MR. RICARDO GAZEL, ECONOMIST, FEDERAL RESERVE BAK OF KANSAS CITY, MOSOURI

CHAIRMAN JAMES: Mr. Gazel.

MR. GAZEL: Thank you very much for inviting me here today to discuss the economics of commercial casino gambling in general and the economics of riverboat gambling in particular. Let me just say that the views expressed here are solely mine and do not necessarily reflect the views of the Federal Reserve Bank of Kansas City, of the Federal Reserve system. I am the only foreigner and I apologize if you don't understand my accent. It's much better now. Up to six months ago I had braces and had this funny Brazilian accent.

I have no problems with casino gambling. I'm not against it; I'm not in favor of it. My only intention is to look at the economics of casino gambling. Most of my comments here are based on studies I did for the state of Illinois in 1995.

It's my opinion that the pace of the spread of gambling in the U.S. has not been accompanied by comparable levels of studies dealing with the consequences of such an expansion. There is a lack of comprehensive evaluation of the economic impact of gambling activities in the U.S., while there are many reports on the impact of casino gambling at the local and state levels. However, the majority of these reports were commissioned by the gambling industry and most of them focus exclusively on the positive impact of casino gambling and completely ignore or minimize the negative impact also associated with casino gambling.

The Commission's work is a superb opportunity to improve our understanding of such an important industry and its economic and social impacts on the United States. Once again I thank you for the opportunity of sharing some of my thoughts and some results of my research in this area.

My remarks today address the major aspects of an economic impact analysis of casino gambling at the state and local levels, which are usually neglected in the literature. I will, however, limit my remarks to the monetary impact of casino gambling on the local and state economies. In the question and answer part, I will talk more about other aspects of legalized gambling, such as regressive taxes, income redistribution, compulsive gambling, etcetera. In other words, the question I will address is what's the likelihood of a casino having a positive economic impact on the local economy.

The answer depends on many factors and their resulting impacts on the positive and negative sides of the equation. On the positive side, after accounting for differences in casino size, differences among casino expenditures are likely to be relatively small for expenditures such as wages and salaries, utilities, insurance, new construction, maintenance, etcetera. Large differences across jurisdictions are more likely for expenditures such as purchases of goods and services from local suppliers.

Larger local economies are more likely than smaller economies to supply larger shares of goods and services to a local casino. State and local taxes also vary substantially across jurisdictions, and they can make a large difference on the economic impact of casino gambling across regions. Commercial casinos face different gambling tax rates in each jurisdiction, from as low as Nevada's average eight percent to as high as Illinois' 20 percent.

The share of profits which stays locally is one of the most, if not the most important item on the list of positive impacts of a casino on a local economy. Profit as a share of growth revenues varies substantially across jurisdictions. Casinos facing substantial competition experience lower rates of profits than casinos operating as monopolies or oligopolies. Casinos in Illinois, for example, experience little to no competition within their market boundaries and as a result, most of them have experienced very high profit rates. The situation has changed somewhat for some of them since have opened in Indiana.

Monopoly or oligopoly market structures resulting in above normal profit rates, in economic terminology, positive economic profits or positive economic rents, affect the local economy in a very different way than in a competitive market with normal profit rates. For example, profit rates before corporate taxes above 30 percent of gross revenues, even higher for some casinos, represent in general a much higher share of total revenues than do expenditures on wages and salaries. If a large share of profits is reinvested locally or distributed to local shareholders, most of the income stay in the local economy, the positive impact can be large; otherwise, the positive impact will be small. In summary, if profits represent a large share of total revenues and most of these profits leaves the local economy, the direct positive impact of the casino is likely to be small.

Corporations located in Nevada and New Jersey own most of the casinos in new gambling jurisdictions in the U.S. Additionally, many new gambling jurisdictions have adopted a monopoly or oligopoly market structure. The result of such a structure is that in most of the new gambling jurisdictions, the positive monetary impact of casinos is relatively small compared to gross casino revenues. More competitive jurisdictions such as Las Vegas, Atlantic City and Southern Mississippi are more likely to experience higher rates of positive impact to gross revenues.

The impact of expenditures of non-local visitors on non-casino businesses, another potentially important item on the positive impacts of a casino, is likely to be small if the casino targets basically the local market and day-trippers from adjacent areas. Most of the new jurisdictions have failed to attract a substantial number of tourists to their local areas. Additionally very often casinos offer subsidized food and beverages below cost of production, reducing or eliminating competition. Monopoly and oligopoly market structures are likely to result in a low ratio of non-local to total casino gamblers. In other words, if casinos can be profitable catering only to the local market, there is no incentive to increase spending in attracting non-local tourists. In the absence of sufficiently large local markets, casinos, in order to survive, must expand their markets beyond local boundaries. Other things equal, a local market is likely to be large enough for a casino operating alone than if there is a concentration of casinos in the area.

On the negative side, the so called cannibalization effect due to local gamblers and non-casino visitors, although controversial, is important in measuring the economic impact of casino gambling in a local economy. The casino industry in general has argued that there is no evidence of reduced expenditures on other businesses due to increased expenditures on casino gambling. To prove this point, the industry shows expenditure growth in both casinos and other entertainment and other consumption items. However, expenditure growth has been substantially higher in the casino industry than growth in other consumption items and most important, growth in personal income.

There is no doubt that some expenditure shift occurs when a casino starts operation in a specific area. The micro-economic argument that consumers know best how to allocate their dollars as some merit in the case of a casino. For occasional gamblers, the shift of expenditures from an previous consumption item toward gambling is not different than if they had shifted their preference from movie going to dinner in a restaurant. However, for a problem or compulsive gambler the decision is not rational and the implications of their gambling activity are severe. But independent of the consumer sovereignty army, there is a shift in expenditures and some established businesses are likely to lose with the presence of the casino.

In a strict monetary sense, a shift of expenditures from one activity to another does not represent new income for the local economy. Since expenditures by local gamblers were accounted for in the positive side, they should also appear in the negative side. However, in the absence of a local casino, some local residents would travel to gamble in other jurisdictions and their expenditures would be lost for the local economy. Yet, these local gamblers are likely to visit a casino outside the local area less often than they would visit a local casino. Thus, adjustments can be made and should be made to estimate the share of their current expenditures in the local casino that would have leaked from the local economy in the absence of gambling locally. The above discussion applies to all types of expenditures by local residents within the casino.

The size of the cannibalization effect due to non-casino visitors depends on the share of non-casino to total visitors. Expenditures within the casino by non-casino visitors, those who would have come to visit the local area without the presence of the casino, but they gamble when the casino is there, are included in the positive side. The part of those expenditures that represents a decrease of demand for non-casino businesses, shift of expenditure pattern from non-casino toward casino activities, represent a loss of income for the local economy and should be included in the negative side as well. However, there will be no negative effects if a casino visitor keeps the same level of expenditures in non-casino businesses before and after the casino opens and additionally he and she gambles in the casino as well. There is, however, evidence that this is not the average behavior and that some expenditure shifts occur when casinos open in a specific area.

The additional public sector expenditures, if any, due to the presence of the casino should be included in the negative side as the counterpart of taxes revenues generated by the casino included in the positive side. Such expenditures include costs with casino regulations and supervision by gaming boards or other institutions, new roads, additional police force and fire fighters, among others.

Negative externalities are generally omitted in the majority economic impact studies of casinos in the literature. Most economic activity results in some type of negative externalities, costs borne by everybody regardless of whether they are involved in that activity. For example, a convenience store brings additional traffic congestion and noise to a particular area. Even those who do not patronize that store bear those negative costs.

There are two main negative externalities associated with a casino in a new jurisdiction, higher crime rates and problem gambling. Higher crime rates and their associated costs represent a controversial item in the literature and in the public policy in general. Some people argue that using crime rate based on population number to investigate the relationship between casino gambling and crime is misleading since crime rates do not take into account the large number of tourists visiting gambling jurisdictions and in reality, overestimate crime rates. However, other studies show that independent of the tourist population effect or accounting for that, there is evidence of a relationship between certain types of crimes and gambling activity.

My own research with Professor Thompson and Professor Rickman using crime rate data for each of Wisconsin's 72 counties for 14 years found a statistically significant relationship between casino gambling and crime rates for different types of crimes. Our results suggest that the presence of casinos in a county or the presence of casinos in two adjacent counties explains a major crime rate increase of 6.7 percent beyond what otherwise would be experienced in the absence of a casino. I need to say here that some studies on crime just look at changes in crime rates. We know that crime rates are going down in the country as a whole, so we accounted for that. It's not if a crime rate is going down in one specific county with a casino, but how that crime rate would have been in the absence of the casino. So we used some economic techniques to measure that. Friedman, Hakim and Weinblatt in a paper from 1989, investigated crime spillover from Atlantic City to other localities in the region, concluding that the statistical results suggest that casinos might have brought significantly more crime than the population increase warranted.

The lower opportunity costs for criminal activities are most likely the main reason for the increase in crime rates associated with casino gambling. Large agglomerations of people carrying cash and in a less alert mood make it easier for criminals to act and reduce their relative chances of getting caught.

The second and maybe the most important negative externality deals with the problems of additional problem and compulsive gamblers. There is plenty of evidence that incidence rates of problem and compulsive gambling increases as gambling becomes available in a convenient way. Independent of the reasons why some people experience gambling problems, there are costs associated with that. Thank you.

CHAIRMAN JAMES: Thank you, Mr. Gazel.