

# The Gross Annual Wager of the United States 1999

"Marking Time"

*"Fear is a bad counselor."*

*--Nikolas Count Szécsen von Temerin<sup>1</sup>*

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<sup>1</sup>Nikolas Count Szécsen von Temerin, Austro-Hungarian ambassador to France(1912-1914), in a report to Leopold Count Berchtold von und zu Ungarschitz, Fratting und Pullitz, Austro-Hungarian minister to the imperial household and for foreign affairs (1912-1915), July 30, 1914; two days after Austria-Hungary declared war on Serbia, precipitating World War I.

Consumer spending on commercial games increased by \$3.86 billion in 1999, or by 6.9%, to a record \$59.4 billion. The single-digit gain kept pace with a strong economy, but only just. U.S. personal income rose by 5.9%,<sup>2</sup> meaning that while consumers had more money to spend they allocated about the same percentage of their rising incomes to blackjack and lottery tickets.<sup>3</sup> The fears resounding in Congress, that gambling is a kind of supernaturally powerful black hole into which American household budgets are pouring with accelerating speed, is unsupported by the facts. The numbers say Americans have all the gambling they want. By and large, latent demand for commercial games has been satisfied. The era of gambling's higher than average growth has ended. Bingo halls and slot machines now move in lockstep with the economy. Gambling is marking time.

## **Topline**

Consumers spent \$59.4 billion on legal gambling in 1999. That is more than they spent on movie tickets, recorded music, theme parks, spectator sports and video games combined. U.S. Gambling, Inc. (USGI), our fictional holding company for the nation's lotteries, casinos and other gambling businesses, ranked 10th in the 1999 *Forbes* Sales 500, ahead of Boeing (\$57.9 billion) and below Philip Morris (\$61.75 billion).<sup>4</sup>

## **Tax Revenues**

USGI paid about \$20 billion for the privilege of operating its commercial games in 1999. Lotteries accounted for most of gambling's direct tax contribution, although gaming privilege taxes paid by casinos are significant to Nevada, New Jersey and the riverboat States, as well as to Indian tribes fortunate enough to have a Class III facility.

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<sup>2</sup>1998 U.S. personal income was \$7,358.86 billion, 1999 \$7,791.78 billion. The increase, \$432.92 billion, was 5.9%. United States Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, vol. 79, no. 5, (May 2000), Table 2.1.

<sup>3</sup> The percentages of U.S. personal income spent on legal gambling, excluding Internet gambling (Table 16), were 0.747% in 1998 and 0.762% in 1999.

<sup>4</sup> *Forbes*, "The Forbes 500s Annual Directory", April 14, 2000.

## **Demand**

Lottery tickets and roulette wheels are important drivers of the U.S. economy, right up there with Regis Philbin or Britney Spears and similar staples of American leisure consumption. But American demand for commercial games appears to have peaked. Aside from casinos in States like Texas or Florida where continuing prohibition prevents suppliers from entering the market, American consumers, when confronted by additional supply, are just saying No.

Further increases in supply will not increase consumption (casinos in undersupplied markets excepted). In terms of American social welfare this is reassuring, or ought to be: bingo cards and blackjack tables, having taken their places on the shelves of the leisure supermarket, are reaching natural limits; these limits are imposed by consumer choice among the shiny new amusements issuing from AOL TimeWarner, Vivendi Universal *et al.* and flooding through the pipes of the incredibly fecund leisure economy. From here on out, growth in the economy's gambling sector will come from two, and only two, sources: new products; and new channels of distribution.

## **The Internet**

The new distribution channel in evidence is the Internet. The Internet has created the first global gambling market. Consumers, some of them Americans, spent an estimated \$1.2 billion on gambling through the Internet in 1999. We project this expenditure to rise to \$6.4 billion in 2003.

This growth will occur regardless of what happens to the Kyl-Goodlatte bill ("the Internet Gambling Prohibition Act"), at the time of writing being deliberated in the House of Representatives with uncertain prospects of enactment. The Kyl bill would not prevent gambling through the Internet or materially curtail demand, anymore than 18 U.S.C. § 1084 ("the Wire Act") has curtailed sports betting. Prohibition would merely prevent licensed companies from supplying this demand. In other words, the Kyl bill would replicate the Wire Act experience and drive the Internet gambling industry, already numbering perhaps 1,000 Web sites operated by 300 parent companies, underground and (in the U.S.) keep it there. Licensed offshore Internet gambling operators would benefit accordingly. Internet gambling has a future. The question is, Whose?

## **New Products**

The other avenue of industry growth is new products.

Lotteries, racetracks and other pari-mutuel businesses might tap remaining pools of unsatisfied demand for machine gaming by seeking permission to add slot machines or video poker ("VLTs") to their operations. This works; it also increases social friction by making a demonstrably dangerous form of gambling more widely available. This is more of a problem with lottery VLTs, with their neighborhood deployment, than it is for racetracks, which tend to be situated away from population centers, but the politics of expanded machine gaming will remain difficult.

A less controversial and to us more promising long run alternative is to move away from gambling altogether into the larger leisure-entertainment economy. The post-Mirage Las Vegas Strip is the template for this strategy, which other location-based gambling businesses, including racetracks, Class III Indian operations and bingo halls, might profitably adopt.

Run your eye down the percentage change figures in industry gross gambling revenues (or consumer spending) in Exhibit 1. They're mostly single-digit. The exceptions are Nevada sports books, which caught one of the periodic upswings in the volatile hold percentage (or consumer price) of booking bets at fixed odds; land-based casinos other than Nevada and New Jersey, which are exploiting locally unsatisfied demand for this form of gambling; card rooms, which are doing the same thing; and the Internet. Other gambling industries are starting to look like pari-mutuels: plus-or-minus single-digit changes that add up pretty close to zero.

To us this is a compelling argument for thinking out of the box. No one in any gambling industry has done this as well as Steve Wynn--ever. The post-Mirage Strip is his handiwork: what are its implications for gambling's future?

## **Las Vegas**

Las Vegas is no longer a gambling market in the sense that Atlantic City or riverboat markets are. It is a full-service leisure destination offering multiple attractions that are absolutely world class. The falling casino share of Strip resort facility revenues we've reported on in previous annual installments in this series continues, as does the percentage of multi-day stays allocated to gambling.

An increasing number of visitors to Las Vegas do not gamble at all. Rooms, retail, restaurants, shows, art museum admissions and a lengthening list of other non-gambling pastimes are driving return on big cap investment in Las Vegas today. It is all due to Steve--to the investment/re-investment/refreshment

capital spending cycle he set in motion by opening The Mirage in November 1989.

The end of this transformation is not yet in sight. The Strip is nipping at Orlando's heels and eating some of Disney's and Universal's theme park lunch. And not just theme parks: Bellagio's art museum, unwisely shuttered by MGM Grand, and the rumoured Las Vegas Guggenheim tap into the rising curve of U.S. museum attendance--the fastest growing location-based entertainment in the world today. The entry of mainstream leisure companies into Las Vegas is only a matter of time--perhaps through the acquisition of one of the handful of true entertainment companies anchored on the Strip.

## **Outlook**

With gambling markets fully supplied companies seeking to grow face difficult choices.

- i. They can buy market share by cutting prices on games that have become commodities; casinos can buy customers with comps. This strategy has ruinous near-term effects on operating margins and profitability: ultimately it favors those with deep pockets and staying power--and shareholders who will tolerate reduced returns or even losses.
- ii. They can grow through acquisition.
- iii. They can emulate Steve and pour capital into bigger, better and more diversified products that give consumers multiple reasons for visiting a location and spending time on a property.

The second and third alternatives require access to capital--cheap capital. There has been unprecedented liquidity in the past few years, and the availability of capital has combined with tightening gambling markets to force a continuing industry consolidation. Three companies, Park Place Entertainment, MGM Mirage, and Harrah's Entertainment now account for about 45% of non-Indian U.S. casino win; the first two of these companies effectively control the U.S. market for high-stakes table play. Three more companies, Magna Entertainment, Churchill Downs (in the process of merging with Arlington Race Course as this is written) and the New York Racing Association (NYRA) control about 50 % of the \$16.6 billion wagered on horse racing in 1999. Smaller companies like Penn National Gaming are consolidating smaller gaming device, riverboat, and OTB/simulcasting markets. Get big, gambling markets are saying, or die.

But there is a fourth alternative for companies nimble or astute enough to grasp it. That is to enter the one new market going--the Internet. E-gambling is the industry's New Frontier: for lotteries, for horseracing and other sports, for bingo, for casinos, for Indian gambling operations. E-gambling's potential is by now obvious. Capital costs are low compared to the capital costs of entering traditional gambling industries. The barrier to entry is legal uncertainty, and the danger this uncertainty poses for holders of gambling licenses.

Large companies that do *not* hold gambling licenses may not be similarly deterred by Internet gambling's uncertain legal status. Of a growing number of examples, the one we are most intrigued by is Microsoft. In February 2000 Bill Gates announced a joint bid with Virgin's Richard Branson for the U.K. lottery management contract now held by Camelot, a consortium in which Gtech is a partner. Lotteries, Mr. Gates said, have not sufficiently exploited the PC as a sales platform.

Microsoft wants to change that.