

## 2 Considerations

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We make progress slowly. Discredited institutions of one century, thought to have been permanently abolished after a long struggle, are revived in later centuries and the battle has to be fought all over again.

*M. L. Walker (1934)*

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**CHAPTER SUMMARY.** For most of the twentieth century, casino gambling was criminalized in all states except Nevada. This situation was dramatically reversed, primarily in the last decade of the century. What lessons does this teach? Have we forgotten what our forebears once knew or is the nature of modern gambling different? Here, we identify a puzzle: Why does one generation judge gambling harshly and another embrace it? Those making decisions about gambling must understand its special features and decide whether or not it is appropriate for government to intervene. In any event, the present generation is embarked on a nearly perfect social experiment in most locations of the nation: comparing the complete absence of casinos on one extreme to their prominent presence on the other.

U.S. legal tradition is rooted in the value of personal freedom. A citizen has the right to do as he or she wishes, even to engage in activities that others might think dangerous or harmful to himself or herself, such as suntanning, smoking, or skydiving. Citizens' liberty to do as they wish is restricted only when their choices infringe on the freedom and rights of others. It is significant, therefore, that in 1909, after the last remaining state – Nevada – outlawed casino gambling, no state in America allowed casinos within its borders. New York closed its racetracks the following year and, at that moment, virtually all gambling anywhere in the United States was illegal – the only exceptions being a handful of racetracks in Kentucky, Maryland, and Illinois. Just as interesting as the actual presence of the ban is the fact that 76 percent of the states prohibiting gambling did so in *constitutional* provisions. Constitutions are intended to constrain behavior not only of individuals, but also of government; they are intentionally difficult to change. Even legislative simple majorities may not engage in constitutionally prohibited actions.

Table 2.1 lists states and adoption years of constitutions that prohibited gambling at the beginning of the twentieth century. The right-hand column lists the forms of gambling legally available at the end of the century. The language prohibiting gambling was generally written in terms of lotteries. A **lottery** is a scheme for the distribution of prizes by chance. The elements of a lottery are consideration (i.e., payment for play), prize, and chance.<sup>17</sup> Many court decisions establish that the term *lottery* applies to any game of chance and any game in which chance predominates.<sup>18</sup> The contrast between the large number of states that enforced constitutional prohibitions against any form of gambling in 1900 and the number that encourage multiple gambling forms today is remarkable. At this writing, only two states – Hawaii and Utah – authorize no form of gambling. Horseracing is allowed by Tennessee, but there are presently no operating tracks.<sup>19</sup> A sample of the constitutional provisions follows:

“No law shall be passed, abridging the right of the people peaceably to assemble and to petition, on the government, or any department thereof, nor shall any office be granted, otherwise than by due judicial proceedings, nor shall any lottery hereafter be authorized or any sale

of lottery tickets allowed within this state. (New York 1846)

**TABLE 2.1.** Contrast between Nineteenth Century Constitutional Gambling Prohibitions and Gambling Acceptance in 2000

State	Year of Constitutional Ban in Effect in 1900	Gambling Allowed in 2000
Alabama	1875	Bingo, Parimutuel
Alaska		Bingo
Arizona		Bingo, Indian Casinos, Lottery, Parimutuel
Arkansas	1874	Parimutuel
California	1879	Bingo, Card Rooms, Indian Casinos, Lottery, Parimutuel
Colorado		Bingo, Card Rooms, Casinos, Indian Casinos, Lottery, Parimutuel
Connecticut		Bingo, Indian Casinos, Parimutuel
Delaware	1897	Bingo, Lottery, Parimutuel
Florida	1887	Bingo, Boats to Nowhere, Card Rooms, Lottery, Parimutuel
Georgia	1877	Bingo, Boats to Nowhere, Lottery
Hawaii		0
Idaho	1890	Bingo, Lottery, Parimutuel
Illinois	1887	Bingo, Indian Casinos, Lottery, Parimutuel, Riverboats
Indiana	1851	Bingo, Card Rooms, Lottery, Parimutuel, Riverboats
Iowa	1857	Bingo, Indian Casinos, Lottery, Parimutuel
Kansas	1857	Bingo, Indian Casinos, Lottery, Parimutuel
Kentucky	1891	Bingo, Lottery, Parimutuel
Louisiana		Bingo, Casinos, Lottery, Parimutuel, Riverboats
Maine		Bingo, Lottery, Parimutuel
Maryland	1867	Bingo, Card Rooms, Lottery, Parimutuel
Massachusetts		Bingo, Lottery, Paramutuel
Michigan	1850	Bingo, Casinos, Indian Casinos, Lottery, Parimutuel
Minnesota	1857	Bingo, Indian Casinos, Lottery, Powerball

(continued)

TABLE 2.1 (continued)

State	Year of Constitutional Ban in Effect in 1900	Gambling Allowed in 2000
Mississippi	1890	Bingo, Casinos, Riverboats
Missouri	1875	Bingo, Lottery, Parimutuel, Riverboats
Montana	1889	Bingo, Card Rooms, Lottery, Parimutuel, Sports Betting, Video Poker
Nebraska	1875	Bingo, Indian Casinos, Lottery, Parimutuel
Nevada	1864	Bingo, Casinos, Lottery, Parimutuel
New Hampshire		Bingo, Lottery, Parimutuel
New Jersey	1844	Bingo, Card Rooms, Casinos, Lottery, Parimutuel
New Mexico		Bingo, Casinos, Indian Casinos, Lottery, Parimutuel
New York	1846	Bingo, Indian Casinos, Lottery, Parimutuel
North Carolina		Bingo, Casinos, Indian Casinos
North Dakota	1889	Bingo, Card Rooms, Indian Casinos, Parimutuel, Sports Betting
Ohio	1851	Bingo, Lottery, Parimutuel
Oklahoma	1890	Bingo, Indian Casinos, Parimutuel
Oregon	1857	Bingo, Card Rooms, Indian Casinos, Lottery, Parimutuel, Sports Betting
Pennsylvania		Bingo, Lottery, Parimutuel
Rhode Island		Bingo, Lottery, Parimutuel
South Carolina	1895	Bingo
South Dakota	1889	Bingo, Card Rooms, Casinos, Indian Casinos, Lottery, Video, Parimutuel
Tennessee	1870	0
Texas	1861	Bingo, Lottery, Parimutuel
Utah	1895	0
Vermont		Bingo, Lottery, Parimutuel
Virginia	1902	Bingo, Lottery, Parimutuel
Washington	1889	Bingo, Card Rooms, Casinos, Indian Casinos, Lottery, Parimutuel

State	Year of Constitutional Ban in Effect in 1900	Gambling Allowed in 2000
West Virginia	1872	Bingo, Casinos, Lottery, Parimutuel
Wisconsin	1848	Bingo, Indian Casinos, Lottery, Parimutuel
Wyoming		Bingo, Parimutuel
<b>Number of bans by Constitutional Prohibition</b>		<b>35 (76 Percent*)</b>

\*Arizona, New Mexico, Alaska, and Hawaii did not become states until after 1900.

“Lotteries and the sale of lottery tickets, for any purpose whatever, shall forever be prohibited in this state.” (Ohio, 1851)

“The legislature shall not authorize any games of chance, lottery, or gift enterprise, under any pretense, or for any purpose whatever.” (Nebraska, 1875)

“The legislature shall not authorize any game of chance, lottery, or gift enterprise under any pretense or for any purpose.” (Utah, 1895)

According to historians, there have been eras in which gambling in America was more prevalent, followed by periods of restriction, followed again by periods of resurgence. The growing movement in the early 1800s to oppose slavery, lawlessness on the frontier, and alcoholism also worked to curtail gambling. After the Civil War, a second wave of gambling occurred, including for a time an era of national lotteries that eventually led to so much corruption that policy moved in the reverse direction.

Consider Missouri:

- In 1814, gambling was prohibited in Missouri.
- In 1862, however, it was the only state except for Kentucky not to ban lotteries.
- It subsequently banned lotteries in 1875.
- In 1991, Missouri legalized riverboats, but allowed only games of skill.
- In April 1994, Missouri rejected full riverboat casino gambling, but

legalized it in a second vote in November

The pendulum has similarly swung in Nevada:

- In 1861, gambling was outlawed in Nevada.
- In 1869, it was made legal again.
- In 1909, Nevada banned gambling.
- In 1913, it legalized it again, but not commercial gambling.
- In 1931, it legalized commercial gambling.

Similar histories could be produced for other states. The social ambivalence about gambling is evident in Table 2.1. What one generation worked to permanently eradicate, another generation resurrected.

## BACKGROUND

**SUMMARY.** Any public position on gambling needs to accommodate a number of relevant facts. Gambling is an ancient practice and the nature of people's response to it appears to be similar through time, including its popularity, the associated tendencies for it to lead to harm for some, and for promoters to use it as a vehicle for fraud. Gambling needs government regulation, which is frequently an enticement to corruption. The bulk of gambling is done by 10 percent or less of the population. Furthermore, information from **problem and pathological gamblers** implies that they account for a disproportionate and sizable percentage of casino revenues. Thus, gambling differs in important ways from many other types of entertainment.

What really do we know about gambling? First, it has appealed to humankind from its earliest history. The first known six-sided dice reportedly date from 2750 B.C. and were found in Mesopotamia made of baked clay. Dice also appear at the same time in the Indus valley.<sup>20</sup> One of the earliest written documents about chance is the "Lament of the Gambler," written in Sanskrit in 1000 B.C. It is "a monologue by a gambler whose gambling obsession has destroyed his happy household and driven away his devoted wife."<sup>21</sup> Apparently, gambling affected some individuals then in much the same way it does today. Dostoyevsky's book, *The Gambler*, also comes to mind, as well as the 1828 novel, *The Gamesters*: "The duties of his profession had been for some time totally neglected" and "the hope

of recovering what he had so inconsiderately lost plunged him still deeper in the abyss of ruin.”<sup>22</sup> Adam Smith in *Wealth of Nations*, published in 1776, wrote “in the state lotteries the tickets are really not worth the price which is paid by the original subscribers, and yet commonly sell in the market for twenty, thirty, and sometimes forty per cent advance. The vain hope of gaining some of the great prizes is the sole cause of this demand.”<sup>23</sup> The willingness to overpay that Smith noted in his time is still evident today. Assume that  $n$  people play a simple lottery that taxes  $t$  percent of proceeds, charging  $c$  per ticket. The value of the lottery is the sum of the probability of receiving the payout multiplied by the amount received and the probability of not receiving the payout multiplied by the nonpayout amount (zero):  $V = \frac{1}{n}(nc - tnc) + (1 - \frac{1}{n})0$ . The percentage by which the purchaser overpays is given by the extent to which the purchase price exceeds the value  $\frac{c}{V} - 1 = \frac{t}{1-t}$ . Overpayment reaches 40 percent for a lottery tax rate of 29 percent. Modern buyers of lottery tickets overpay by even more because higher tax rates usually apply to modern state lotteries.

Gambling has other enduring characteristics. For example, games of chance have traditionally been vehicles for fraud, often involving promoter scams and the inability of promoters to make promised payments. The *Encyclopedia Britannica* reports, “Much of the stigma attached to gambling has resulted from the dishonesty of its promoters, and a large proportion of modern legislation is written to control cheating.”<sup>24</sup> The 1970 edition states, “As long as there has been gambling, there have been devices, such as dishonest dice and marked cards, to victimize opponents in a social game. . . . Nearly all casinos operate honestly up to a point, but if a plunger, or big bettor, seems likely to achieve a winning damaging to the casino, there is usually a dealer available with skill at prestidigitation equal to that of a stage magician who can manipulate cards or dice so as to recover the losses of the house.”<sup>25</sup> Verifying that the odds applied and the payouts made are correct on Internet wagers presents new types of technological challenges.

It is well accepted, therefore, that gambling must be closely watched and regulated by government if it is allowed. The first major casino in

Nevada, El Rancho, was opened in the early 1940s, followed by others.<sup>26</sup> A short time later, in 1955, Nevada had to close a casino for the first time because of its links to organized crime.<sup>27</sup>

Because gambling requires public regulation, those who want favors for licenses or operating conditions must obtain them from government, which creates an enticement to public corruption. The Michigan Attorney General reported in 1995,

such widespread bribery and corruption, all of which was done by gamblers to influence public officials, that we had indictments and convictions for felonies of the mayor... the superintendent of police... the sheriff of the county... and the prosecutor of the county... And in the police department of the city at that time... the following numbers of officers were indicted for taking bribes: fifteen inspectors, thirty-nine patrolmen, and two superintendents.<sup>28</sup>

Edwin Edwards, Governor of Louisiana, became an example of the potential for dishonesty when he was found guilty in 2000 of seventeen charges of corruption in connection with extortion and awarding of casino licenses. The book *Bad Bet on the Bayou* by former *Times Picayune* writer Tyler Bridges documents the sad story, including how extremely hard it was to gather the necessary evidence for conviction.

From the policy perspective, the dilemma is this: free, unregulated gambling engenders the need for government oversight, but restricting and regulating it creates permanent incentives and enticements to subversion and government corruption. Sometimes government regulation takes the form of limiting the number of casinos that can operate. Restricting the number of entrants raises the return to financial capital invested in the gambling sector, leading to pressure for gambling expansion. Unregulated, free-entry gambling is allowed virtually nowhere. We must conclude, therefore, that most jurisdictions believe that if *laissez faire* prevailed, gambling could soon reach unacceptable bounds. This would lead to the need for restriction and the cycle starting over.

Another feature of gambling is related to the fact that Americans have many forms of recreation. Gambling is not a major activity for most



of the population. Even in Las Vegas, a third of the population recently reported that they had not gambled at all in the past year.<sup>29</sup> Another 60 percent of the population might gamble occasionally, but most gambling is done by the remaining, relatively small percentage of the population. A Minnesota study found that 1 percent of gamblers accounted for 50 percent of the wagers.<sup>30</sup> According to the National Gambling Impact Study Commission, 5 percent of the population accounts for 51 percent of lottery revenues.<sup>31</sup> In an Illinois study, the top 10 percent of riverboat gamblers accounted for 80 percent of revenues.<sup>32</sup>

The use of the word *gaming* instead of gambling is meant by industry promoters to emphasize the recreational element of casinos. However, gambling appears to differ fundamentally from most forms of entertainment. Few suicides have been reported in the press and few family fortunes have been lost due to excessive opera attendance. Pathological bowling and pathological baseball attendance are not recognized disorders in the *Diagnostic and Statistical Manual of Mental Disorders - Fourth Edition (DSM-IV)*, published by the American Psychiatric Association; pathological gambling is. Speaking in 1984, the former Director of Gaming Enforcement for the State of New Jersey told a conference that the success of gambling depended on how well it sold its product.

That product is not entertainment or recreation or leisure. It's really adrenaline: a biological substance capable of producing excitement – highs – and generated usually by anticipation or expectation of a future event, especially when the outcome of that event is in doubt.<sup>33</sup>

Medical research is still in the beginning stages of learning about the chemistry of gambling, but there does appear to be a biological connection. According to a 2002 report,

Several studies were published last year looking at monetary rewards and dopamine.<sup>34</sup> Money is abstract but to the brain it looks like cocaine, food, sex, or anything a person expects is rewarding.<sup>35</sup>

The great majority of people who gamble develop no problems; however, according to researchers, the dopamine systems of pathological gamblers

seem to be vulnerable. “The first time they win, they get a huge dopamine rush that gets imbedded in their memory.”<sup>36</sup>

A natural consequence of the demographics and psychological factors of gambling is that casinos and other forms of gambling derive a disproportionate share of their revenues from the losses of problem and pathological gamblers. Whereas an average adult might lose about \$300 per year at a nearby casino, problem and pathological gamblers report losing ten and twenty times as much. Lesieur (2002) reports that problem gamblers lose seventeen times more than nonproblem gamblers. The Australian Productivity Commission, which produced the government study *Australia's Gambling Industries* in 1999, reported that problem gamblers “lose around Aus\$12,000 each year,<sup>37</sup> compared with just under Aus\$650 for other gamblers,” a ratio of 18.5 to 1. A study conducted for the Gambling Impact Study Commission found that 2.4 percent of the population were problem or pathological gamblers among those who lived within 50 miles of a casino.<sup>38</sup> Using these numbers, if the average adult loses \$X annually at casinos, and 2.4 of every 100 adults are problem or pathological gamblers who lose \$17X per year, then 40.8 percent of casino revenues come from problem and pathological gamblers.<sup>39</sup> The Australian Productivity Commission estimated that 42.3 percent of revenues from gaming machines came from such gamblers, whereas overall, one third of gambling revenues came from problem gamblers.<sup>40</sup> A more recent study conducted in the Australian Capital Territory found that the share of gambling-machine revenue from problem gamblers was 48.2 percent.<sup>41</sup> In the United States, estimates have ranged from a low of 25 percent to as high as 50 percent in some locations.<sup>42</sup>

It would be naive to believe that gambling promoters are unaware of the source of so much of their income. One account

... recalls a storekeeper's account of the sales tactics employed by video-gambling machine manufacturers, who “promoted their product to convenience store owners by asserting that if you get one player ‘hooked,’ he’ll pay your taxes. If you get two players ‘hooked,’ they’ll pay your rent.”<sup>43</sup>

The public's reaction to information of this type was tested in a 2002 telephone poll of six hundred people over the age of eighteen who were asked, "It has been shown that nearly half the income the Victorian Government receives from poker machines comes from problem gamblers. With this in mind, if a political party promised to reduce the number of poker machines in Victoria by half, from thirty thousand down to fifteen thousand machines, would you be more likely or less likely to vote for this party?" Of those polled, 54 percent said more likely, 12 percent said less likely, and 34 percent said they did not know or it would not affect their vote.<sup>44</sup>

For those and other reasons, gambling-industry promoters generally have had to find a "hook" to sell to hesitant communities the idea of allowing casinos in their cities and towns; jobs and economic benefits are the hook. From the president of a gambling company:

My message to you today is very simple. Legalized and regulated casino entertainment is a proven job creator, a catalyst for economic rejuvenation, and a proven tourism draw that does not depend on asking taxpayers for handouts in the form of inducements, tax abatements, and infrastructure improvements.<sup>45</sup>

However, from the *World Book Encyclopedia* in the same year:

The employment increases resulting from most gambling operations are illusory. The purchasers of lottery tickets and the patrons of race-tracks are almost exclusively local residents. The money they wager comes from the local economy, and each dollar they spend on a lottery ticket or lose on a horse is a dollar they can no longer spend at a store or restaurant. This situation benefits the gambling operations but works to the detriment of other kinds of business.<sup>46</sup>

Can both characterizations be accurate? In some cases, casinos have become resort destinations, attracting patrons from great distances as in Las Vegas, which has world-class entertainment and a vacation atmosphere. However, in most cases, regional casinos are nothing more than "convenience" gambling to nearby residents. "Evidence shows that most gambling at riverboat casinos is from regional, or

day-trip, patrons,” according to the National Gambling Impact Study Commission.<sup>47</sup> In a study of Illinois casinos,<sup>48</sup> 75 percent of patrons came from within 35 miles, and only a few percent from more than 100 miles.

The bottom line returns us once again to costs and benefits. There would be little or no concern over how much gambling there is – any more than government cares about golf or movie attendance – if the consequences of gambling were confined to those who chose to gamble. Unfortunately, this is not true. Bankruptcy and suicide, for example, are both examples of casino-industry consequences that impose costs on more than just the gambler.

## **FREEDOM, EXTERNALITIES, AND PUBLIC POLICY**

**SUMMARY.** Here, we state the rationale for government to regulate or restrict an activity. The burden of proof is on those who would restrict an activity to show that its unrestricted existence creates more costs than benefits.

We have learned a number of interesting facts about gambling, but still are confronted by our original questions. Why did earlier generations want to prohibit games of chance “forever” and “under any pretense, or for any purpose whatever”? Were they biased? Were they misinformed? Did they misunderstand gambling? Did they restrict personal freedom unjustly?

In the remainder of this book, we attempt to understand the policy questions about gambling by taking an objective and comprehensive look at the economics of gambling, identifying and dispelling a number of misunderstandings about its economic effects, and providing a structure for discourse that has not been evident to this point.

How do freedom and externalities play a role in setting public policy in this recently expanded sector? We accept the view that personal liberty – in this case, the right of firms to offer casino gambling and the right of the people to engage in it – should not be curtailed without cause.

This is the “freedom” contribution to the debate. It places the burden of proof on those who would argue that gambling should be prohibited, even if the status quo already prohibits gambling. They must show that the social costs of casinos exceed their social benefits, and that the costs include those imposed on the nongambler by the gambler’s choice to gamble.

The social benefits of casinos are conceptually similar in principle to the benefits from other industries, especially entertainment industries (explained in detail in Chapter 6). However, gambling is not just another entertainment industry. The Australian Productivity Commission, cited previously, asked this question in the section titled, “Just Another Industry?”: “We don’t seek to assess the costs and benefits of most other industries, so why do we do so for these industries?”<sup>49</sup> Despite claims by some who speak for the industry that there is little that is special, the commission reported that “Even within the gambling industries themselves, many of those with whom the Commission met accepted that their industry was indeed ‘special’; in the words of one senior executive, gambling was seen as a ‘questionable pleasure.’”<sup>50</sup> An economist would say that gambling is the source of negative externalities. A *negative externality* is a harmful effect that a firm or **household’s** choices have on other firms or households and that does not operate through market prices. If my decision to dump my waste pollutes your drinking water, that is a negative externality. If my decision to water my lawn bids up the price of water, which you also purchase for your lawn, that is not an externality because the effect on you, although adverse, operated through market prices. It is in the nature of externalities that the causing agent does not take them properly into account when making decisions because, although they may affect others, they do not affect the agent’s own profits or utility. In the case of casinos, if an increase in the number of pathological gamblers leads to social problems whose costs must be borne by those other than the casinos, there is an externality. If the presence of casinos creates conditions that lead to increase in crime that must be dealt with through money provided by public taxes, then that is an externality. Casinos get the profits; society gets negative externalities.

The contribution of externalities to the discussion, therefore, is to emphasize that one must assess the social costs, including externality costs, and compare them to the benefits of the gambling industry.

Public policy must be able to quantify and evaluate the impact of gambling by knowing how to perform the cost–benefit review without manipulation or mistake, and make the appropriate decisions in light of the common good. The remainder of this book provides the first conceptually complete cost–benefit assessment of an industry that was absent from the economy for most of the twentieth century and was reintroduced largely in the past dozen years. Casino gambling offers the researcher, scholar, and social observer an unusual experiment that is rarely available: the opportunity to observe the effects of an activity where the alternatives range from complete prohibition to free licensing. Prohibition and licensing are both feasible choices because both have been done: we successfully practiced prohibition for most of the twentieth century, and casinos operate in many places today. Why we should prefer one choice over the other is the subject of the rest of the book. In the next chapter, we review the incentives and social forces that play a role in the spread of gambling.