1 Introduction

My object, I think, in this was to promote clear thinking on these matters.

John Maynard Keynes
To the Royal Commission on Betting, 1932

CHAPTER SUMMARY. Government decisions regarding economic development issues matter to the **well-being** of all of us. Knowing how to evaluate **economic development** requires a comprehensive framework to compare benefits and costs that is theoretically grounded and established prior to any choice being made, with reliable data obtained to fill identified information gaps. Without a coherent evaluation process, these decisions tend to be made in response to whichever group applies the most pressure. Fortunately, input from well-informed, unbiased parties can counterbalance this tendency. Here, we examine why the procedures typically employed to evaluate **casinos** as a means of economic development suffer from two deficiencies: lack of a valid framework, and lack of complete and trustworthy information. These problems are not special to casinos; what we learn from them has relevance to the evaluation of other economic development questions.

Two episodes stand out as reasons for writing this book. The first occurred at the start of the 1990s. A newspaper announcement appeared stating that an offtrack betting (OTB) parlor was slated for Champaign, Illinois, where I live. Knowing that OTBs generally drew 90 percent of their clientele from nearby residents; that their profit rates were higher than other businesses (I later learned the figure was 19 percent, including racing-industry payments); and that owners would be out-of-city investors taking their profits out of town, I was surprised and intensely interested to read that supporters believed it would bring 125 jobs to town. A **net export multiplier model** would show the opposite – a drain on community revenues and reduction in jobs. OTBs were not the only type of business that could drain a local economy (e.g., an out-of-area entertainer performing in town could do the same), but the fact that projections were backwards seemed to be valuable information that the city council and mayor would want to know. I appeared before a city council meeting where my offer to volunteer to work with city staff to produce an accurate economic impact study was rebuffed by the mayor.

At the time, it was incomprehensible to me that an offer to provide free service would be refused. I have since become less naive but, at the time, the rejection of evaluative data stirred me enough that I did the work anyway and published it as a newspaper commentary. This commentary was seen by the university news bureau and eventually led to other commentaries in St. Louis, Chicago, and Indianapolis – the nearest large cities. One of these commentaries was read into the Senate record by U.S. Senator Paul Simon. The commentaries led to questions about the effects of **gambling** expansions in other areas coming to me from coast to coast. I found that virtually no economists at that time were working on the question. Seeing that casino expansion was a topic likely to need independent research, I decided that the issue was worthy of further professional attention.

Forward the clock several years. The second episode occurred at a state-sponsored event hundreds of miles from home with invited speakers, including members of the gambling industry. I sat on a panel sandwiched between a New York City gambling-industry consultant and a casino executive. My closing statement was that, apart from the harmful side effects and **social costs** associated with casinos – most operating through problem and pathological gamblers – there was little to object to about gambling. In the absence of such consequences, if some individuals liked to gamble, they should be free to do so; if others did not like it, they didn't have to gamble. At this time, the casino executives I had been exposed to portrayed themselves as well-meaning businessmen who did not want to hurt anyone by what they did for a living, but were saddled with the unfortunate fact of gambling addicts. At the conclusion of the panel, I turned to the young casino owner on my right, who appeared to be well under the age of forty and was already a wealthy man, (having offered to pay $10 million of his own money for a casino license in the state that had invited us). I pointed out that he looked like a well-to-do individual who probably did not need to work another day if he chose not to, an observation to which he assented. I then asked him the following question: If he knew that what he did to make his living unintentionally hurt people – really *hurt* them – would it be enough to make him change his line of work? He quickly replied that, of course, it would. I then drew from my briefcase a photocopy of a newspaper clipping titled, "Woman Gambles Away Family's Savings, Kills Self." He glanced at the title, waved his arm dismissively, blurted that she probably had had a problem before she began gambling, and walked away. In fact, this woman had no known prior problems before she began gambling; she used the house payments and eventually the family's savings in amounts of $150 and $200, one after the other. Her husband was called home from work one day to find a detective in his driveway. According to the newspaper account, "The detective told Steve two things: His mortgage was seventeen months behind, and the sheriff, there to evict him, had found Kate's suicide note."[1] This was the first that he or his two children knew there was any problem.

Of course, stories do not constitute the basis of good policy. The United States is a large country; one can find examples to support either side of virtually any issue. What these episodes graphically taught me was that there was a great unfilled need for an economist to study the costs and benefits of casinos in society and to identify which side of the ledger was predominant.

Policy triage suggests that there always will be those whose personal interests cause them to support casinos. Likewise, there will always be those who are against them without having to be convinced. It is the middle group, especially those in positions of public trust, who need independent information from sources who are not making money from the activity on which they are reporting. This is why the rudiments of a complete cost–benefit review of casinos was so essential; that is what I set out to collect. Since beginning research on the economics of gambling, I have been asked to testify on more than twenty occasions before statehouses and various national and state government commissions and committees, in addition to speaking publicly to chambers of commerce and other audiences. I was fortunate to be one of the first academicians to recommend to Congress (in 1994 testimony)[2] that it should establish a national commission to study the impact of casino gambling. I felt that rivalry between states could engender a **prisoner's dilemma** competition, whereby states that did not want casinos would feel forced to adopt them as defensive measures against bordering states that used casinos to target the populations of their neighbors.[3] A study conducted to determine the impact of gambling in Ohio and to review the desirability of casinos noted early in the report, "Casinos are within a few hundred yards of our border in Indiana, and within an hour's drive of Ohio in Detroit, Michigan, and Windsor, Ontario. Two West Virginia racetracks offer electronic gaming devices (EGDs; also often called video lottery terminals [VLTs]) also within an hour's drive of Ohio."[4] All states cannot gain at their neighbors' expense, but all will experience the impact of casinos, whether good or bad.

The nine-member National Gambling Impact Study Commission was formed in 1996 legislation and produced its final report in 1999. The report explains that the commission recommended

> . . . a pause in the expansion of gambling in order to allow time for an assessment of the costs and benefits already visible, as well as those which remain to be identified. . . . What is most important, however,

is that these reviews take place and that whatever decisions are made are informed ones.[5]

The fact that the commission did not complete sufficient research to provide the elements of a cost–benefit assessment of casinos but recommended that gambling expansion be halted so that *others* could provide research is revealing. The commission had a significant research budget and, in many ways, was better positioned to conduct original inquiry on key questions than others. Many believe that the commission did not live up to its potential because it included members with financial ties to the gambling industry. On one occasion, for example, a commission member representing the gambling industry harshly criticized survey results presented to the commission that might be construed by some as unflattering to the industry, even threatening a lawsuit against the academics involved.[6] The commission chairman, after conclusion of the commission's work and its termination, stated that she "was not prepared for the venom, bigotry, prejudice, and stereotyping" that she experienced from progambling interests in leading the Congressional study commission.[7]

In an ideal world, policy would be determined by commissions and members of government dispassionately evaluating the alternatives, debating their merits, selecting the best, and then implementing. My travels confirmed for me that we do not live in an ideal world: instead, advocacy rules. Promoters produce proposals that benefit themselves. They and their government allies (who are sometimes promised various inducements[8]) urge their adoption. If there is no opposition – sometimes because no time has been allowed for input – the proposals may be adopted. Usually, however, groups that stand to lose have some opportunity to explain their case. This is a guarantee that both sides will be heard, not that the information will be in a meaningful form or that all of it will be accurate.

On one occasion, I was told privately by a gambling-addiction treatment specialist prior to a public hearing that her office did not take a public position on any form of gambling because in the previous year, one of their treatment specialists had made statements that were objected to by her state's casino industry, which promptly had treatment funding cut by the legislature. She said it was made clear to them that reprisals in the form of funding cuts could be expected in the future if similar episodes continued. Money is a carrot or a stick. Academics have been approached with offers to fund their gambling-related research and centers using gambling dollars, and a few have accepted such funding – even as the tobacco industry provided money to scholars and researchers in the smoking and health field for many years.[9] Providing money for gambling research and treatment is not a problem to the gambling industry, as long as what is said by those receiving it does not touch the core of the industry's interests.

Legislative committees tend to be unsatisfactory vehicles to solve the obvious need for independent, utilizable research to compare benefits and costs. In Ohio, the legislative Committee to Study the Impact of Gambling in Ohio reported that "the Committee had no budget, no permanent staff, and a short time frame within which to complete its work."[10]

> Because of limited time and the lack of a budget or full-time staff, this Committee could not conduct original research on gambling behavior and problem gambling behavior by Ohioans. Instead, we had to rely heavily on testimony from interested parties. . . .[11]

The committee noted in its report that a cited study required 1-1/2 man years of professional economists' time, and spent $75,000 for data acquisition alone, and yet did not attempt to quantify the social costs of gambling.[12] In the same year, Maine's 2002 "Task Force to Study the Impact of a Maine-Based Casino" found its budget of $6,800 "wholly inadequate to address the task force needs," in the words of one member.[13] The task force concluded that limited resources and very complex issues did not allow it even to scratch the surface of the types of questions facing the state. In Connecticut, the state's study to identify the effects of legalized gambling on state citizens did not allow its authors "to address issues related to (1) the social costs of gambling, or (2) any of the important psychological, social, or treatment characteristics of intemperate gamblers in Connecticut," in the words of one reviewer. "This deficiency is remarkable, since the project's primary purpose was to complete 'A study concerning the effects of legalized gambling on the citizens of the state of Connecticut.'"[14] In South Dakota, the government's Legislative Research Council (LRC) had to insist on receiving more information from researchers, Deloitte & Touche, concerning social impacts although the original contract had called for such information. In its letter to Deloitte & Touche, the Council's director explains:

> Items J and N in the scope of the study specify social problems and social impacts. Module III [in your report] is titled "Identification of Social Issues." Later in the paragraph, the scope of the study in this respect is limited to costs expended by the state due to problem and pathological gambling addictions. Items J and N indicate that the LRC had in mind some information would be forthcoming relative to gambling and social phenomena as suicide, divorce, child neglect, failure in child-support payments, bankruptcy ... the LRC had in mind a much more extensive discussion relative to items J and N.[15]

In short, it is rare if ever that a valid framework of analysis is adopted, its elements understood relative to the overall question of well-being of the **citizens**, the information successfully acquired to fill the elements of the framework to undergo evaluation, and then evaluated.

So how should a proper assessment proceed? The question applies not only to the casino industry, but also to *any* industry believed to be associated with harmful social costs. Step One is to construct a framework of discourse. In this book, I take the well-being (i.e., **utility**) of the area's people as my starting point. An economic development proposal – this could be adding a new industry to the economy, as in the case of casinos, or something as far afield as choosing an immigration policy that decides whether to add new residents to a geographical nation – is desirable if it enhances the utility of existing residents. The focus on peoples' well-being has implications for how to measure benefits and costs, which are worked out in Chapter 5.

Chapter 2 presents background information about gambling as an activity and a number of considerations of which policymakers should be aware. Chapter 3 deals with an important preliminary issue, which is to explain why the incentives imbedded in the political and social process – at least in the case of casinos – are often not structured to make choices in the right way. Economics is the study of incentives and their consequences in the commercial interactions of people. Some extend the discipline to include the study of self-interest and incentives in peripheral areas such as political economy, which considers political policies and economic processes, especially as they relate to prevailing social institutions. The change in the social environment and in the institutions relating to the casino industry described in Chapter 3 created incentives that led to outcomes that no single agent controlled, but that all played a part in creating. How to evaluate the consequences of these actions is the subject of Chapters 4 through 8, which organize the process of translating a focus on residents' well-being into a correct **cost–benefit analysis**.

Chapter 4 reveals that it is difficult to keep economic development as it is usually discussed in proper context. Economic development is most often discussed in the halls of power in terms of **impact studies**, in which the focus is jobs and projections of taxes that will presumably be paid by new businesses. This emphasis is encouraged by the promotional studies that are provided to legislators and the public, but it is an emphasis that is decidedly wrong. Economic development in this guise is *not* synonymous with economic development in the sense of enhanced resident well-being. Another reason that there is a false emphasis on impact studies looking at jobs and tax payments is that they are easier to produce than cost–benefit analyses. One of the main themes of this book is that reliance on such studies is misplaced. Impact studies can show both job and tax increases at the same time that utility of the population falls. To appreciate valid cost–benefit analyses, one must understand invalid analyses based on impact studies. Chapter 4 describes how impact studies are invalid assessments for two main reasons: first, they are conceptually the wrong tool; and second, even for the questions they answer, they are prone to manipulation, misrepresentation, and error.

Chapter 5 begins the constructive process of relating costs and benefits to residents' utility. The pertinence of this process is wide-ranging, and it can be applied quite generally. Its specific application to the casino industry is particularly valuable because so many features relevant for casinos might not appear in other selected industries. For example, most entertainments do not generate **externalities** to any significant extent. The underlying concept for the conversion from utility to cost–benefit components is simple. Utility is generated by using income to purchase goods and services at available prices. Income derives from **value added**. Economic activity creates value added when it converts inputs into outputs of higher value. Because any increase in value added, including the value to residents of amenity changes that affect utility, must appear in some form in the post-change economy, performing appropriate budget identity manipulations allows the mathematics itself to identify the forms of increase.

Chapters 6 and 7 discuss what is known about the magnitude of the benefits and costs of casinos. There are certain conceptual issues to discuss because the form that benefits take depends on market structure. Chapter 8 concludes with an evaluation of the strengths and weaknesses of what is currently known.

There is inevitably difficulty in writing a book intended for multiple interested parties. In the case of casinos, this should include legislators and the public, in addition to academicians. Any subject – and economics is no exception – develops special argot. I have tried whenever possible to explain the necessary terminology and its significance whenever it could not be dispensed with. Some may find the material too technical in parts; others may find parts that are the opposite. It is my belief that people of intelligence, regardless of their own occupation or field, are capable of understanding the relevant issues in this book if they are clearly explained. My solution was to write at the level that I felt necessary to the topic at hand, but also to provide explanations to make the material as accessible as possible to all readers throughout. Where possible, I use boxes to separate material that was not essential to the discussion, but whose presence would add to it. I apologize to those who may find some explanations tedious, just as I urge others to bypass technical portions when not germane to their objectives.

Before concluding this chapter, I should explain my relationship to and personal views on casino gambling. I have studied the economic implications of casinos for twelve years. In that time, I have had to think carefully about the issues and determine fully my own views in light of the data and my research. I have received income neither from the gambling industry nor from its opponents. I do not accept honoraria for my testimony or public addresses, and my research has not been directly or indirectly funded or paid for by progambling or antigambling organizations or individuals. Thus, the time that I spend on this issue has no financial implications to me. This is one advantage of a research university as the provider of public services. Within the economics discipline, the study of the casino industry has not been on the list of professionally important or prominent activities. At best, the time devoted to it has been neutral to my career.

In view of this, why would anyone spend time studying the economics of gambling? One reason is curiosity. Early on, I felt that those making decisions about casinos needed to know what the consequences of introducing the new industry into their economy were, and I wanted to know what a cost–benefit study would find. Despite the longevity of casinos in Nevada, there was no good research available on casino costs and benefits. For example, the question of how much the opportunity to gamble nearer to home was worth had not been addressed, even though the issue has similarities to the question of what the value of creating a new amenity such as a national park might be.

Another reason is fascination with what I learned about the failings of the public decision-making process. It was a continual surprise to me how little reliable advice legislators tended to receive through the lobbying and hearing process and how confused was the information they did receive. I felt a certain degree of obligation to provide objective information.

The most important reason, however, came from the realization that the methodology of evaluating casinos had wider applicability. If one theme of this book is that legislators have difficulty inherent in the advocacy system in getting good information, another is that there is a pervasive lack of understanding among legislators and the business community – and even among the ranks of some economists – about what economic development is and how to evaluate it. Many accounting firms, consulting firms, and those academics who were often consulted on gambling issues have little or no understanding of how to construct the elements of a cost–benefit analysis and how to validate its components once they have done so. Many would be unable to differentiate the logical differences between the net export multiplier models they provide (i.e., jobs and income multiplier impact studies) and the related but different concept of cost–benefit. This is a shame because economic development is a subject of great importance. The environmental movement has reminded us that cutting down every tree in the land might create jobs but would be a foolish way to think about whether that should actually be done.

Previously in this chapter, I reported my view that if there were no social costs caused by gambling, there would be no reason to object to it. That is, when individuals understand risk and odds and want to gamble for enjoyment, budgeting and planning as they would for any other form of recreation, there is no argument, in my opinion, to object. I have no moral objections to gambling. However, a much misunderstood point is that *morality* is simply a term that refers to codified injunctions – often long-standing and ancient in origin – against activities that cause more social harm than good. Murder inflicts greater social costs than benefits; this has been known for centuries, and thus there exist widespread moral codes against murder. My approach is simple: Activities that create more social harm than good and, therefore, fail a cost–benefit test need to be regulated, monitored, and in some cases altered or banned to achieve greater social well-being. Rational agents will not choose to engage in an activity where social costs exceed social benefits and the costs are inflicted on the agents themselves. The need for public intervention occurs precisely when the costs are borne by one agent or group and the benefits by another.

CONCLUSION

Too often, public decisions are made with deficient information and evaluation. There is even a lack of agreement or understanding of what constitutes a proper evalution or review. This is especially true in the class of activities that falls under the rubric of "economic development." The incentives for government to seek out and receive unbiased and trustworthy assessments of proposed projects and to understand them in terms of their impact on the well-being of their citizens are unreliable. Those with significant money at stake are motivated to present only their own views.

However, the dictum that "you can fool some of the people all of the time, and all of the people some of the time, but you cannot fool all of the people all of the time"[16] suggests that truth and right thinking tend to be more persuasive in the long run. Good policy requires that some party generate an unfooled public by providing factual and accurate information. Because a casino promoter, an Indian tribe, or even local government places itself in the role of the house, thereby reaping benefits, does not mean that casinos are socially beneficial. Social benefits must take into account all stakeholders. There are benefits of casinos to players, to owners, and to citizens, and there are costs as well. Identifying a winner or loser from the social perspective requires understanding the complete picture and knowing which components should be compared.

The purpose of this book is to address this state of affairs by enunciating a framework for social evaluation and applying it to the casino industry. Precise numbers relating to gambling will undoubtedly change with the passage of time, but the framework for evaluating them – as well as many relative magnitudes and ratios – will remain accurate. Human nature and how it relates to gambling has not changed, nor will the requirements for right evaluation of social issues based on the well-being of households.