not restricted to only two actors.[69] The standard prisoner's dilemma involves only two players who have a relationship with just each other and only one chance to play the game. In contrast, the real world is an open system with many players engaging in non-simultaneous, repetitive decision-making. The overall behavior of several players caught in circumstances akin to the prisoner's dilemma may be better viewed as a "race to the bottom." Under the same prisoner's dilemma scenario, imagine that the suspect who confesses *the most* about a multi-person criminal enterprise will receive the most lenient treatment.[70] Every player, therefore, rationally decides to confess as much as possible, although if all had agreed to cooperate, each individual punishment would be less severe.

The race to the bottom model is often used as an analogy to describe regulatory competition. In a basic regulatory race to the bottom, states attempt to increase economic activity by reducing the legal and regulatory impediments on businesses. States believe that businesses will relocate to the state and that businesses within the state will increase production because the reduced governmental impediments can increase their profit margins. To preempt or reverse the loss of business and draw in new business, other states will respond by making the same reforms or going even further. Thus, the states are "racing" or "defecting" towards the lowest level of regulation possible, the "bottom." As a result, we find limited regulations in multiple jurisdictions and the potential for zero firm movement, because if a firm's original host state reaches the "bottom," the incentive for that firm to relocate no longer exists.[71] If the reforms lead to internal costs that exceed the economic benefit from increased business activity, the result may be inefficient under-regulation in every state, leaving all states in a worse position.[72] This inefficiency results because the state must bear the costs of reduced regulations without receiving the benefit that induced it to reform in the first place.

In state-versus-state gambling competition, there are some differences from the basic model. States are generally not competing to at-

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69. Thompson & Gazel, *supra* note 10, at 205.

70. Revesz notes that when there are more than two possible choices available, the dominant strategy depends on the actions of the others, and will lead to a "Nash equilibrium" rather than a "dominant strategy equilibrium" that can be identified in advance. Revesz, *supra* note 54, at 1231 n. 68. For the purposes of this Note, the game is used primarily to illustrate the circumstances states find themselves in, and not to deeply discuss game theory.

71. Allan Erbsen, *Horizontal Federalism*, 93 MINN. L. REV. 493, 525–27 (2008).

72. *See id*.

tract a limited number of firms. Instead, states are trying to capture a larger share of the wagered dollars in a given region, and it is fair to assume that they are also trying to increase the amount of overall wagers. Thus, the focus of the competition is on the gambler, not the gambling firms.[73] Still, the general trend of legalization shows a pattern of competition that clearly resembles a "race," and particular policies described below appear to be a "bottom," in that the eventual result will be less productive than states initially imagined.

B. Externalities

Externalities greatly increase the complexity of the game. The choices made by one state have major implications for its neighbors beyond the battle to take a higher share of one gambling pot. Casinos generate negative externalities that cross state borders; a state may experience negative effects from gambling even if gambling is not legal there. These externalities may cause states to legalize or expand gambling in response to the presence of gambling in a neighbor state.

Polluting industries offer a classic example of how externalities can affect state relationships and decision-making.[74] A factory that releases pollutants into the air or bodies of water may provide benefits to its host state through jobs and tax revenue. However, the pollution, which creates costs in the forms of damage to the ecosystem and human health, may not remain contained in the host state. Any downwind or downstream states affected by the pollution are forced to take on these costs without necessarily receiving any benefit from the factory. To maximize its own utility, the host state will establish environmental regulations only to the extent needed to ensure that the factory's benefits offset the costs that remain in state. If the factory is located on the border between states and most or all of the pollution spills over to the neighbor, the host state will have little incentive to regulate, since it incurs few, if any, of the environmental costs. The net outcome that the two states achieve will be inefficient because the host state ignores exported costs when doing a cost-benefit analysis.[75]

73. Felsenstein treats gambling competition as the complete opposite of the normal economic development competition, such as when states attempt to induce manufacturers to build a factory within their borders. The manufacturer is the resource holder and states are the bidders, but in gambling, the state holds the resource (licenses) and the casino corporation is the bidder. This is a useful approach in some respects, but by focusing on competition among bidders, the article tends to overlook the importance of state-to-state competition. *See* Felsenstein et al., *supra* note 10.

74. Revesz, *supra* note 54 at 1213–15.

75. *See id*. at 1222.

The situation of an island state can be contrasted with that of states that share land borders. Insulated from spillover effects and less vulnerable to the threat of emigration, an island state can choose a regulatory system that optimizes its own welfare.[76] Another way to conceptualize this is to imagine that it is illegal to gamble in any state other than one's own. Assuming that there was perfect compliance with this rule, states would be insulated from the decisions made by their neighbors. An insulated state would be forced to make a detailed cost-benefit analysis based only on internal effects and the preferences of residents, and would prohibit or regulate gambling so as to achieve a "Pareto efficient" outcome.[77] People who strongly desire legal gambling or gambling prohibition would move to the jurisdictions that fit those preferences. Without insulation, externalities will affect neighboring jurisdictions and policy choices will not be entirely driven by internal conditions.

The casino has qualities similar to that of a polluting factory. An adult American may patronize any casino he chooses. If he crosses state lines to gamble, his inevitable losses represent negative capital flow for his home state.[78] The home state receives no tax revenues on the expenditures, and his community loses capital that may have been spent at local businesses, thereby decreasing the local economic multiplier and money velocity.[79] Furthermore, the tourist gambler's home state will bear most or all of the potential social costs of his gambling.[80] Inversely, the host state enjoys multiple benefits: capital in-

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76. *Id.* at 1213–15.

77. Pareto efficiency is the condition in which goods are allocated among individuals such that no one can be made better off without making another person worse off. Charles Tiebout argued that if certain assumptions are made, jurisdictions should make Pareto efficient policies because people would move to a jurisdiction that has policies fitting the individual's preferences. *See* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

78. There is always the potential that an individual gambler will win money at an out-of-state casino on a specific visit and bring it home. Since every form of casino gambling has a negative expected value, however, the aggregation of gambler outcomes eliminates the significance of this hypothetical for purposes of this discussion. For a breakdown of typical casino game odds, see Eadington, *supra* note 26, at 179.

79. Local economic multiplier and money velocity are terms that describe the reuse of dollars within a particular community. The more goods and services that are purchased from residents of the same community, the more times those particular dollars can be used within the community, as opposed to dollars spent outside of the community or profits taken by owners who do not reside within the community. Even when residents gamble at their local casino, their losses may substitute other potential local spending in a way that hurts the local economy, especially since most casinos are not locally owned. *See* Thompson & Gazel, *supra* note 10, at 197.

80. States are highly cognizant of these externalities. *See, e.g.*, GOVERNOR'S BLUE RIBBON COMM'N ON MICH. GAMING, BLUE RIBBON REPORT—EXECUTIVE SUMMARY

flow (at the casino and complementary industries such as restaurants and hotels), tax revenues, and employment. The host state will bear few of the social costs related to a tourist gambler, essentially free-riding by exporting some costs and internalizing all the benefits. Thus, states with legal gambling are incentivized to increase the proportion of tourist gamblers in their casinos.

Unlike the pollution described above, however, the state experiencing spillover effects from gambling can take preventative measures by legalizing gambling itself. Currently, most states fall into one of four broad categories: (1) states without gambling and with low losses to neighbors, (2) states without gambling but with high losses to neighbors, (3) states with gambling and a high percentage of tourist gamblers, and (4) states with gambling and a low percentage of tourist gamblers. In Category I, gambling causes a minor economic loss for the state; in Category II, gambling causes a major economic loss; and in Category III, gambling provides a major economic gain. The economic impact in Category IV is more complicated and will depend on many factors, especially the actual percentage of revenues coming from tourist gamblers. Many early gambling states were in Category III, and new gambling states aspire to be the same. As legal casinos spread, however, more states will end up in Category IV, and the overall economic impact of casinos is less likely to be positive.

Nevada is the paradigm Category III state. Gambling has been a boon in Nevada, and is the bedrock on which the state was built.[81] With no personal or corporate income taxes, Nevada has the nation's second-lowest tax burden and had the nation's fastest population

(1995), *available at* http://www.michigan.gov/mgcb/0,1607,7-120-1382_1452-14473—,00.html ("Social ills linked to gaming already afflict Michigan citizens because casino gambling currently is within easy reach of all the state's residents in Windsor, Ontario, and at Indian facilities within the state. Riverboat gaming has been authorized in the nearby State of Indiana and now exists in Illinois. The easy accessibility that Michigan citizens now have to land-based and riverboat casino gaming gives rise to the belief that the state is exporting gambling dollars while importing, and being financially responsible for, the social harm resulting from gaming.").

81. Nevada's reliance on gambling is clear from economic data. In 2009, Nevada's GDP was about $125 billion. News Release, Bureau of Econ. Analysis, U.S. Dep't of Commerce, Table 3 (June 7, 2011), *available at* http://www.bea.gov/newsreleases/regional/gdp_state/2011/pdf/gsp0611.pdf. The American Gaming Association reports that Nevada's gambling revenue in fiscal 2009 was $10.39 billion, about 8.3% of Nevada's GDP. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 18. That figure represents only casino revenue, so when additional tourism-generated revenue from sources such as hotels and restaurants is also considered, gambling is undoubtedly a core industry in Nevada.

growth rate for decades.[82] Hawaii, a true island state, has not legalized any form of gambling, including lotteries. The high cost of traveling out of Hawaii makes it a paradigm Category I state, and its isolation may help explain its reluctance to legalize.

The externality problem is the central battleground of this interstate competition. When a state in Category I finds itself moving into Category II, the chance that the state will legalize gambling increases. To maintain Category III status, an early adopting state may react by issuing more licenses or making regulations that will help its casinos better "compete" with those of other states. This is slightly different from the once-played prisoner's dilemma; here, states are able to see the policies of their neighbors in advance, but those policies are always subject to revision. State A knows that State B has legal gambling and knows the current locations of State B's casinos, but State A does not know how State B might react to legalization in State A. State B might respond by authorizing more casinos near the border between itself and State A, or changing other regulations to keep its casinos competitive. Meanwhile, all of the other surrounding states are also affected and may take steps of their own.

Focusing on externalities leads to the risk that capital flow will be overestimated or interpreted as having other kinds of significance. Because there is no formal monitoring, the actual amounts of money crossing state borders have never been precisely calculated, but estimates are frequently made.[83] Without precise data, decision-makers cannot have a true grasp on how much money is spent on gambling in other states. They may also perceive tourist gambling as "voting with their feet," indicating that those who gamble in another state would prefer local gambling options, when such is not necessarily the case.[84] By legalizing gambling, the possibility arises that states will end up

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82. State-Local Tax Burdens Fall in 2009 as Tax Revenues Shrink Faster than Income, Tax Found. 3, 6 (2011), *available at* http://www.taxfoundation.org/files/sr189.pdf; Delen Goldberg, *Census Bureau: Nevada Was Fastest Growing State in the Nation*, Las Vegas Sun (Dec. 21, 2010), http://www.lasvegassun.com/blogs/nevada-wonk/2010/dec/21/census-bureau-nevada-was-fastest-growing-state-nat/.

83. *See* Clyde Barrow, New England Casino Gaming: Update 2010 (UMass-Dartmouth Ctr. for Policy Analysis 2010) (estimating amount of cross-border gambling in New England).

84. Even though many Americans travel to gamble, they may prefer paying the transaction costs involved in doing so over hosting a casino in their own community. *See* PublicMind, Farleigh Dickinson Univ., US Public: Keep Las Vegas in Las Vegas (2010), *available at* http://publicmind.fdu.edu/casino/final.pdf (finding that a majority of Americans do not want casinos in their towns and a plurality, even among individuals who had visited a casino in the previous twelve months, believe casinos have a negative impact on local communities).

internalizing more costs than they were losing to out-of-state casinos, even after accounting for the economic benefits of hosting.

States that are home to federally recognized Indian tribes are in a particular bind. Since the passage of the IGRA, these states are required to negotiate regulations and tax rates for Class III gambling in good faith with the tribes and cannot demand higher tax rates than those for private casinos.[85] Since these states' ability to negotiate with tribes is limited by this requirement, they may be tempted to legalize commercial casinos and impose even higher taxes.

III.
Evidence of Competition and Negative Effects

A. *Are States Really Competing?*

For most of the twentieth century, it did not appear that states were racing to the bottom in gambling. Legalization came at a slow trickle, and many states did not respond to the adoption of gambling by their neighbors. The expansion of gambling in the past thirty years is compelling, however, and evidence of competition is growing. A recent study that attempted to identify factors that would predict casino legalization found that a neighboring state with Indian tribe gambling was a significant predictor, and that a neighbor with a commercial casino suggested a positive correlation but was a statistically insignificant predictor.[86] Gambling advocates seize on externalities, pointing to capital outflow as a primary justification for legalizing gambling.[87] Put simply, state leaders believe that if their residents are already gambling, it is better that they gamble within the home state than anywhere else. That is, if a state is already incurring costs from gambling, it might end up with a better bargain by legalizing and realizing benefits. Gambling advocates' constant invocation of the "defen-

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85. 25 U.S.C. § 2710(d)(3)(C)(iv) (2006); *see generally* § 2710(d)(3).

86. Peter T. Calcagano et al., *Determinants of the Probability and Timing of Commercial Casino Legalization in the United States*, 142 Pub. Choice 69, 84 (2010). The authors hypothesized that the "adjacent state with commercial casinos" factor was an insignificant predictor because still relatively few states have commercial casinos. *Id.*

87. *See* James Dao, *Two States Try to Keep Gambling Money at Home*, N.Y. Times (Mar. 22, 2004), *available at* http://www.nytimes.com/2004/03/22/us/two-states-trying-to-keep-gambling-money-at-home.html?pagewanted=ALl&src=pm (describing legislative and executive efforts to legalize gambling on grounds that state residents gamble in neighboring states). In an interview with *60 Minutes* at the end of his tenure, Governor Ed Rendell repeatedly cited Pennsylvania's capital loss to Atlantic City as a primary reason for legalization. *60 Minutes: Slot Machines: The Big Gamble* (CBS television broadcast, Jan. 9, 2011) (9:02–9:18, 11:00–11:08), *available at* http://www.cbsnews.com/video/watch/?id=7228424n&tag=contentMain;contentBody.

sive" justification for legalization is evidence that states would be less inclined to legalize if their neighbors had not done so before them.[88] When other arguments have failed, renewed campaigns that highlight capital losses appear to persuade voters. Florida's legalization history illustrates how advocates for legalization can change vote outcomes by pointing to externalities. Surveys of Florida residents discovered that legalization was met with more approval when capital outflow was mentioned in the question.[89] Not surprisingly, in 2004, advocates of legislation highlighted capital losses and promised major payments to public education, and after many failures, they finally succeeded in a ballot initiative that led to legal gambling in certain Florida counties.[90]

Tax revenues and recent year-to-year changes illustrate that competition is real. Pennsylvania's new casinos clearly took a bite out of New Jersey revenues; the 18.6% drop in New Jersey's gambling tax revenues between 2008 and 2009 was the greatest nationwide, significantly more than the 10% decline experienced by the nation's biggest gambling destination, Nevada.[91] Pennsylvania revenues increased substantially during this time as it opened new facilities.[92] New Jersey's steeper loss compared to Nevada suggests that it is suffering from both the effects of neighborly competition and the economic recession; Nevada has fewer close competitors and may therefore be more insulated from competition.

At least three elements of law can be compared state by state to evaluate competitiveness: the amount and types of gambling permitted, the tax rates on gambling, and the required minimum return per

88. Edward J. Furlong, *A Logistic Regression Model Explaining Recent State Casino Gaming Adoptions*, 26 POL'Y STUD. J. 371, 373 (1998). Furlong did not find that competition had statistical significance as a predictive factor to legalization, but he was working with a more limited data set than is available now. Therefore, the more recent Calcagano study, Calcagano et al., *supra* note 86, at 80, 88, is probably more indicative of the importance of competition.

89. Donahue, *supra* note 10, at 77.

90. Martin Dyckman, *Lies Fuel Slot Machine Campaign*, ST. PETERSBURG TIMES (Oct. 17, 2004), http://www.sptimes.com/2004/10/17/Columns/Lies_fuel_slot_machin.shtml ("The Amendment 4 propaganda argues that Florida already has slot machines, unregulated and untaxed, on cruise ships and Indian reservations."); Linda Kleindienst & Sarah Talalay, *Final Tally a Winner For Slots*, ORLANDO SUN-SENTINEL (Nov. 5, 2004), http://articles.sun-sentinel.com/2004-11-05/news/0411050242_1_seminole-tribe-slot-machines-broward-county ("Supporters, which include the Florida School Boards Association and the state teacher union, have promised taxes on the slot revenues could raise $500 million in the first year to supplement education statewide and as much as $2.5 billion over five years.").

91. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 6.

92. Pennsylvania's gambling revenues increased 21.2% from 2008 to 2009, attributable to the opening of two new casinos in that time frame. *Id*.

dollar gambled.[93] If states are influenced by competitive pressure, permitted types and amounts of gambling will increase.[94] Tax rates and required minimum returns will face downward pressure.[95] Basic economic principles suggest that competition between casinos in the same market will benefit gamblers through increasing payouts, thereby decreasing the average percentage of wagers lost by gamblers. To lure gamblers away from other facilities, casinos in competitive areas will offer better payouts and more gambler-friendly rules.[96]

The overall economic impact of gambling in a state or municipality can be clearly positive, clearly negative, or somewhere in between. The result depends on a handful of specific factors, especially the proportion of tourist gamblers.[97] States and casino host towns hope that gambling will have a clearly positive or at least mostly positive impact. Regulatory competition decreases the beneficial factors and increases internal costs, making it harder for states to achieve the results they originally sought.

If every state has legal gambling, it is not mathematically possible for all of them to achieve net capital inflow from American tourists. Using real data from Pennsylvania, it is possible to construct a worst-case scenario that illustrates how gambling might fail to deliver economic benefits unless some gamblers come from out of state. From July 2009 to June 2010, statewide slot revenue (gambler losses) was greater than two billion dollars.[98] Based on population estimates, per capita gambling losses would be $171 if the only patrons were Penn-

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93. Returns are more useful in evaluating slot machine gambling because the return can be adjusted fairly easily compared to table games. The actual dollar amount returned to gamblers should be a function of competition for gamblers among casino operators, but the legally required minimum or nonexistence thereof should be a function of *state* competition for casinos.

94. Colorado's Amendment 50 ballot measure, which led to increased bet limits and allowed casinos to remain open twenty-four hours, was proposed in the name of improving casino competitiveness. The measure was similar to one that had been approved in South Dakota in 2000. *See* Andy Vuong, *College Gamble*, DENVER POST, Oct. 26, 2008, at K.1.

95. Actual returns are bounded by competition for gamblers, so casino operators may be indifferent about the legally required minimum returns.

96. Eadington, *supra* note 26, at 180–81.

97. For gambling to be a positive economic generator, tax revenues, added jobs, and increased secondary activity (such as hotel or restaurant business) must be greater in the host region than the losses of local residents and the costs associated with gambling, such as those associated with oversight and increased crime and traffic.

98. PA. GAMING CONTROL BD., GAMING REVENUE FISCAL YEAR 2009/2010, *available at* http://www.pgcb.state.pa.us/files/revenue/Gaming_Revenue_Monthly_FY2009 2010.pdf (showing yearly revenue of $2,164,839,765.25).

sylvanians.[99] Taxes and casino wages are paid out of this amount, but these are merely redistributions and not "new" revenues for the state. Negative costs such as consumer money moved from in-state businesses to the casinos and social problems will remain in-state. Payments to out-of-state corporate employees and shareholders will also leave the state.[100] The best and perhaps only way for Pennsylvania to offset these losses would be to increase its percentage of tourist gamblers, thereby providing both capital inflow and cost exporting.[101]

When states attempt to stop tourist gamblers from leaving, they tend to be somewhat successful. Studies from the mid-1990s showed that between 59% and 62% of the demand served by new casinos came from redirection or "import substitution."[102] A study of the competition between Pennsylvania and New Jersey concluded that within thirty months of Pennsylvania's entrance in the market, Pennsylvania seemed to be redirecting gamblers from Atlantic City and expanding the overall regional gambling market.[103] Still, the first few years of Pennsylvania gambling did not produce the projected results, so in 2010, Pennsylvania made multiple changes designed to increase revenues, including legalization of table games.[104] A 2009 study projected that Pennsylvania would earn $864.5 million in table game revenues

99. The most recent official estimate of Pennsylvania's population is 12,632,780. *See* CENSUS BUREAU, PRELIMINARY ANNUAL ESTIMATES OF THE RESIDENT POPULATION FOR THE UNITED STATES, REGIONS, STATES, AND PUERTO RICO: APRIL 1, 2000 TO JULY 1, 2010 (Feb. 2011), *available at* http://www.census.gov/popest/eval-estimates/eval-est2010.html.

100. Thompson & Gazel, *supra* note 10, at 197.

101. Some have analogized export-based casinos to "factories" and local-based casinos to "restaurants." In gambling literature, there is significant debate over the importance of "exporting," and there is no consensus that exporting is necessary for positive growth. *See* Douglas M. Walker, *Legalized Casino Gambling and the Export Base Theory of Economic Growth*, 3 GAMING L. REV. 157 (1999) (discussing the debate and questioning the validity of the export necessity argument).

102. Felsenstein et al., *supra* note 10, at 414.

103. Richard McGowan, *The Competition for Gambling Revenue:* Pennsylvania v. New Jersey, 13 GAMING L. REV. & ECON. 145, 153 (2009).

104. Tom Barnes, *Pa. Senate OKs Table Games, House Expected to Follow Suit by End of Week*, PITTSBURGH POST-GAZETTE (Jan. 6, 2010), *available at* http://www.post-gazette.com/pg/10006/1026066-454.stm (describing legislative efforts in early 2010 to expand slot casinos by adding table games); Janice Crompton, *Casino Revenue Hasn't Met Expectations, But Greater Tax Relief Anticipated*, PITTSBURGH POST-GAZETTE (May 6, 2010), *available at* http://www.post-gazette.com/pg/10126/1055709-55.stm (observing that slot revenue in Pennsylvania had been less than anticipated by early 2010 and describing state and industry efforts to tweak operations in response).

in 2012, with $502.8 million (58.2%) of that amount coming from gamblers who were already playing in out-of-state casinos.[105]

Across the Delaware River, competition from Pennsylvania is a serious problem. New Jersey, a state where casino contributions typically comprise 1.5%–2% of the state's overall revenue,[106] is facing tremendous pressure to stop Atlantic City's decline. Gross revenues have dropped from $5.018 billion in 2005 to $3.943 billion in 2009.[107] While some of this drop is attributable to the general economic recession, the Pennsylvania casinos have taken market share from New Jersey that may never come back.[108] In response, New Jersey has begun taking legislative action toward increasing Atlantic City's revenues. In 2011, the New Jersey legislature approved a revitalization plan for Atlantic City; the plan includes the creation of new tourism districts, state investments in infrastructure and financing for a new casino, and allowing forms of Internet gambling at casinos.[109]

1. *Tax Competition and Unpredictable Outcomes*

Because many states are new to the gambling market, it may be too early to find strong empirical evidence of back-and-forth tax competition, but the stage is being set for more detailed studies in the future. The wide range of tax rates among gambling states raises important questions: such as how a state determines gambling tax rate, what advantages lower-than-average tax rates provide to a state, and whether those advantages can make up for the foregone revenues.

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105. Mark Belko, *Casinos in W.V. to Lose Their Edge*, PITTSBURGH POST-GAZETTE (Jan. 10, 2010), *available at* http://www.post-gazette.com/pg/10010/1027184-455.stm.

106. *See, e.g.*, OFFICE OF MGMT AND BUDGET, FISCAL 2003, BUDGET IN BRIEF, 34 (Apr. 2002), *available at* http://www.nj.gov/treasury/omb/publications/03bib/pdf/bib.pdf; OFFICE OF MGMT AND BUDGET, FISCAL 2007, BUDGET IN BRIEF 102 (2006), *available at* http://www.nj.gov/treasury/omb/publications/07bib/pdf/bib.pdf. The economic importance of the gambling industry is probably somewhat understated by casino contribution figures because they exclude the additional sales taxes and other revenues generated by gambling tourism.

107. *Compare* AM. GAMING ASS'N, STATE OF THE STATES 2006 16 (2006), *available at* http://www.americangaming.org/files/aga/uploads/docs/sos/aga-sos-2006.pdf (showing New Jersey's 2005 gambling revenue), *with* AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 18 (showing New Jersey's 2009 gambling revenue).

108. McGowan, *supra* note 103, at 153.

109. Ginger Gibson, *Gov. Christie Signs Legislation Establishing Atlantic City Tourism District*, NJ.COM (Feb. 1, 2011), http://www.nj.com/politics/index.ssf/2011/02/gov_christie_signs_atlantic_ci.html; Suzette Parmley, *N.J. Assembly Backs A.C. Plan*, PHILA. INQUIRER, Jan. 11, 2011, at D1, *available at* http://articles.philly.com/2011-01-11/business/27021877_1_slots-revenue-gaming-revenue-table-games.

Gambling tax rates vary widely, with a national average around 30-35%.[110] Nevada and New Jersey, first-comers to gambling, have tax rates between 3.5% and 10.5%, depending on the size of the taxed casino.[111] Pennsylvania, a newcomer in the market and surrounded by competitors in New Jersey, New York, Canada, and West Virginia, still managed to secure for itself one of the highest gambling tax rates in the nation: 55% of gross revenues.[112] Ohio fared much differently, however. Despite similar demographics and proximity to Pennsylvania, Ohio set a tax of only 33% on its casinos.[113] Because this tax rate was included as part of the constitutional amendment, a change would require further amending the state constitution.

The disparity between Ohio and Pennsylvania shows that some states may be setting gambling tax rates significantly below what operators will tolerate.[114] In the future, competition for gamblers may create downward pressure on tax rates. If the number of wagers in a particular state decreases due to competition from neighbors or economic downturn, jobs and tax revenues will be put in jeopardy. State leaders may suggest tax reductions as a mechanism to save jobs and improve competitiveness because a lower tax rate gives the operator a larger profit margin, some of which can be reinvested in the casino.[115] Lower taxes can also help the casino increase payout rates, making the casino more attractive to gamblers.

Increased competition for revenues means that the economic rents that states are able to charge will also decrease as more states enter the market. Each new license issued in a new state decreases the marginal value of licenses generally, which drives down the cost ca-

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110. A simplified calculation of the average gambling tax rate yields a figure of roughly 35%. This includes states with video lottery terminals, slots, or table games in any form of commercial casino or racino. For states that tax forms of gambling at graduated or varying rates, only the highest possible rate on gross revenues was included. Where local or other taxes are known, they are included, but per-machine or per-gambler visit charges are excluded. Indian casinos are excluded. In some cases, figures were rounded. For a recent compilation of tax rates, see AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 12–24.

111. NEV. GAMING CONTROL BD., GAMING REGULATION IN NEVADA 11 (July 2006), *available at* http://gaming.nv.gov/documents/pdf/gaming_regulation_nevada.pdf; AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 18.

112. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 18.

113. Ohio Sec'y of State, *Proposed Constitutional Amendment*, *supra* note 41; Ohio Sec'y of State, *State Issue 3: November 3, 2009—Official Results*, *supra* note 41 (showing the amendment's passage).

114. The causation of the wide variation in gambling tax rates is a topic worthy of future scholarship.

115. Responding to Pennsylvania's table games legalization, a West Virginia state senator proposed dropping West Virginia's table game tax from 35% to at least 16%, matching Pennsylvania's table game rate. Belko, *supra* note 105.

sino operators are willing to pay. The last states to legalize will have difficulty establishing tax rates or license fees as high as those of their neighbors, even if capital outflow from the state is massive. For example, assume that a small state such as New Hampshire has no casinos, but all of its neighbors do, and many of them are located along the borders with the small state. Since even the most insular section of the state is less than one hundred miles from a border, the travel costs for residents to gamble in another state are relatively low. New Hampshire residents who enjoy gambling enough to pay those travel costs will do so. If New Hampshire wants to legalize in order to limit border-crossing and decrease capital outflow, it must ensure that enough gamblers are diverted or created to achieve the desired levels of revenue. Some potential casino operators may own a casino near the border, meaning that the operator already has access to New Hampshire gamblers and will not be interested in opening a new location, unless New Hampshire enacts favorable laws and charges low rents.[116]

2. *Interest Alignment and Revenue Dependence Leads to Concessions*

Regulatory competition is fueled by the political importance of gambling revenues, which results because many states have dangerously chosen to treat casino tax revenues the same as other revenue sources, such as income taxes. These states use gambling revenues for new or existing obligations, creating a dependence on the gambling industry in order to maintain government services. This leads state lawmakers to create budgets that rely on gambling revenue projections.[117] Consequently, preserving gambling revenues becomes important to lawmakers averse to the political risk of cutting government services, aligning their interests with those of the industry.[118] This in-

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116. Maryland has authorized slot machine gambling, but its high tax rate of 65% may be responsible for the state's inability to open a casino thus far. *See* Joseph M. Kelly, *U.S. Land-Based and Internet Gambling; Would You Bet on a Rosy Future?*, 17 VILL. SPORTS & ENT. L.J. 339, 360 (2010).

117. In Pennsylvania, Governor Ed Rendell included $200 million in table game revenues as part of his proposed budget for 2009–2010 *before* table games were legalized, threatening the legislature with state employee layoffs if the table games bill was not passed. Tom Barnes, *Rendell Decries Delays in Table Games Bill*, PITTSBURGH POST-GAZETTE (Dec. 9, 2009), http://www.post-gazette.com/pg/09343/1019510-100.stm.

118. The economy of Nevada is highly dependent on gambling. Gaming taxes alone comprised 26.3% of the state's general revenues in fiscal year 2008. STATE OF NEV., EXECUTIVE BUDGET IN BRIEF, 2009–2011 BIENNIUM 1 (2009), *available at* http://nevadabudget.org/index.php. Between 2008 and 2009, 12.3% of casino jobs in the state were lost. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 7.

terest alignment may cause concessions to the industry at the expense of gamblers or the general public.[119] When a state's gambling industry suffers from lagging revenues, casino owners will pressure state politicians to make regulatory changes to improve business. Faced with the choice of conceding to the changes or cutting programs and services dependent on gambling revenues, lawmakers will justify these changes to the public by invoking the economic importance of gambling, but the costs of these changes may be downplayed or not fully evaluated.[120]

3. *Creating New Gamblers*

Competition between states for revenues increases the gambling industry's need to find new gamblers to sustain revenues. This is a result of simple principles of supply and demand; if the gambling population did not increase, an equilibrium would eventually be reached once demand was fully met, and the total number of casinos would reach a plateau. When states authorize new casinos, total gambling supply increases. Many gamblers, choosing to reduce their travel costs, will be drawn away from preexisting casinos in favor of a closer location. If the gambling population does not increase, the preexisting casinos will lose revenue, causing some casinos to reduce costs or cease operations. Assuming a constant participation rate, the only potential increase in gambling revenues would come from gamblers who switch to closer in-state casinos and convert their travel savings into wagers or simply gamble more often.

Without accounting for possible substitution, it certainly appears that more people are gambling. Commercial casino revenues increased from $24.5 billion in 2000 to $34.1 billion in 2007.[121] This increase

119. West Virginia recently passed a law that will divert some tax revenues into a "Licensed Racetrack Modernization Fund." The fund will provide up to one hundred million dollars over ten years to casino operators to discount new slot machines by 50%. *See* S.B. 550 (W.Va. 2011); W.VA. CODE § 29-22A-10 ("For each two dollars expended by a licensed racetrack for facility modernization improvements at the racetrack, having a useful life of three or more years and placed in service after July 1, 2011, the licensed racetrack shall receive $1 in recoupment from its facility modernization account.").

120. Colorado recently cut gambling taxes, reducing the revenues to several state programs, because, in the words of a regulator, "We needed to give some relief to the gaming industry." Andy Vuong, *Colorado Regulators Cut Taxes on Casinos; Recipients Fear Added Loss of Funding*, DENVER POST (June 7, 2011), http://www.denverpost.com/search/ci_18219849. The 2008 ballot measure Amendment 50 in Colorado, which led to higher maximum bet limits and twenty-four-hour operations, also contained a provision that reduced the maximum tax rate regulators could set from 40% to 20%. *Id.*

121. AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 5.

cannot be explained by an absolute decrease in other forms of gambling activity; nationwide lottery sales during the same time period increased from $35 billion to $51.4 billion.[122] A poll commissioned by the casino industry's largest trade group, the American Gaming Association, found that 42% of casino host county residents had visited a casino at least once between February 2009 and February 2010;[123] 28% of the general American public had the same response.[124] These numbers suggest that the presence of a casino in a county increases the chance that the county's residents will gamble at least once a year by roughly 50%.

The spread of gambling will likely increase the social costs of problem gamblers. Studies have conflicted on whether the prevalence of pathological gambling across a population is affected by proximity to a casino.[125] Regardless of whether proximity affects prevalence, the prevalence rate is not the most important measurement. A gambling addict living in Las Vegas is in a much different position than a gambling addict in Hawaii because the former's ability to legally gamble is much greater than that of the latter. The proliferation of casinos across many different states dramatically reduces the transaction costs of gambling for many Americans. A problem gambler in a legal jurisdiction has cheap and constant access to casinos, which obviates the gambler's need to gamble illegally or to set aside significant extra time and money to travel long distances to casino resorts. Thus, even if the overall prevalence of problem gambling does not change, access to new local casinos increases opportunities for the addict to engage in the activity and increase social costs.

Regulatory capture is also a threat. Once gambling begins, regulators are susceptible to interest alignment for a number of reasons. First, the people who are most knowledgeable about the gambling industry are often those with experience working on the private side of the industry. Years of contact with gambling operators may lead regulators to form impressions of gambling as an entirely benign busi-

122. *Compare* U.S. Census Bureau, Income and Apportionment of State-Administered Lottery Funds: 2000 (2002), *available at* http://www.census.gov/govs/state/00lottery.html, *with* U.S. Census Bureau, Income and Apportionment of State-Administered Lottery Funds: 2007 (Nov. 2008), *available at* http://www.census.gov/govs/state/07lottery.html.
123. Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 25.
124. *Id*.
125. *See* NGISC, Final Report, *supra* note 62, at 4-3 to 4-5.

ness.[126] They may view threats to gambling as threats to their own jobs, or may develop an interest in leaving the public sector for a higher-paying job in the industry.

When the recent recession caused a massive drop in Nevada's gambling revenue, the industry started a campaign to lower the legal gambling age from twenty-one to eighteen.[127] Facing looming competition from Ohio and potentially Kentucky, the Indiana legislature recently voted to remove the requirement that its ten riverboat casinos could only operate on water.[128] Even seemingly insignificant rules are subject to regulatory competition; for example, if it will improve revenues, more casinos may impose smoking bans.[129]

4. *Deregulations with High Costs*

Competition may lead states to deregulate in certain areas even when the social costs of doing so are staggering. To put this into perspective, it has been estimated that between 25% and 50% of casino revenues may come from problem gamblers.[130] Yet regulations aimed toward directly reducing the impact of problem gambling are rarely enacted.

The availability of credit on the gaming floor is widely permitted. Operators lobby for casino-floor credit because it allows casinos to keep gamblers at the tables and machines even after their available cash has been exhausted. Those utilizing credit in casinos are often problem gamblers who have no available cash but still desire (or feel

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126. This problem contributed to the difficulties experienced by alcohol prohibitionists in getting support for federal reforms. *See* RICHARD F. HAMM, SHAPING THE 18TH AMENDMENT 94 (1995).

127. Richard N. Velotta, *Idea Floated to Lower State Gambling Age to 18*, LAS VEGAS SUN (Nov. 7, 2008), http://www.lasvegassun.com/news/2008/nov/07/idea-floated-lower-state-gambling-age-18/.

128. Lesley Stedman, *Indiana Legislature Passes Bill Allowing Casinos to Eliminate Motors, Crews*, COURIER-J. (Apr. 5, 2011), http://pqasb.pqarchiver.com/courier_journal/access/2311941861.html?FMT=ABS&date=Apr+05%2C+2011. Historically, riverboat casinos were required to be moving on the water while gambling took place, but most states with riverboat casinos have gradually loosened the rule.

129. One survey found that a smoking ban would make 50% of the respondents more likely to visit a casino. CLYDE BARROW, NEW ENGLAND GAMING RESEARCH PROJECT, PLACE YOUR BET II: THE POTENTIAL REGIONAL COMPETITIVE ADVANTAGE OF A NON-SMOKING POLICY FOR MASSACHUSETTS CASINOS 2 (2011).

130. EARL L. GRINOLS, GAMBLING IN AMERICA: COSTS AND BENEFITS 22 (2004); Robert J. Williams & Robert T. Wood, *The Proportion of Ontario Gambling Revenues Derived from Problem Gamblers*, 33 CANADIAN PUB. POL'Y 367, 367 (2007). Similarly, one study found that "[t]he top 5 percent of lottery players (who spend $3,870 or more) account for 51 percent of total lottery sales." *See* NGISC, FINAL REPORT, *supra* note 62, at 7-10.

compelled) to continue playing.[131] However, credit also has positive effects; for example, it is convenient for gamblers who would like to pay for multiple casino visits with one check, or gamble without bringing cash or paying an ATM fee. But credit is also very dangerous because it can allow a gambler to ruin his personal finances during just one trip to the casino. To reduce that danger, states can prohibit credit altogether or require casinos to make more rigorous analyses of their customers' finances before opening credit lines. The former option would reduce the extreme social and economic costs imposed by problem gamblers, but most states seem reluctant to do this.[132] Credit bans and strict regulations are often seen at the outset of legal gambling activity within a state, but states usually loosen the restrictions. For example, after three years of legal gambling, Pennsylvania removed its bar on casino-floor credit, burying the provision in an omnibus bill.[133]

Twenty-four hour casino gambling has also become widespread, despite the fact that casino closing times can interrupt gambling binges without cutting too deeply into revenues from healthy gamblers.[134] Colorado, a state that kept strict betting limits and limits on gaming hours, removed those restrictions in a 2008 constitutional amendment.[135]

131. *See* FLA. COUNCIL ON COMPULSIVE GAMBLING, GAMBLING ON CREDIT: EXPLORING THE LINK BETWEEN COMPULSIVE GAMBLING AND ACCESS TO CREDIT 18–20 (2006). ("In this context, credit that is available while an individual is involved in a gambling activity represents the most significant threat to a compulsive gambler. Treatment providers and advocates for compulsive gamblers value the 'break in play,' created whenever a gambler steps away from the computer, slot machine, card game or other gambling venue or device, as an opportunity for a compulsive gambler to reconsider his or her actions and decision to continue gambling . . . . access to credit in a gambling venue works against the 'break in play,' offering the compulsive gambler the immediate ability to continue gambling without time for reflection.").

132. Only Colorado, Maine, Missouri, and Oklahoma prohibit casinos from extending credit. *See* AM. GAMING ASS'N, RESPONSIBLE GAMING STATUTES AND REGULATIONS (2008). Pennsylvania removed its credit prohibition in 2010. *See infra* note 133 and accompanying text.

133. Commw. of Pa., S. LEGIS. J., No. 1, 2d Sess., at 1657 (Jan. 5, 2010) (Remarks of Sen. Gordner: "I am especially troubled by the provision that allows casinos to extend unlimited and unsecured credit to slot machine and table games players. This could lead to absolute financial devastation for some players and their families by causing them to play for more than they can afford.").

134. For instance, forcing casinos to close from 4:00 AM to 6:00 PM on weeknights might interrupt gambling bingers, but would probably not precipitate a significant loss of revenue from healthy gamblers.

135. AMENDMENT 50, COLO. DEP'T OF REVENUE, http://www.colorado.gov/cs/Satellite/Rev-Gaming/RGM/1218795716371 (last visited Oct. 4, 2011).

B. New Patterns of Casino Distribution Exacerbate Negative Effects

The ill effects of interstate competition are exacerbated by the emerging patterns of geographical casino distribution. By 1990, a handful of gambling communities earned reputations as resorts for their unique combination of legal gambling and clusters of large, opulent hotel-casinos providing numerous entertainment and retail options. The nation's most liberal licensor, Nevada, has over three hundred separately licensed gaming locations.[136] Patterns of widespread competition exist within the state, and within every well-populated region of the state.[137] Because visitors to Nevada have many choices, casinos must distinguish themselves and offer gamblers incentives to patronize them. In contrast, most other states award a very limited number of licenses.[138] In new markets, casinos usually have a much different look than resorts: they are less stylized, smaller, and rarely have integrated hotels or retail centers. These "convenience casinos"[139] can be built more quickly and cheaply than a resort facility, and are more efficient from the owner's perspective.

The convenience casino is a by-product of the race to the bottom, but its proliferation directly influences gambling behavior in a way that can undermine the economic benefits casinos can offer. Established gambling resorts such as Atlantic City, Biloxi, and Las Vegas became prominent and successful at a time when legal gambling was

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136. NEV. GAMING CONTROL BD., GAMING REVENUE REPORT, FEB. 2011, *available at* http://gaming.nv.gov/documents/pdf/1g_11feb.pdf.

137. In 2010, there were two hundred and fifty-six Nevada gambling locations that earned more than one million dollars in gross revenues. One hundred and forty-eight of these locations were in Clark County, five were in Douglas County, eighteen were in Elko County, thirteen were in the Carson Valley Area, thirty-one were in Washoe County had, and the forty-one remaining locations were dispersed among other counties. *See* NEV. GAMING CONTROL BD., NEV. GAMING ABSTRACT 2010, *available at* http://gaming.nv.gov/documents/pdf/2010_abstract.pdf.

138. Though the numbers are constantly in flux, no states other than Nevada and Mississippi currently have more than twenty commercial casinos, excluding low-stakes parlors in Colorado and South Dakota. AM. GAMING ASS'N, STATE OF THE STATES, *supra* note 2, at 4.

139. The term "convenience casino" is emerging as a moniker to distinguish the new variety of standalone casinos from resort-style facilities found in older gambling cities. The term has some negative connotations and is often used in derogatory fashion by casino opponents, but it accurately reflects the new economic model and gambling behavior such facilities create. *See* Isaiah Thompson, *Proximity! Steve Wynn and the Birth of the "Convenience Casino"*, PHILA. CITY PAPER (Mar. 3, 2010), http://archives.citypaper.net/articles/2010/03/04/steve-wynn-foxwoods-philadelphia. For another example of usage, see Josh Goodman, *Philadelphia's Mixed Feelings on Legalized Gambling*, GOVERNING (Nov. 2010), http://www.governing.com/topics/economic-dev/Philadelphias-mixed-feelings-legalized-gambling.html.

rare, and many people would travel in order to gamble. The main attraction of these resorts continues to be gambling; it is the primary, and perhaps only, feature of those cities that non-residents can identify.

These established resorts, most of which fit into Category III, exemplify how gambling can be very economically beneficial, but these cities had advantages that new jurisdictions will not. When the early resort cities first turned to legal gambling, they had obvious advantages that made legalization look like a promising choice. Their non-competitive catchment areas[140] extended several hundred miles, and the vast majority of wagers came from out-of-state players.[141] The huge influxes of capital that resulted made it easy for the host cities to absorb the localized costs the casinos brought on, and many social costs went home with the gamblers. Gambling likely benefitted a handful of small, economically depressed areas, such as Tunica, Mississippi.[142]

When the widespread model becomes local, a casino's noncompetitive catchment area becomes smaller, but travel costs for gamblers in that zone are reduced significantly. This makes patronage of the convenience casino incredibly cost-effective for regular gamblers, who are likely to replace most of their long trips with shorter ones. While this undoubtedly creates some efficiency for people who would otherwise travel long distances to gamble, that segment is a small percentage of the population.[143] As casinos become more ubiquitous, the mere presence of legal gambling will no longer distinguish one locale from another. Casinos will primarily serve local client bases and will not generate a notable amount of gambling tourism. Furthermore, convenience casinos will attract people who would not have paid to travel long distances for the purpose of gambling, effectively creating new gamblers.

In choosing a casino, a gambler must weigh several options, including proximity, perceived payouts, environment, and the quality

140. "Catchment area" is a term for the radial zone surrounding a casino in which most of the casino's customers live.

141. The largest casino in the United States, Foxwoods in Connecticut, draws a majority of its gamblers from out of state; less than a third come from Connecticut. Barrow, *supra* note 83, at v.

142. *See* NGISC, Final Report, *supra* note 62, at 7-11.

143. Cummings Assocs., Analysis of Current Markets for Casino Gaming in Iowa, with Projections for the Revenues and Impacts of Potential New Facilities, 4, Exhibit 2-1 (2003), *available at* http://www.iowa.gov/irgc/Cummings.pdf.

and quantity of supplemental amenities.[144] Each factor will have a different significance to every individual. However, proximity will usually be a primary factor because travel costs put a financial constraint on the gambler. When new casinos open in the catchment area of an existing casino, the amount of redirected gambling traffic will vary. New casinos in Pennsylvania and New York had big impacts on Atlantic City and the Connecticut resorts, but the Hollywood Slots casino in Bangor, Maine has not dramatically reduced Maine-to-Connecticut traffic.[145] Differences such as these may be explained by the fact that some gamblers continue traveling further to older casinos if they believe the experience is better; however, these gamblers are likely to be a minority.

A recent survey demonstrates how casino visitation habits are changing. Among individuals who had visited a casino at least once in the previous year, 60% visited only local casinos, 23% visited both local casinos and destination resort casinos, and only 13% exclusively visited long-distance destination casinos.[146] These numbers would not have been possible in 1980, when only Las Vegas and Atlantic City residents lived near a casino. Gambling corporations recognize the threat that widespread legalization poses to their facilities in gambling destination cities and are therefore actively attempting to expand to new regions. Companies with major presences in older markets, such as Wynn Resorts Limited, Caesars Entertainment Corporation (Harrah's), Trump Entertainment Resorts, and the Pequot tribe (owners of the Foxwoods Resort in Connecticut) all competed for one of two Philadelphia casino licenses at one time or another.[147]

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144. *See* Mark Belko et al., *Snake Eyes Coming Up in the First Weeks for New Casino*, Pittsburgh Post-Gazette (Oct. 4, 2009), http://www.post-gazette.com/pg/09277/1003006-53.stm?cmpid (discussing various reasons people choose one Pennsylvania casino over another).

145. Barrow, *supra* note 83 at 28. One possible reason for the Bangor casino's limited impact is that Foxwoods Resort Casino in Connecticut is the largest casino in the world. Peter Applebome, *In Sour Economy, Biggest Gambler at Foxwoods is the Casino Itself*, N.Y. Times (Jan. 10, 2010), http://www.nytimes.com/2010/01/11/nyregion/11towns.html?scp=1&sq=foxwoods%20largest&st=cse. Maine gamblers faced with only two casino choices may be more likely to opt for travel than gamblers in New York or Pennsylvania, who now have a wide variety of casinos to choose from that require less travel.

146. Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 29.

147. *See* Tom Barnes, *State Might Revoke Unbuilt Philly Casino's License*, Pittsburgh Post-Gazette (Apr. 29, 2010), http://www.post-gazette.com/pg/10119/1054295-100.stm; Jennifer Lin, *Commonwealth Court Hears Testimony on Foxwoods License*, Phila. Inquirer (Sept. 15, 2011), http://www.philly.com/philly/news/local/20110915_Commonwealth_Court_hears_testimony_on_Foxwoods_license.html.

1. Regional Monopolies

Convenience casinos are very frequently the only casinos in a region. Many new gambling states specifically restrict the number of casino licenses available in a geographic area, essentially granting a casino operator a regional monopoly over legal gambling.[148] This pattern of anticompetitive distribution is both a symptom and a cause of increasing state-versus-state competition, and the supposedly moderate approach to legal gambling may do little to reduce the costs.

License apportioning systems vary from state to state and have different advantages and disadvantages, but new states consistently put tight limits on the number of licenses. One argument in favor of these tight limits is that licenses must be kept scarce so that states can achieve higher economic rents, in the forms of up-front bids for licenses and higher tax rates. In current practice, however, license scarcity seems to be neither a necessary nor a sufficient condition for high rents.[149]

Regardless of the reasons for its emergence, one implication of the local monopoly model is that it prolongs the appearance that casinos are making a positive impact in a region. If a state's casinos have large buffer zones, they can draw gamblers from a bigger geographical area. Since it is easier to determine benefits to areas near a casino than to determine its costs to a wider area, the casino appears to be an economic growth generator in the region when that may not be the case.[150]

Regional monopolies may also diminish consumer utility. The quality of a casino, its payout rates, and the availability of other perks to gamblers are all jeopardized when casinos have no meaningful

148. Pennsylvania prohibits any two Category I casinos from existing within a 20-mile radius and prohibits Category II casinos from being within 30 miles of a racino, 20 miles of a standalone casino, and 20 miles from another Category II casino, except for the Category II casinos in Pittsburgh and Philadelphia, though a mandatory 10-mile radius applies in Philadelphia. H.B. 2330 §§ 1302(B), 1304(B) (Pa. 2004). Category III casinos, the "resort" casinos, must be 15 miles apart. *Id.* at § 1305(B).

149. The scarcity argument is compatible with the low tax rates in the early states Nevada, New Jersey, and Mississippi because each license had significant marginal value and the states could expect high numbers of nonresident gamblers. But elsewhere, scarcity does not seem to produce the highest possible rents. Pennsylvania has fourteen licenses and a tax rate of 55%. Ohio offers just four licenses, yet, its tax is only 33%. *See* 2004 Pa. Laws 572, 601; Jeremy Boren, *Ohio Casinos to Join Western Pennsylvania's Game*, PITTSBURGH TRIBUNE-REVIEW (Mar. 19, 2011), http://www.pittsburghlive.com/x/pittsburghtrib/news/s_728157.html.

150. "[T]he economic benefits were generally most pronounced within the immediate vicinity of the gambling facilities, while the social costs tended to be diffused throughout a broader geographic region." NGISC, FINAL REPORT, *supra* note 62, at 7-11.

competition. The minimum long-term slot payout in many states and provinces, such as Ontario, Pennsylvania, and New Jersey is around 85%.[151] Since today's slot machines are computerized, payout rates can be adjusted fairly easily, but insulation from competition with other casinos gives operators much less incentive to reduce the price of gambling.[152]

2. *Saturation and Border-Hugging Casinos*

Competition between states is responsible for peculiar licensing patterns and casino saturation in some areas. In the classic prisoner's dilemma scenario, if one actor knows with certainty that the other will defect, his optimum strategy is the same as when he is in the dark: he will also defect. Some two-state relationships evince the dilemma. Political borders will not affect the catchment area of a casino, but tax revenues will only be earned by one state. Casinos located near a border are therefore likely to draw significant revenues from across the line. To protect itself, a neighboring state without a casino has only one possible response: licensing its own casino in the same area.

Recognizing that out-of-state gamblers are preferable to in-state gamblers, many states locate casinos strategically to lure gamblers across a border. Indiana's pattern of casino locations is an obvious illustration: of thirteen casinos in the state, ten are located in border counties, even though the only one of these counties that is very densely populated is Lake County in the northwest.[153] Assuming Indiana is targeting only in-state gamblers, we would expect to see patronage of casinos mirroring population centers. Yet there are no casinos within a thirty-mile radius of Indianapolis, Indiana's largest city, and three of Indiana's casinos are located in the sparsely populated southeastern corner of the state. Unsurprisingly, those casinos are located in counties bordering southwestern Ohio, a major population center surrounding Cincinnati. Clearly aware of the cross-border

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151. N.J. Stat. Ann. § 5:12-100(e) (West 2011) (83%); Ont. Lottery & Gaming Corp., Payout Levels of Slot Machines at OLG Gaming Facilities (Apr. 2007), *available at* http://www.olg.ca/assets/documents/media/slots_payout_fact_sheet_2007.pdf (85%); 58 Pa. Code § 461a.7(a) (2011) (85%).

152. State-run lotteries, which are monopolies by law, usually have lower expected values than casino games. *See* NGISC, Final Report, *supra* note 62, at 2-3.

153. *Compare* Am. Gaming Ass'n, State of the States 2010, *supra* note 2, at 14, *with* Indiana Population Map, Wikipedia, http://en.wikipedia.org/wiki/File:Indiana_population_map.png (last updated Sept. 29, 2006) (created using Census 2000 data).

presence of casinos, in the vote on legalization, those Ohio counties voted for legalization by the largest margins.[154]

Clear evidence of border hugging can be seen in other markets, including "Chicagoland," Iowa, Mississippi, Missouri, and West Virginia. The placements of casinos in Canada follow similar patterns, although, in contrast to casinos in the United States, Canada's casinos (except tribal casinos) are state-owned.[155] The Ontario Lottery and Gaming Commission owns ten casinos and seventeen racino facilities.[156] Three are on the U.S. border; two are located in Niagara Falls, one is in Windsor (bordering Detroit).[157] Oddly, there are no casinos near Toronto or Ottawa, the major population centers in Ontario.

Border hugging is a natural consequence when states want to export costs, but through the very act of intentionally increasing externalities to neighbors, the state unwittingly induces its neighbors to change their laws. Faced with a neighbor's border-hugging casinos, the state builds its own casino along the border. From that point, the states' interests in the success of their own casinos will lead to policies in each state that favor the casino over the gambler.[158] This triggers a domino effect that may result in saturated markets and an increase in local gambling.[159] States attempting to stay in the export-based Cate-

154. *See* Felesia M. Jackson, *How Ohio Voted on Issue 3*, CLEVELAND PLAIN DEALER, http://www.cleveland.com/politics/index.ssf/2009/11/how_ohio_is_voting_on_issue_3.html (last updated Nov. 4, 2009).

155. Eadington, *supra* note 26, at 177 n.5; David Heinzmann, *In Canada, A Cautionary Casino Tale*, CHI. TRIB. (June 26, 2011), http://articles.chicagotribune.com/2011-06-26/news/ct-met-windsor-casino-20110626_1_tribal-casinos-gambling-halls-gambling-industry ("Other than the tribal casinos, the gambling industry north of the border is owned and operated by Canada's provincial governments.").

156. *See* Ont. Lottery & Gaming Corp., *Find a Location*, http://www.olg.ca/find_location.jsp (last visited Apr. 30, 2011).

157. *Id.*

158. For example, New Jersey recently changed a rule on progressive slot jackpots. A progressive jackpot is accumulated from a particular bank of slot machines that advertise a jackpot that increases, or "progresses" the more times those machines are played. Instead of being forced to eventually pay out the advertised sum, casinos in New Jersey may now remove banks of progressive slot machines on 30 days notice without paying the ultimate jackpot to anyone. *New Rule Lets Atlantic City Casinos End Some Multi-machine Slot Jackpots and Keep Money*, NJ.COM (Apr. 5, 2011), http://www.nj.com/news/index.ssf/2011/04/new_rule_lets_atlantic_city_ca.html. Essentially, players may be putting money into machines based on their hope of winning a progressive jackpot that is no longer required to be delivered.

159. With three casinos in the greater metropolitan area, Philadelphia is showing signs of saturation, despite the fact that one remaining license designated for the area has not yet been used. *See* Suzette Parmley, *Lagging SugarHouse Slots Revenue Casts Doubt on Need for Second Philly Casino*, PHILA. INQUIRER (Jan. 23, 2011), http://articles.philly.com/2011-01-23/news/27044737_1_slots-revenue-harrah-s-chester-second-casino.

gory III instead end up in Category IV because as their neighbors legalize, fewer tourist gamblers will come to the state.

Another context in which this effect is observable is the fireworks retail industry. Many states with strict fireworks bans paradoxically allow retailers to sell products that would be illegal to use within their borders.[160] The only caveat is that purchasers must provide out-of-state identification and, in states such as Ohio and Wisconsin, sign a form attesting that the purchaser will take the fireworks out of the state within a specified number of hours or days.[161] The selling state receives tax revenues and jobs from the fireworks business while the buyer's home state bears the costs of damage to persons or property and policing. Neatly rounding out this analogy, cross-border purchasing directly led Kentucky to legalize aerial fireworks in March 2011.[162]

As Ohio was nearing legalization, Indiana commissioned a study to determine how decisions made by its neighbors could affect its casinos. It projected potential revenue losses attributable to the new Ohio casinos between $82.9 million and $103.6 million.[163] Reactive measures have already been proposed, such as opening a new casino in Fort Wayne, and converting a Gary riverboat license to a land-based casino license.[164]

C. Local Preferences May Be Overridden

The increase in legal gambling does not necessarily reflect a democratically legitimate shift in the policy preferences of Americans. If gambling is spreading to new states because casinos are desired by the residents of those states and host cities, the policy analyst's primary questions would be whether the cost/benefit information is reliable and whether the regulatory systems developed are effective at tailoring gambling activity to suit residents' preferences. If casinos are

160. Richard G. Jones, *Fireworks Fans Defy the Law, Crossing State Lines for Some 'Red, White and Boom!'*, N.Y. Times, July 2, 2007, at B2.

161. *Id.*; Andrew Seaman, *Buying Fireworks Often a Matter of Loopholes*, USA Today (July 3, 2008), http://www.usatoday.com/news/nation/2008-07-02-fireworks_N.htm.

162. Dave Kirk, *Kentucky Legalizes High Powered Fireworks*, WFIE (Mar. 25, 2011), http://www.wfie.com/story/14322991/kentucky-legalizes-high-powered-fireworks.

163. Jim Landers, Ind. Legislative Servs. Agency, Estimates of the Fiscal Impacts from Out-of-State Casino Competition and Movement of Casino Licenses in Indiana 1 (Oct. 19, 2009), *available at* http://www.in.gov/legislative/interim/committee/reports/GSCOCB4.pdf.

164. *Id*. at 2.

built in spite of popular opposition, concerns about democratic legitimacy arise.

The spread of gambling to so many states may represent a failure of lawmakers to behave in accordance with the actual desires of the public majority. In the Kentucky fireworks case, law-breakers, who may have comprised a small minority of the state's population, successfully undermined a longstanding statute through belligerent disregard for the laws of their home state.[165] The change in law was apparently not a result of popular opposition to the law based on the pros and cons of fireworks; it was a legislative attempt to capitalize on the law-breaking. This echoes the decision-making process for gambling legalization.

Gambling has been legalized both with and without public referendum, but almost all decisions made beyond general legalization are left to legislatures and regulatory bodies. One such decision, casino placement, almost always engenders extensive debate.[166] Though some states allow local option votes, many do not.[167] In states without a local veto, it is possible that casinos may be built against the will of the local population. Local costs associated with casinos and moral opposition to gambling frequently make casinos a target of "not in my backyard" protests, known as NIMBYism.[168] Whether or not a state government may override local preferences depends mostly on the rights of municipal governments as defined by state constitutions or statutes.

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165. This has been referred to as a "haven" problem, where an "outlier permissive state" is capable of frustrating the goals of other "restrictive states." *See* Erbsen, *supra* note 71, at 516–17.

166. For example, proposals to build a casino in Gettysburg, Pennsylvania led to a long and fierce battle between those who believed a casino would improve the local economy and those who believed that building a casino near a historic battlefield would be inappropriate. After years of debate, Pennsylvania's Gaming Control Board awarded the only authorized license to a different location. Laura Bly, *No Dice: Gambling Board Rejects Gettysburg Casino*, USA TODAY (Apr. 14, 2011), http://travel.usatoday.com/destinations/dispatches/post/2011/04/gettysburg-pa-casino-gambling-license-civil-war-/155900/1.

167. *See* AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 13–24 (listing methods of legalization).

168. Studies frequently show casinos among the most disfavored local land uses. *See, e.g.*, *NIMBY Dislike of Wal-Mart Drops as Landfills, Casinos, Quarries Top Public Ire in Saint Index*, SAINT CONSULTING GRP. (Jan. 14, 2009), http://tscg.biz/saintblog/2009/01/walmart-drops-but-landfills-casinos-quarrys-top-public-opposition-in-saint-index.html; *Poll Finds 'NIMBY' Factor on Casinos,* THE DAILY HAMPSHIRE GAZETTE (Mar. 18, 2008), http://gazettenet.com/2008/03/19/poll-finds-nimby-factor-casinos?SESS568227375bd02b2bd9ecfa048f2e76f4=gnews.

Americans in general may favor having options for legal gambling while simultaneously preferring that there be no casinos in their home region, perhaps because they believe casinos will have a negative impact on their community. Several opinion polls support this proposition.[169] It is possible that most people will accept some level of capital outflow if their state or city remains casino-free. Individuals who greatly enjoy gambling or who have careers dependent on the activity will pay the travel costs or relocate to jurisdictions where it is legal.

Issue 3, the recent legalization referendum in Ohio, provides a window through which to examine local voter preferences and compare them to outcomes. Advocates spent $60 million on the election, $47 million of that amount coming from pro-casino interests. About 3.2 million voters participated in the election, and 1.7 million voted in support of the legalization measure,[170] roughly 15% of the overall population of Ohio.[171]

Voters in Franklin County, which contains Columbus, rejected the amendment.[172] Franklin County is the most insular of the four future casino sites, and as such likely experiences fewer effects from out-of-state casinos than the other three host counties. Perhaps many voters recognized that their county was less vulnerable to competition from other states and considered only the prospective local effects of closer casinos. The rejection by Franklin County prompted a state lawmaker to introduce an amendment that would allow local veto of casino placement, but the measure was not included on the ballot.[173]

In California, the frequent use of statewide referendums provides a glimpse into voter attitudes towards gambling. The large number of recognized tribes in California and the state's large population led the state to become the nation's leader in tribal gambling by the 1990s.[174] Two gambling issues were on the ballot in the 2004 election. Proposi-

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169. *See* PUBLICMIND, *supra* note 84 ("Americans' views of the local impact of casinos are not favorable; 46% say casinos have a negative effect on the local community, while 38% say they have a positive effect.").

170. OHIO SEC'Y OF STATE, STATE ISSUE 3: NOVEMBER 3, 2009—OFFICIAL RESULTS, *available at* http://www.sos.state.oh.us/SOS/elections/electResultsMain/2009ElectionResults/20091103issue3.aspx.

171. *See* U.S. CENSUS BUREAU, *supra* note 99.

172. Jackson, *supra* note 154.

173. *Ohio 2010 Ballot Measures*, BALLOTPEDIA, http://www.ballotpedia.org/wiki/index.php/Ohio_2010_ballot_measures (last modified July 6, 2011).

174. In 2009, California tribal casinos accounted for 26% of tribal casino revenue nationwide, the most of any state. Joe Garofoli, *Revenue Falls at Indian Casinos, Especially in California*, S.F. CHRON. (Mar. 2, 2011), http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/03/03/MNTN1I2OFM.DTL.

tion 68, supported by commercial gambling interests, would have authorized the Governor to negotiate compacts offering a 25% tax rate and would have required tribal compliance with state laws. To coerce the tribes to accept these terms, the state threatened to authorize slots at non-tribal facilities if the tribes refused the compacts.[175] Proposition 70, introduced and supported by many gambling tribes,[176] would have allowed for ninety-nine-year compacts that would maintain tribal exclusivity in exchange for an 8.84% tax rate.[177] The overwhelming rejection of Proposition 68 and Proposition 70 might evince that Californians were uncomfortable with expanding gambling further. Nevertheless, Governor Arnold Schwarzenegger continued negotiating with tribes to expand gaming.[178]

Similar problems are observed in other realms. The use of public funds to acquire or maintain the placement of a professional sports team often raises concerns of overbidding. States and municipalities will go to great lengths to incentivize a franchise owner to move a team or keep it where it is. The incentives offered can include tax breaks, partial or whole financing for the construction of stadiums, arenas, and other necessary infrastructure, assumption of facility or parking management duties by the government, and even direct loans to potential franchise buyers.[179] Politicians and pro-initiative advocates typically justify these incentives by citing the "tangible economic benefits" and "community self-esteem" that building a stadium or hosting a team will bring.[180]

In 1989 and 1997, the cities of Phoenix and Pittsburgh put public finance proposals for stadiums to referenda, and both proposals were rejected by large margins.[181] Subsequently, politicians in both cities nevertheless devised methods to circumvent the actual preferences of

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175. *See* PROPOSITION 68, SMART VOTER, http://www.smartvoter.org/2004/11/02/ca/state/prop/68/ (last visited Apr. 22, 2011).

176. *Proposition 70: Tribal Gaming Compacts. Exclusive Gaming Rights. Contributions to State. Initiative Constitutional Amendment and Statute*, CAL. VOTER FOUND. (Feb. 10, 2006), http://www.calvoter.org/voter/elections/2004/props/prop70.html

177. Dan Morain & Glenn F. Bunting, *Gov. Says Tribal Pacts Provide Better Oversight*, L.A. TIMES (Oct. 20, 2004), *available at* http://articles.latimes.com/2004/oct/20/local/me-chumash20.

178. Dan Morain, *Defeats Don't Mean the Dealing's Done*, L.A. TIMES, Nov. 4, 2004, at B8.

179. *See* KEVIN J. DELANEY & RICK ECKSTEIN, PUBLIC DOLLARS, PRIVATE STADIUMS: THE BATTLE OVER BUILDING SPORTS STADIUMS 45–48 (2003).

180. *Id.* at 4.

181. *Id.* at 1–2.

their constituents, which had been clearly expressed in formal, recent, and supposedly dispositive votes.[182]

The publicly financed stadium analogy illustrates anti-democratic outcomes that could be caused by a collective action problem.[183] In both situations, a small minority of groups and individuals with a specific objective may have an easier time organizing and amassing the resources to successfully lobby politicians than would a larger group with less specific goals. Gambling politics feature similar problems; the organized gambling lobby may be able to wield more influence with policymakers due to its clear goals, powerful motivation, and financial resources.[184]

The inevitable alignment of interests that occurs when states compete for revenues may be reinforced by actual corruption. The casino industry is notorious for its ability to illegitimately influence politicians and other decision-makers. History is rife with examples of political corruption tied to gambling interests.[185]

IV.
What Would Improve Gambling Policy?

As described above, the competition between states and the externalities of gambling are leading states towards widespread deregulation of gambling. In the face of increasing social costs and the danger of inefficient regulation, mechanisms that can stabilize the environment should be sought. Much like how distrust of one's co-conspirator is a driving factor in the prisoner's dilemma scenario, the race to the bottom in gambling legalization is driven by distrust of neighboring states and absence of important data. This futile, albeit rational, strategy does not change unless the two states trust each other and can

182. *Id*.

183. See *generally*, Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups (1965) (theorizing that due to "free riding," small, well-organized groups are often able to secure government-conferred benefits at the public expense).

184. Consider the disparity in spending on campaigns for and against Ohio's Issue 3: Between July and mid-October 2009, pro-casino groups had spent $32 million and anti-casino groups had spent $5.4 million. James Nash, *Gambling Interests Ante up to Promote Issue 3*, Columbus Dispatch (Oct. 23, 2009), http://www.dispatch.com/content/stories/local/2009/10/23/CASINO_CASH.ART_ART_10-23-09_A1_SGFF2IM.html.

185. A recent case, the scandal involving Jack Abramoff's lobbying on behalf of casino operating Indian tribes, implicated a U.S. Representative, a deputy secretary of the Department of the Interior, and numerous other government officials. Edmund L. Andrews, *Former Interior Aide Pleads Guilty to Lying*, N.Y. Times (Mar. 24, 2007), *available at* http://www.nytimes.com/2007/03/24/us/24griles.html?scp=3&sq=Steven%20Griles&st=cse.

communicate intent to cooperate. Information sharing and an honest desire to improve gambling regulation are therefore crucial if sound policy is to be achieved. Ideally, if neighboring states cooperated and devised ways to share information, costs, tax revenues, and decision-making, they would be able to create more efficient policies and casino distributions.

As it stands, information on cross-border gambling is largely sourced from informal license plate counts in casino parking lots, "patron intercept" surveys, and phone surveys.[186] These methods, though usually as reliable as estimates, do not provide precise data, especially in terms of actual money won and lost. License plate surveys also fail to identify numerous long-distance travelers who rent cars or find other methods of transportation to a casino. It would not be prohibitively costly to gather precise information about gamblers and their losses; in fact, casino operators already collect much of this data for their own strategic purposes. Many casinos currently calculate average bets and losses per visitor, and slot machine wins and losses can be easily tracked.[187] Tracking home zip codes or states of gamblers would provide a better picture of how much money crosses borders. If casino patrons' losses can be tied to their home zip codes, reports can be generated that detail where a casino is drawing its patrons from and how much patrons are losing on average. This information, if collected and shared by states, could be used to determine more precisely how much money crosses borders.

Once that information is available, several cooperative strategies emerge which may prevent a race to the bottom or alleviate negative spillover effects. By cooperating, states can make regulatory decisions with less concern about the choices of their neighbors.

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186. *Cf.* BARROW, *supra* note 83 at 21.

187. Due to computerization and the use of loyalty cards, modern casinos can track an individual's win/loss numbers on slot machines with ease. Many casinos will provide statistics to customers on request for tax write-off purposes. *See, e.g.*, GAMING HISTORY REQUEST FORM, SUGARHOUSE CASINO, *available at* http://www.sugarhousecasino.com/pdf/SH_WinLossStatement.pdf; RIVERS CASINO GAMING HISTORY REQUEST FORM, RIVERS CASINO, *available at* http://www.theriverscasino.com/images/stories/gaming/Win_Loss_Request_form.pdf. Many casinos currently have loyalty programs that utilize unique player cards that collect specific data about a player when plugged into a slot machine or swiped at a table game. *See Foxwoods Plays A Strong Hand Developing Profitable Patron Relationships*, IBM SOFTWARE (May 2011), *available at* http://www.netezza.com/documents/foxwoods-case-study.pdf.

A. Voluntary Associations/Interstate Compacts

Voluntary interstate associations or compacts among states could solve many problems related to interstate competition while maintaining state control over casino gambling. Compacts are most frequently used by states to facilitate management of shared natural resources or infrastructure. They are useful in preventing a "tragedy of the commons" or free ridership, and by proactively creating interstate compacts, states can prevent federal intervention. Thus, compacts can mitigate market failures without relying on additional federal laws.

The U.S. Constitution requires states to get Congressional approval for interstate compacts,[188] but the Supreme Court has held that the rule applies only in certain situations. In *United States Steel Corporation v. Multistate Tax Commission*, the Court ruled that the proper test was whether an agreement "would enhance the political power of the member states in a way that encroaches upon the supremacy of the United States."[189] The test is permissive enough that it should not impede a gambling compact. If states feared they could not get congressional approval, they could draft the compact in a way that would make it likely to pass the Supreme Court's test, specifically by providing opt-out provisions and avoiding invocation of powers the states do not already have.[190]

A gambling compact could start on a regional level with specific short-term objectives.[191] Priorities could include any of the following: agreement to cap licenses and subject new license proposals to approval of member states, development of a system of cooperation for casino siting, revenue sharing in certain areas, setting uniform minimum limits on game rules, credit, payouts, and operating hours, and finally, long-term agreements on tax rates.

To prevent border wars, states could agree to share some of the tax revenues earned from tourist gamblers with the tourists' home states. States that take in high tourist gambling dollars might be reluctant to part with the fruits of their competition, but "loser" states have their own bargaining chips. Assume a model wherein State A has legal gambling and its neighbor State B does not. State B could offer not to legalize gambling or license casinos along the border if State A will make payments to State B based on the number of State B gamblers that patronize State A's casinos. Kentucky, for instance, could forge

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188. U.S. Const. art. I, § 10, cl. 3.
189. U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452, 472 (1978).
190. *See id*. at 472–73.
191. *See* McNeil, *supra* note 11 (suggesting the use of compacts for several purposes, including limiting cross-jurisdictional problems).

deals with Ohio and Indiana to create a program of revenue sharing along the Ohio River, where border hugging is rampant. Kentucky has not legalized yet, but Indiana has already estimated that Kentucky casinos along the river could cost Indiana up to $160 million in revenue.[192] Assuming those numbers are accurate (which could be confirmed through patron tracking), it would be in Indiana's interest to offer something less than that potential loss to Kentucky in exchange for Kentucky's promise not to authorize casinos in that area. A simple method for calculating revenue sharing is a per-gambler fee. Some states already use this method for their own tax programs, and it does not require tracking the gambler's individual losses at the tables.[193]

There are reasons for states to cooperate that go beyond avoiding the race to the bottom and reducing externalities. Every state with legal gambling has some sort of oversight agency and must pay to maintain its services. Economies of scale could be realized if the states delegated certain responsibilities to a shared joint board.[194] These responsibilities could include maintenance of gambler exclusion lists and conducting background checks of licensees to exclude members of crime syndicates.[195] Currently, some states maintain lists of gamblers who choose to be prevented from gambling or are ordered to do so as a result of criminal or civil proceedings.[196] Duties of rule compliance monitoring could also be shared. Though popular table games have many variations, most states have similar minimum standards. Technical requirements for slot machines, which are more expensive to monitor, also vary little from state to state. By pooling resources, states could eliminate redundancies and save regulatory costs.

Support for a compact could come from taxpayers, gambling consumers, legislators, or regulators. States with the most to lose, such as those with declining resort cities or that still do not have gambling, could form a core and build from there.

B. Federal Intervention

In the current political climate, the notion of an increased federal role in gambling is probably a non-starter, but its potential benefits should be considered seriously. In other contexts, such as environmen-

192. LANDERS, *supra* note 163, at 1.
193. Illinois, Indiana, and Missouri charge casinos a two to three dollar tax for every patron that a casino admits. *See* AM. GAMING ASS'N, STATE OF THE STATES 2010, *supra* note 2, at 14, 17.
194. McNeil, *supra* note 11, at 450–51.
195. *Id.*
196. *See, e.g.*, EXCLUSION LIST, PA. GAMING CONTROL BD., *available at* http://www.pgcb.state.pa.us/?p=173&list=list.

tal law, problems emerging from interstate competition have led to federal standards, though the benefits of those standards are frequently debated.[197]

Some scholars argue that the burden should be on those who propose taking a power from smaller jurisdictions and placing the power at the federal level. The problem with federal power is that it creates uniform systems, destroying the efficiency benefits of pluralism and making it harder for individuals to find a jurisdiction that satisfies their personal preferences.[198] It also moves decision-making further away from the people and places that will be impacted by the rules, increasing agency costs.[199]

Despite these concerns, federal involvement could bridge crucial gaps in gambling regulation. In the complex, expanding web of gambling availability, states do not have the ability to regulate in every sphere. However, the federal government has the authority to make binding agreements with Indian tribes and foreign governments and to handle regulation of offshore gambling providers, all of which states are constitutionally forbidden from doing.[200] Only the federal government is capable of creating a consistent regulatory approach that is all-encompassing and based on a single set of objectives. A federal gambling policy aimed at controlling social costs, preventing casino saturation, and setting minimum standards for gambling rules could be necessary if states will not cooperate on their own.

It may take several more years before the problems of interstate gambling competition become so widespread as to foster support for federal involvement. In the meantime, more research of the costs of competition can help decision-makers better understand the areas where reform is most needed.

Conclusion

The proliferation of gambling is now a national phenomenon, but the regulatory competition between states involves more than the decision to legalize. Although gambling may be intractable once it is legalized, other regulations such as tax rates, license distributions, and other specific rules can be revised with less difficulty. Rather than

197. *See* sources cited *supra* note 54.

198. David A. Super, *Rethinking Fiscal Federalism*, 118 Harv. L. Rev. 2544, 2556–57 (2005).

199. *Id*.

200. The IGRA gives states some bargaining ability, but they must still negotiate in good faith and get approval from the federal government before state-tribal compacts will be enforced. *See* 25 U.S.C. § 2710(d) (2006).

surrendering to pressure from neighbors, states should look for common ground. The aspects of gambling that cause the greatest costs should be priorities for cooperation, and states must be willing to make trade-offs to improve overall national welfare.