The Maryland Public Policy Institute

AN ECONOMIC ANALYSIS OF THE PROPOSED EXPANSION OF GAMING IN MARYLAND

AN ECONOMIC ANALYSIS OF THE PROPOSED EXPANSION OF GAMING IN MARYLAND

The Maryland Public Policy Institute

Published by
The Maryland Public Policy Institute
One Research Court, Suite 450
Rockville, Maryland 20850
240.686.3510
mdpolicy.org

AN ECONOMIC ANALYSIS OF THE PROPOSED EXPANSION OF GAMING IN MARYLAND

BY JOSEPH V. KENNEDY, PH.D., J.D.
ADJUNCT FELLOW, MARYLAND PUBLIC POLICY INSTITUTE

INTRODUCTION

ON NOVEMBER 4, 2008, MARYLAND'S CITIZENS VOTED TO AMEND the state constitution to legalize commercial gaming for the first time. The amendment allowed for the creation of up to five casinos with video lottery terminals (VLTs) in specified locations within Maryland. A major political motivation for this approval was to raise funds for education. But another was the fact that Pennsylvania, Delaware, and West Virginia had already built casinos near the Maryland borders and were attracting Maryland residents. Emulating those states would keep the economic activity and the tax revenue at home.

Now, only four years later, voters are being asked to expand gaming again, this time by allowing casinos to also offer gaming tables and by authorizing a sixth casino, to be located in Prince George's County. Although not mentioned in the referendum, the preferred plan for this new casino is to build a destination facility[1] on one of the most valuable undeveloped sites at National Harbor. Its proponents believe that such a facility, together with a similar one in Baltimore, could compete with casinos in Las Vegas and Atlantic City. MGM Resorts International, which already operates casinos in Las Vegas, Reno, Detroit, Macau, and elsewhere, recently entered into an agreement with the developer of National Harbor to build what they call "a world-class destination resort casino," subject to approval of November's referendum.[2]

Would such an amendment benefit the citizens of Maryland? This study clarifies the referendum in a political and economic context and analyzes the impact such a change would have on state revenue and economic activity.

COMPARATIVE ADVANTAGE AND ECONOMIC GROWTH

Understanding how local economies grow helps when looking at any development proposal. Any economic activity creates short-term jobs. If a state merely wanted to create jobs it could hire people to dig holes and fill them again. But not all economic activity is sustainable. To create sustainable growth and jobs that pay well because they create significant economic value, a state must develop a comparative advantage in some field or industry. Some states naturally possess a comparative advantage, such as tourism in Florida and oil drilling in North Dakota. Elsewhere, comparative advantage is carefully developed over a long period, as in computing in Silicon Valley and medical devices in Minnesota. Comparative advantage can be lost easily, however, due to outside competition or complacency. Good examples are textiles in South Carolina and the auto industry in Detroit. Washington D.C. has a comparative advantage in government and tourism.

It is always tempting to support the first economic activity that comes along, especially in a climate of slow economic growth and high unemployment. But the construction of a casino is likely to create roughly the same number of short-term jobs as a development of high-value condos or an office building for the regional headquarters of Apple. More important is which project will generate the greatest long-term value to the state. By putting forth the current gaming referendum, Maryland seems to be shifting from the motivation of education revenue to an overall increase of gaming activity in Maryland. However, Maryland does not clearly have any comparative advantage at gaming.

THE 2008 REFERENDUM

The 2008 referendum authorized the operation of no more than 15,000 VLTs at five casinos in the following jurisdictions: Anne Arundel County; Cecil County; Worcester County; Allegany County; and Baltimore City.

The constitutional amendment listed the primary purpose of the referendum as "raising revenue for education,"[3] specifically:

- Education in public schools from pre-kindergarten through high school
- Public school construction and improvements
- Construction of capital projects at community colleges and higher education institutions

To achieve this goal, the accompanying legislation implementing the amendment limited the casino owners' take to 33 percent of all gross revenues. The remaining 67 percent was devoted to a number of distinct purposes. The vast majority of state funds, however (48.5 percent of gross revenues) was dedicated to a new Education Trust Fund.[4]

Secondary purposes of the amendment were to strengthen the state's horse racing industry and generate new economic activity. Yet concern about the unlimited expansion of the gaming industry was strong enough that the amendment sponsors inserted a clause preventing the General Assembly from authorizing any future expansion of commercial gaming unless another constitutional amendment were approved by a future majority of voters.[5]

Over 58 percent of Maryland voters supported the referendum in 2008.[6] State estimates were that the five casinos would generate almost $1.4 billion in 2013.[7] This was based on the assumption that each casino would begin operations in 2011 and be at full capacity by 2012.[8] As we shall see, that assumption was overly optimistic.

To date only three of the five locations have been granted licenses and are operational:

- Hollywood Casino in Perryville (Cecil County) opened September 2010 with 1,500 VLTs. However, it recently requested a reduction of between 400 and 500 in the number of its VLTs.[9]
- Ocean Downs (Worcester County) opened January 2011 with 750 VLTs (now 800)
- Maryland Live! (Anne Arundel County) opened June 2012 and now has 4,750 VLTs.

In addition, on April 1, 2012 a license was granted to Evitts Resorts to operate a casino at Rocky Gap Lodge and Golf Resort in Allegany County. The casino would have 500 VLTs and, if the state referendum passes, nine tables.[10] Site construction is expected to start in the second quarter of 2013 with the opening a year later.

On July 31, 2012 the Video Lottery Facility Location Commission also awarded a license to GBAC Gaming, a partnership that includes Rock Gaming and Caesars Entertainment Corporation, for a casino in Baltimore. The group has announced plans to build a Harrah's casino with 3,750 VLTs. However, two groups have challenged this award and their appeal of the Commission's decision is currently pending. More recently, the Baltimore Urban Design and Architecture Review Panel rejected the casino's plans and asked the partnership to redesign the facility.

Maryland has thus found operators for each of the original five locations who have committed to operate a casino under the terms of the law as it existed prior to passage of Senate Bill 1.

THE 2012 REFERENDUM

Now, only four years after Maryland voters first authorized gaming in the state, and even before two of the initially authorized casinos have been built, voters are being asked to expand the gaming industry. Once again, voters are told that the referendum is for "the primary purpose of raising revenue for education."[11] It asks for approval of three primary changes:

- Allow table games, in addition to VLTs, at each casino[12]
- Increase the number of allowed VLTs from 15,000 to 16,500
- Authorize a sixth casino location, this one in Prince George's County[13]

It is not clear why additional VLTs are needed. When all five original casinos are operating at their licensed capacity, they will only use 11,300 VLTs or 3,700 less than the ceiling. The referendum states that the Prince George's casino will have 3,000 VLTs. The likely answer is that the legislature wants to retain the power to increase gaming activity without going back to the voters.

The General Assembly has already acted on an expansion by passing Senate Bill 1, which contains three major sections. Section 1 is effective regardless if voters approve the referendum in November. One of the provisions of Section 1 authorizes all casinos to remain open 24 hours a day, seven days a week.[14] Section 2 takes effect only if voters approve the referendum.[15] Section 3 takes effect only when the State Lottery and Gaming Control Commission issues an operating license to the Prince George's facility.[16] The bill states the General Assembly's intent that the Video Lottery Location Facility Commission should not award a license in Prince George's if the voters of that county reject the referendum.[17]

The bill authorizes a license for a facility in Prince George's "within a 4-mile radius of the intersection of Bock Road and St. Barnabas Road."[18] Only two locations meet this test. Although the final decision will be made by the newly-named Video Lottery Facility Location Commission, it is widely acknowledged that the government's preferred location is National Harbor. MGM has already agreed to develop a destination facility that would compete with national attractions in Las Vegas and Atlantic City. The other site is Rosecroft Raceway, a harness track founded in 1949 and now owned by Penn National Gaming.

Passage of the bill was extremely controversial. Disagreement over the issue delayed conclusion of the state legislature's regular session. The issue was then referred to a specially-created workgroup that was unable to reach a consensus for action. A special session of the legislature finally passed the bill on its final day.

REVENUE EFFECTS OF SENATE BILL 1

A local newspaper reported that supporters of the bill, including Governor Martin O'Malley and Senate President Thomas V. Mike Miller, Jr. (D-Calvert), said the bill would raise an additional $200 million in state taxes each year.[19] Official estimates are around $160 million in 2017.[20]

Any analysis of the tax revenue with and without passage of the referendum depends on estimates of future revenue from each casino, both with and without the facility in Prince George's County. This figure, of course, is unknowable. Revenue estimation is difficult because Maryland Live! has only operated since June and two of the original five casinos have not yet opened. Moreover, it is widely acknowledged that a casino in Prince George's will take patrons away from at least two of the other five sites, Maryland Live! and Baltimore. In fact, the Prince George's facility may cast doubt on the financial feasibility of the Baltimore location.

There have been a few attempts to measure the impact. In its deliberations on whether to support a gaming expansion, the Workgroup to Consider Gaming Expansion seems to have relied on estimates developed by the Department of Legislative Services in consultation with PricewaterhouseCoopers (PwC).[21] As a result, the estimates can be said to have at least some state backing.

PwC's presentation to the Workgroup claimed that it used a drive time analysis method to estimate the potential revenues for each casino. This

TABLE 1 ADDITIONAL GROSS REVENUES CREATED BY PASSAGE OF QUESTION 7

SOURCE OF ADDITIONAL GROSS REVENUES	$ MILLIONS	% OF TOTAL
NEW CASINO IN PRINCE GEORGES (SLOTS ONLY)	$189	26%
TABLE GAMES AT ALL SIX CASINOS	$331	46%
24-HOUR OPERATION (5 LOCATIONS ONLY)	$56	8%
CASINO OWNERSHIP OF VLTS (GROSS SAVING TO STATE)	$150	21%
TOTAL	$726	100%

Source: MBTPI 2012 Study, p.3.

method makes separate estimates for the probability that an adult will visit a particular casino, the number of visits per year, and the amount spent on each visit. The estimated probability of visiting depends on a number of other factors, including proximity to gaming facilities, alternative leisure activities, and the availability of transportation.[22] The study apparently does not use demographic data such as age, sex, or income in its estimates. Although the presentation notes that drive time is an established method in the industry, it does not list any statistics on the method's accuracy. Nor does it give the assumptions and equations used in this particular application so that they can be checked for accuracy and reasonableness. It merely lists the final conclusions.

The PwC estimate shows that fully 45 to 47 percent of Prince George's revenues will come at the expense of the authorized casinos in Anne Arundel and Baltimore County, depending upon whether the Prince George's facility is a regular or destination casino. Another 31 percent will come from additional visits from local patrons and only 22 to 24 percent will come from out-of-market visitors.[23]

This paper will also review a study conducted by the Business Research and Economic Advisors.[24] This report also recommends the establishment of a destination casino at National Harbor. This study states that it used age-specific population and household income data from the U.S. Census Bureau as well as revenue and patrons/admission data from over 50 casinos in the Eastern United States to estimate revenues.[25] Again, the study provides no specifics on either the model used or the assumptions behind it. All the BREA study scenarios assume that a sixth casino will be built. Although it estimates revenues for each of the six casinos under various assumptions, it does not contain an estimate of revenues from only the original five casinos either with VLTs or with VLTs and tables. It is therefore impossible to assert exactly how much revenue the Anne Arundel and Baltimore City casinos would lose to Prince George's.

The decision to authorize table games at the original five locations and expand hours is separate from the decision to authorize a facility in Prince George's County. Although both Senate Bill 1 and the referendum combine the two, the legislature could have confined the referendum to allow existing sites to also offer table games and not have asked voters to approve gaming at a sixth site. As we shall see, had the legislature done this, it would also have avoided the need to pass massive tax reductions on VLT revenue.

The key fact to understanding the referendum's fiscal implications is that in order to win approval for the Prince George's site, the legislature had to lower the tax rates on other facilities to compensate them for the negative effect on their earnings and to reduce their political opposition. Taking these reductions into account dramatically reduces the revenues going to the state. Under the original 2008 legislation, all casinos were required to pay 67 percent of their gross revenues on VLTs to the state. These revenues were then divided up among a number of purposes, with 48.5 percent of gross revenues going to the Education Trust Fund. However, the law makes the Trust Fund the residual claimant so that any increase in payments to other participants, including the casinos, automatically comes at the expense of the Trust Fund unless another provision is made.

The original request for proposals (RFP) for a site in Allegany County produced only one proposal, which the licensing facility rejected for failing to meet the minimum state and RFP requirements. A second RFP apparently failed to produce any bids. As a result, the legislature amended the

TABLE 2 DISTRIBUTION OF REVENUES FROM VLTS AND TABLES UNDER THE LAW PRIOR TO SENATE BILL 1

LOCATION	GROSS VLT REVENUE	VLT TAX RATE	TAX FROM VLTS	GROSS TABLE	TABLE TAX RATE	TAX FROM TABLES	TOTAL TAXES	FACILITY SHARE
ANNE ARUNDEL	$479.2	67%	$321.1	$110.2	20%	$22.0	$343.1	$246.3
BALTIMORE CITY	$384.4	67%	$257.5	$88.4	20%	$17.7	$275.2	$197.6
CECIL	$131.3	67%	$88.0	$30.2	20%	$6.0	$94.0	$67.5
WORCHESTER	$53.8	67%	$36.0	$12.4	20%	$2.5	$38.5	$27.7
ALLEGANY	$49.6	50%	$24.8	$11.4	20%	$2.3	$27.1	$33.9
TOTAL	$1,098.4		$727.4	$252.6		$50.5	$777.9	$573.0

Source: Author's calculations and PwC study. Numbers may not add due to rounding.

statute to raise the operator's share of gross revenues to 50 percent for the first 10 years of operation and waive the initial license fee of $3 million for every 500 VLTs.[26] As discussed above, the Location Commission awarded a license in response to a third RFP in April 2012.[27]

A recent study by the Maryland Budget and Tax Policy Institute (MBTPI) used state figures to calculate that gross revenues should rise by $726 million in fiscal year 2017 if the referendum passes.[28] These extra revenues stem from four sources: the approval of the new casino in Prince George's; allowing all casinos to offer table games; increasing the hours of operation to 24 hours a day, seven days a week; and the shift in responsibility for VLTs (discussed below). Of the four changes, only the shift in responsibility for VLTs will take effect if the referendum fails statewide. Table 1 shows the estimated revenues from these changes.[29] According to calculations by MBTPI, in Fiscal Year 2017 the operators of the Prince George's facility would get $237 million and another $289 would be split among the other casino owners. Only $200 million would go to the state. Of that, the Education Trust Fund would get $174 million (local governments and other funds would get the remaining 26 million).[30]

Despite statements that the primary purpose of the referendum is to raise revenue for education, over 72 percent of the additional gross gaming revenues created by the bill goes to the owners. Only 24 percent goes to the Education Trust Fund. How can this happen?

Table 2 shows the revenues the state would have received if Senate Bill 1 authorized table games but had not changed the tax rate on VLTs, using the estimates for gross revenue prepared by PwC. PwC's numbers are for an unspecified year in which all authorized casinos are fully operational.

Gross revenues are estimated at almost $1.1 billion. Table 2 shows that Maryland would receive an estimated $777.9 million in tax revenue each year if the 67 percent tax rate on VLTs remained and table games were added to the original five locations. Most of this ($727.4 million) comes from the existing VLTs. Tables contribute only $50.5 million in added revenue (less than 7 percent of total tax revenue).

However, as mentioned above, in order to win legislative approval for the Prince George's facility, the legislature needed to reduce the tax rates that existing casinos pay. Some of these reductions are contained in Section 1 of Senate Bill 1 and therefore take effect regardless if voters approve the referendum in November, while the other cuts take effect only if a license is granted to a Prince George's casino.

Senate Bill 1 reduces the tax rate for the Baltimore, Anne Arundel, Cecil, and potential Prince George's casinos if they choose to assume responsibility for their VLTs. Anne Arundel receives a reduction of 8 percentage points in its tax rate.[31] The other jurisdictions receive a 6 percentage point reduction.[32] Maryland will continue to supply VLTs to Allegany and Worcester counties, although these jurisdictions can apply to the State Lottery and Gaming Control Commission to assume this responsibility,[33] in which case they would presumably get the 6 percentage point discount.

The original legislation provided that the state commission would own or lease all VLT equipment and software.[34] The legislation also set aside 2 percent of gross revenues to the State Lottery and Gaming Control Agency to pay the costs asso-

TABLE 3 GROSS REVENUES FROM CURRENT LAW ASSUMING TRANSFER OF VLTS

LOCATON	GROSS VLT REVENUE	TAX RATE	TAKE FROM VLTS	TABLE REVENUE	TAX RATE	TAKE FROM TABLES	TOTAL TAXES	FACILITY SHARE
ANNE ARUNDEL	$479.2	59%	$282.7	$110.2	20%	$22.0	$304.8	$284.6
BALTIMORE CITY	$384.4	61%	$234.5	$88.4	20%	$17.7	$275.2	$220.6
CECIL	$131.3	61%	$80.1	$30.2	20%	$6.0	$86.1	$75.4
WORCHESTER	$53.8	67%	$36.0	$12.4	20%	$2.5	$38.5	$27.7
ALLEGANY	$49.6	50%	$24.8	$11.4	20%	$2.3	$27.1	$33.9
TOTAL	$1,098.4		$652.8	$252.6		$50.5	$703.7	$642.2

Source: Author's calculations and PwC study. Numbers may not add due to rounding.

ciated with this responsibility. Unfortunately, these costs have been significantly greater than estimated. As a result of the higher than expected costs, the PwC Study estimated that Maryland would eventually spend $133 million annually on VLT leases, or 11 percent of gross VLT revenues, out of the general fund when all five casinos are operating.[35] It is forecast to spend $72.9 million out of the general fund in Fiscal Year 2013.[36]

According to reported testimony given to the Workgroup to Consider Gaming Expansion, this deficit is expected to rise to $120 million by 2018.[37] It estimated that casino operators could get the same services for 2.5 percent to 8.0 percent of gross revenues.[38] The shift in responsibility will take some time to implement, but by Fiscal Year 2017, the state expects to save $149.6 million in operating costs.[39] In return, Senate Bill 1 lowers the tax rate for casinos that take on this responsibility. The tax reductions reduce this savings by $90.5 million. These figures assume licensing of the Prince George's facility. The direct savings of $59.1 million from this provision are directed into the Education Trust Fund.[40]

One could argue that Maryland should have fought to receive a bigger share of the total savings from not having to provide VLTs (it only receives 40 percent). But since the state was contractually bound to provide these services, it probably had to pay a large portion of the savings to the casinos to entice them to relieve the state of its contractual obligations.

Table 3 shows the new tax rates taking into account the reduction for transferring responsibility for VLTs. Because of the estimates from PwC and the state, we assume all casinos eligible for the reduction will take advantage of it. Referendum proponents can reasonably argue that, because Maryland realizes a net gain from this change, this should be the base case against which voters should measure Senate Bill 1.

Under these assumptions, total gross VLT revenues remain the same at just under $1.1 billion. But $69.2 million of these revenues are now transferred to the casino owners instead of to the state.[41] State revenues fall to $708.7 million. In return, Maryland avoids significant operating costs, estimated by PwC at $133 million, implying a net savings to the state of $63.8 million.

But the bill contains other reductions in the tax rate. Most of these provisions only take effect if the Video Lottery Location Commission grants a license in Prince George's County. However, Senate Bill 1 lowers the tax rate for the existing casino in Worcester County to 57 percent of gross revenues; provided it has fewer than 1,000 VLTs (it currently has 800).[42] This reduction does not depend on passage of the referendum. Since Maryland has already licensed the Ocean Downs casino at the original rates, it is not clear why the concession is necessary or what the state gets in return for this transfer.

Table 4 shows the expected effect of this change on tax revenue. Gross revenue is again $1.1 billion. But the tax revenue from VLTs falls slightly by $5.4 million, which goes to the operator of the Worcester casino. Given the minimal difference in the distribution of revenues, either Table 3 or Table 4 could be used as the baseline case.

However, most of the tax reductions on total VLT revenues depend upon the existence of a sixth facility in Prince George's County. The addition of

TABLE 4 TAX REVENUE ASSUMING TRANSFER OF OWNERSHIP OF VLTS AND REDUCTION IN WORCESTER RATES

LOCATION	GROSS VLT REVENUE	TAX RATE	TAKE FROM VLTS	TABLE REVENUE	TAX RATE	TAKE FROM TABLES	TOTAL TAXES	FACILITY SHARE
ANNE ARUNDEL	$479.2	59%	$282.7	$110.2	20%	$22.0	$304.8	$284.6
BALTIMORE CITY	$384.4	61%	$234.5	$88.4	20%	$17.7	$252.2	$220.6
CECIL	$131.3	61%	$80.1	$30.2	20%	$6.0	$86.1	$75.4
WORCHESTER	$53.8	57%	$30.7	$12.4	20%	$2.5	$33.1	$33.1
ALLEGANY	$49.6	50%	$24.8	$11.4	20%	$2.3	$27.1	$33.9
TOTAL	$1,098.4		$652.8	$252.6		$50.5	$703.3	$647.6

Source: Author's calculations and PwC study. Numbers may not add due to rounding.

a facility in Prince George's County generates new revenues, but these gains are partially offset in two ways. First, the Prince George's facility is expected to divert patrons from the casinos in Anne Arundel and Baltimore, reducing their gross revenues, together with the tax on those revenues. According to the PwC study, 45 percent of the gross revenues created by a destination casino come at the expense of these two jurisdictions. Essentially, 45 percent of the revenues expected to be generated by a Prince George's casino are existing gaming revenues—not new revenues. The study estimates that the new facility would bring in $424 million in gross revenues, but that this would be partially offset by a decline in gross revenues of $125 million for Anne Arundel County and $65 million for Baltimore.[43]

Second, as part of the political compromise needed to pass Senate Bill 1, legislators further reduced the tax rates on three of the original locations. These reductions are significant and they are explicitly conditioned on the referendum passing statewide. They can therefore be said to offset the benefits of getting political support for the referendum. Other casinos would argue that the referendum unfairly changes the rules of the game only a few years after the 2008 referendum. The changes come just after Maryland Live! opened and before construction has even started on the Baltimore and Allegany casinos. The tax reductions may therefore represent fair compensation for the decline in their property rights. But this does not mean a good bargain for Maryland. Since these rates only go into effect if the Prince George's County facility is licensed, they should be considered when measuring the net impact of approving the referendum. Neither the PwC nor the BREA studies appear to use the old tax rates in any of their calculations.

Once the Video Lottery Facility Licensing Commission grants a license to operate a casino in Prince George's County, the tax on gross revenues for the Anne Arundel and Baltimore facilities falls by 8 and 7 percentage points, respectively.[44] The bill also gives the State Lottery and Gaming Control Commission the discretion to further decrease the VLT tax rates once a casino in Prince George's has been licensed. Under this provision, the Commission may reduce the tax rate on the Anne Arundel facility by an additional 2 percentage points, by an additional 3 percentage points for Baltimore and by an additional 5 percentage points for Cecil County.[45]

The figures in Tables 5 and 6 assume that the Commission maximizes its authority to reduce tax rates for each of the three jurisdictions.

For Prince George's County, the owner's percentage of VLT gross revenues is set at a maximum of 38 percent,[46] but this excludes the 6 percentage point reduction for owning its own VLTs. We therefore assume that the total tax rate on Prince George's is 56 percent.

PwC estimated two scenarios for a facility in Prince George's County. In each case they assumed the facility would be located at National Harbor. In the first scenario, a regular facility is built. Table 5 shows the effect on gross revenues.

Gross revenues (VLT and table) increase by $246.2, from $1,351 million to $1,597.2 million. Most of this comes from VLTs. Total tax revenue again decreases from Table 2 ($35.3 million), falling from $777.9 million to just $742.6 million.

TABLE 5 GROSS REVENUES IF A REGULAR FACILITY IS APPROVED IN PRINCE GEORGE'S COUNTY

LOCATION	GROSS VLT REVENUE	TAX RATE	TAKE FROM VLTS	TABLE REVENUE	TAX RATE	TAKE FROM TABLES	TOTAL TAXES	FACILITY SHARE
ANNE ARUNDEL	$367.5	49%	$180.1	$84.5	20%	$16.9	$197.0	$255.0
BALTIMORE CITY	$321.6	51%	$164.0	$74.0	20%	$14.8	$178.8	$216.8
CECIL	$131.3	56%	$73.5	$30.2	20%	$6.0	$79.6	$81.9
WORCHESTER	$53.8	57%	$30.7	$12.4	20%	$2.5	$33.1	$33.1
ALLEGANY	$49.6	50%	$24.8	$11.4	20%	$2.3	$27.1	$33.9
PRINCE GEORGES	$374.6	56%	$209.8	$86.2	20%	$17.2	$227.0	$233.8
TOTAL	$1,298.5		$682.9	$298.7		$59.7	$742.6	$854.5

Source: Author's calculations and PwC study. Numbers may not add due to rounding.

When we use Table 4 as the baseline total tax revenue rises from $703.3 million to $742.6 million, an increase of only $39.3 million, far from the $160 million estimated by the state.

The key assumption here is the revenue of the new facility in Prince George's and its effect on Anne Arundel and Baltimore. In this scenario at least 45 percent of the revenues from Prince George's come from these two Maryland casinos.[47] Estimates from the Department of Legislative Services, although based on different assumptions, predict that a facility in Prince George's County will cause a reduction of about 23 percent and 16 percent in the gross revenues generated by the Anne Arundel and Baltimore casinos, respectively. [48]

Table 6 shows the estimates for a destination facility. Annual tax revenue now increases by a further $21.2 million to a new total of $763.8 million. However, this is still $14.1 million less than Maryland would have received if it had merely allowed the original five locations to expand their hours and add table games, and held their tax rates constant.

Even against the more realistic baseline of Table 4, state revenues only increase by $60.5 million. But note that total revenues to casino operators have increased by $225.8 million. Although the main purpose of the referendum is supposedly to increase revenues for education, the state gets just over 21 percent of the increased revenues.

Despite the wording of both the 2008 and 2012 referenda, the primary purpose of expanding gaming in Maryland has switched from raising tax revenue for education to expanding the size of the gaming industry for its own sake. Figure 1 shows the distribution of total revenues between the state and the casino owners in each of the last five tables. We can clearly see a significant shift in the distribution of gains, indicating that gaming interests rather than the public interest are calling the shots.

THE BREA STUDY

The BREA study illustrates some of these issues. BREA, which lists gaming companies among its clients, analyzed several questions:[49]

- Expected revenue from six facilities if casinos were only allowed to operate VLTs
- Expected revenue from the six facilities if table games were also allowed
- The best location for locating a casino in Prince George's County
- The merits of a regular versus a destination casino in Prince George's County
- The optimal tax rate for casinos in Maryland.

Notably, the study did not make estimates of revenue under the original law or for table games at only five facilities. The existence and desirability of the Prince George's facility is simply assumed.[50] BREA concludes that Maryland is better off allowing all casinos to operate table games and establishing a destination casino at National Harbor that can compete with similar venues in Las Vegas and Atlantic City, bringing in tourists from outside the region.

BREA's study is difficult to evaluate because it does not provide its assumptions for the following components of its model, including:

TABLE 6 GROSS REVENUES FROM FULL IMPLEMENTATION OF SENATE BILL 1 AND A DESTINATION RESORT

LOCATION	GROSS VLT REVENUE	TAX RATE	TAKE FROM VLTS	TABLE REVENUE	TAX RATE	TAKE FROM TABLES	TOTAL TAXES	FACILITY SHARE
ANNE ARUNDEL	$354.2	49%	$173.6	$81.0	20%	$16.2	$189.8	$245.4
BALTIMORE CITY	$319.5	51%	$162.9	$73.0	20%	$14.6	$177.5	$214.9
CECIL	$131.3	56%	$73.5	$30.2	20%	$6.0	$79.6	$81.9
WORCHESTER	$53.8	57%	$30.7	$12.4	20%	$2.5	$33.1	$33.1
ALLEGANY	$49.6	50%	$24.8	$11.4	20%	$2.3	$27.1	$33.9
PRINCE GEORGES	$423.9	56%	$237.4	$97.0	20%	$19.4	$256.8	$264.1
TOTAL	$1,332.2		$702.8	$305.0		$61.0	$763.8	$873.4

Source: Author's calculations and PwC study. Numbers may not add due to rounding.

- Attendance at each of the casinos
- Revenue from each patron from both VLTs and table games
- The reduction in VLTs as a result of allowing table games
- The amount of competition between Prince George's and other casinos

But the data produced by their assumptions lead to several interesting observations. For instance, BREA assumes that Anne Arundel and Baltimore will reduce the number of VLTs by 5 percent if table games are allowed. The smaller locations are expected to reduce the number of their VLTs by 7 percent.[51] The PwC study largely assumes that table revenues are static in all scenarios, even with the addition of the Prince George's facility.

THE OPTIMAL LOCATION FOR ANY FACILITY IN PRINCE GEORGE'S COUNTY

Both the PwC and BREA studies conclude that building a destination casino at the National Harbor in Prince George's County will maximize state revenues. The BREA study actually estimates what an optimal facility at each location would generate.

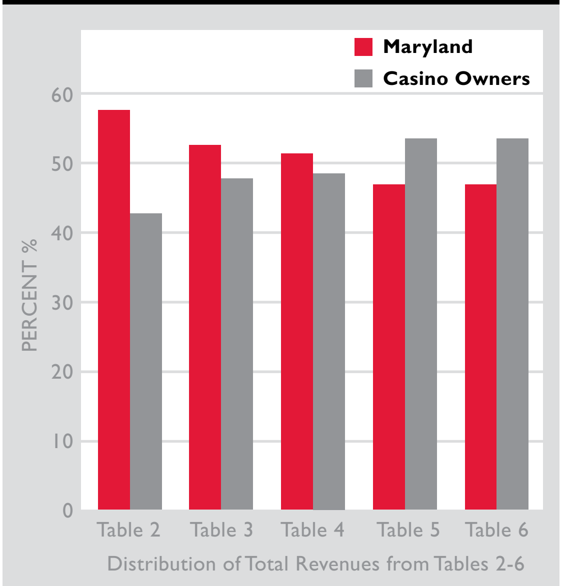
Given the assumptions made in the study, the result could hardly be surprising. Development of either of the two Prince George's sites entails costs and benefits: both have to be considered. One of the largest costs associated with the National Harbor site is the large opportunity cost of not being able to use the site for some other purpose. BREA assumes that a destination casino will require $980 million in capital costs including the value of the land and buildings. BREA evaluated both National Harbor and Rosecroft Raceway according to several criteria:

- Accessibility
- Visibility
- Existing transport structure
- Local community impact
- Casino patronage by residents of Prince George's County

With the possible exception of casino patronage, each of the criteria that make National Harbor the optimal site for a mega-casino also make it the more attractive site for almost any other major development that might occur there. Indeed, the National Harbor site is one of the most attractive locations in the region. There is little question it will eventually be developed and that, when developed, it will generate both jobs and economic activity. Ideally, both Maryland and Prince George's County should consider a number of possible opportunities before deciding that a large casino is in fact the best, long-term economic use.

The BREA study does not attempt this. One could argue that doing so was outside of its scope. But the study also includes very little evidence that National Harbor could successfully compete with Las Vegas and Atlantic City, where casino gaming is largely concentrated, or that enough patrons will come to justify the large expense of such a significant development. Rather than build something that plays into the area's actual or desired competitive advantage, a destination casino directly competes in a market where Maryland

FIGURE 1 DISTRIBUTION OF TOTAL GAMING REVENUES UNDER TABLES 2 TO 6



clearly does not have a competitive advantage: a market for destination or world-class casinos such as Las Vegas and Atlantic City. National Harbor starts with an enormous price disadvantage. We have calculated that the total tax will be 56 percent on VLT gross revenues and 20 percent on table revenues. The BREA study estimates that the total facility tax in Nevada is only 8.0 percent and in New Jersey it is 8.6 percent.[52] It is hard to see how the owners can overcome this difference.

Moreover, when people visit either of these locations, gaming is usually a large part of the draw. Indeed, there is often little else to do outside the casinos. The proponents of a large casino at National Harbor thus hope for one of two things: either the casino will successfully draw high-income and high-stakes gamblers away from these two cities to the Washington area, even though it clearly does not offer all of the amenities they do; or that typical tourists will want to take one or more days away from their usual activities to spend in a casino. Neither of these seems realistic. Some may even suggest that multinational casino companies such as Caesars (Baltimore) and MGM (Prince George's) will only use Maryland as what is called a "feeder market" and ship their high-dollar players to the lower tax rate locations such as Atlantic City and Las Vegas so that each company can retain more earnings from those high-dollar player revenues.

In contrast, Rosecroft Raceway is already dedicated to one aspect of the gaming industry: horse racing. Although the casino could draw less revenue than National Harbor, locating an appropriate-sized casino there would fit in with its current use. It would also preserve the racetrack since the owner has indicated that Rosecroft would close its racetrack if a casino were built at National Harbor (the PwC and BREA studies do not take this into account). Although the site might be less desirable than National Harbor, development at Rosecroft Raceway would leave the National Harbor site open for an alternatively lucrative development, whereas given its current use, there are few other development alternatives for Rosecroft Raceway. Neither study tries to calculate the opportunity cost foreclosed by not developing the National Harbor site for its next best purpose, or the decline in value that would occur if Rosecroft Raceway closes. Once these are considered, any effort to maximize the development of both facilities is likely to place any new casino at Rosecroft Raceway in order to leave maximum flexibility for developing the National Harbor site.

IMPACT ON ANNE ARUNDEL COUNTY

The establishment of a sixth gaming facility in Prince George's County will have an impact on the revenues available to Anne Arundel County. The original 2008 legislation authorizing gaming provided that 5.5 percent of the gross revenue from VLTs would be devoted to local impact grants. Of this amount 82 percent goes to the local jurisdictions with video game facilities.

Using the assumptions in the PwC study, Anne Arundel County would have been entitled to $21.6 million each year. If a gaming facility is licensed in Prince George's County, the formula for determining local impact grants changes significantly. In that case Anne Arundel County, Baltimore City, and Prince George's County would equally share the money devoted to local impact grants as a result of the facilities in each of the three jurisdictions.[53] But in no case would Anne Arundel or Baltimore receive less than the amount they received in the fiscal year before a license is granted to the facility in Prince George's County.[54] Under Senate Bill 1, the Prince George's facility is prohibited from opening prior to July 2016.[55] Baltimore has announced that it would open in the second quarter of 2014, although the recent rejection of its designs may delay this.

At first this provision would seem to protect Anne Arundel, even allowing it to share in some of the proceeds of Baltimore City and Prince George's County should their casinos generate the higher revenues that Question 7 proponents predict. But the wording of the statute appears to make it possible that Anne Arundel would have to share a substantial part of its growing revenues with the other two jurisdictions if their projects are substantially delayed. The statute appears to entitle both Baltimore and Prince George's to one-third of the local impact grants even if their facilities are not generating any revenues. In this case, the savings clause only guarantees that Anne Arundel impact grants will remain flat in nominal terms. In other words, Anne Arundel will be forced to redistribute its local impact revenues with the other two jurisdictions as a result of an impact to one of those jurisdictions (Prince George's), which actually harms Anne Arundel. Anne Arundel would be better off with the law passed in 2008 and in place today, prior to the November referendum.

The lost revenues might be made up in later years if the Baltimore and Prince George's casinos perform to expectations. But even here the potential gains are limited. As stated above, with five facilities, Anne Arundel could expect to receive $21.6 million in local impact grants each year. Under the PwC assumptions for a regular facility in Prince George's, Anne Arundel's share under the pooling arrangement would drop to $19.5 million, although in this case it would still be guaranteed to get at least as much as it received in the year before the Prince George's facility received a license. Part of the reason for this decline is that the Baltimore casino is forecast to produce fewer revenues than Maryland Live!. But the main reason is that Anne Arundel's revenue share from the Prince George's facility does not compensate for the losses that the Maryland Live! site suffers. With a destination facility Anne Arundel's share is still only $20.1 million. The net result is that whereas now Anne Arundel County can anticipate increasing revenues as its casino grows with the economy, if the referendum passes the funds for local impact grants are likely to remain static for several years after the Prince George's facility is licensed.

Baltimore's local impact revenues are also affected. Under the existing law, Baltimore could count on $17.3 million. Under the new formula this would be $19.5 million with a regular facility in Prince George's and $20.1 with a destination site. These latter two numbers are the same as Anne Arundel's share since the proceeds are split equally unless the saving clause applies.

THE ROLE OF GAMING IN MARYLAND

One of the primary concerns expressed during the 2008 debate on whether to authorize commercial gaming in Maryland was that the initial vote amounted to letting the camel's nose under the tent: the gaming industry, once established would become a powerful political force pressing for expanded locations and lower rates the way it has in Nevada, New Jersey, and other states. Gaming proponents often dismissed these fears. For instance, in 2010, shortly after the first casino opened in Perryville, Governor Martin O'Malley, who later became a champion of the current referendum and the facility at National Harbor, was quoted by the Associated Press as saying: "I don't believe that people want our state to be a casino state. I believe they approved slots at five locations in order to keep some of those Maryland dollars in Maryland, and I think it's the right approach for Maryland."[56] Senate Bill 1 abandons this approach.

The figures show that, when all the changes are taken into account, tax revenue is unlikely to rise much and may even fall compared to what would be the case if no sixth casino were built. But there is a deeper problem. As noted, the decision to expand gaming represents a large bet on an industry where Maryland does not have a comparative advantage and is likely to face strong competition from other jurisdictions. As a result, this legislation and referendum are unlikely to be the last ones, either in terms of adding casinos or reducing tax rates.[57]

The rise of the gaming industry has drawn into the state powerful national players such as Caesars and MGM. These companies can bring global resources and significant amounts of political pressure to expand operations and reduce tax rates. Local operators have long-standing ties to the region and few alternatives. Larger players can pit jurisdictions against each other.

There are two ways this is likely to happen. As mentioned above, the BREA study includes an analysis of the optimal tax rate in Maryland, largely by conducting a survey of gaming tax rates in other states. Its findings lead it to conclude: "The scale of casino gaming is negatively correlated with the effective tax rate on gaming revenues, that is, the higher the tax rate the more limited the non-gaming amenities."[58] The clear purpose of BREA's optimal tax rate is to maximize operator revenues rather than tax revenues. This is directly opposite to the main purpose stated in the 2008 and 2012 referenda.

Note that BREA's argument is much different than saying that Maryland tax revenue is negatively correlated with the effective tax rate. There is likely to be a tradeoff between maximizing tax revenue and maximizing the gross revenues of the gaming industry. Indeed, this study shows that although the proposed changes to Maryland law significantly increase gross revenues, they do not have an equivalent effect on tax revenues.

BREA estimates that the maximum tax rate for a destination casino such as the one Maryland wants to build at National Harbor is only 32.6 percent of gross revenues.[59] If the tax rate on tables was kept at 20 percent, BREA estimates that the tax rate on VLTs would have to drop to 40 percent, rather than the 56 percent called for in Senate Bill 1.[60] Although Senate Bill 1 explicitly provides that the tax rate on the Prince George's facility shall never be less than 62 percent[61] (less the 6 percentage point reduction for owning and operating its own machines), it would not be surprising if MGM pressed for a lower rate once its casino is underway. After all, that is exactly what developers of the Baltimore casino did before even putting a shovel into the ground.

The likely argument will be that, having built a large casino in order to compete with Las Vegas and Atlantic City, Maryland now needs to ensure its competitiveness by lowering its tax rate to that of those cities, otherwise the high-value customers will not come. This indicates that even BREA's estimate of the optimal tax rate may not be the final answer.

Second, and perhaps more important, Maryland faces strong gaming competition from its neighboring states: Pennsylvania, West Virginia, and Delaware. Each of the four states has a history of adopting changes in response to attempts by the others to take an increasing share of total gaming revenues from the region. The three neighboring states can do several things to respond to an expansion of gaming in Maryland. These include lowering tax rates (the new VLT tax rates are roughly comparable to those that exist in the neighboring jurisdictions), licensing more facilities, and expanding gaming at existing facilities. Any of these would likely result in calls for Maryland to do more. Unlike other industries, the state has no comparative advantage that would protect it from price competition other than is locational distance, which is not great.

THE EFFECT ON EDUCATION REVENUES

Finally, what is the effect of the referendum on educational spending, the main purpose of the expansion? The PwC study estimates additional revenues to the Education Trust Fund that will unlikely benefit students. As the MBPTI Study mentioned above argues, there is no legal requirement that revenues to the Fund be devoted to net new spending. The state is free to reduce funding from other sources. Under the Thornton formula, the legislature is supposed to increase funding every year using a calculation that includes enrollment and inflation. The study estimates that the state is already $718 million behind in real terms since 2008 and shows little inclination to catch up by devoting more general revenues to education.[62]

JOSEPH V. KENNEDY, PH.D., J.D. *is President of Kennedy Research, LLC., and an Adjunct Fellow at the Maryland Public Policy Institute. For almost three decades he has provided legal and economic advice to senior officials in the public and private sectors. Dr. Kennedy previously served as Chief Economist for the Department of Commerce and served on committees in both Houses of Congress and in the Executive Branch. At Pew Charitable Trusts he started and oversaw the Financial Reform Project, which was widely credited with bringing timely, objective information to Congress and the Administration.*

1 The definitions of a "regular" and "destination" casino are not precise. Basically, the former is meant to compete with other regional casinos. Business Research and Economic Advisors (BREA), which performed a study of the relative merits of each type of facility in both Baltimore and Prince George's counties, based its regular scenario on the Anne Arundel casino (which had not been completed at the time of the study). BREA lists the amenities as a 300,000 square-foot gaming area, five upscale restaurants, a nightclub featuring live acts, proximity to hotels with 1,000 rooms and to 1.3 million square feet of retail, entertainment, and commercial space with over 225 specialty stores.
A destination casino is intended to compete with Las Vegas, Atlantic City, and international casino destinations. The BREA report assumes a casino with 150,000 square-foot gaming area, a 1,000-room hotel, five upscale restaurants with an average of 250 seats per restaurant, five casual dining restaurants with a total footprint of 70,000 square feet, a 10,000 square-foot night club, a 30,000 square-foot spa, two event centers totaling 60,000 square feet, and 10 specialty shops totaling 30,000 square feet. As models, BREA used the Wynn Resorts Casino in Las Vegas and The Borgata and Caesars casinos in Atlantic City. ("Maryland Gaming Market Analysis: Part I, Gaming Market and Tax Analysis," Business Research and Economic Advisors, February 2012 (BREA Study), pp. 5-6, 9-10.)
2 "MGM Resorts International and Peterson Companies Announce Intent to Develop a Resort Casino at National Harbor," press release, MGM Resorts International, June 15, 2012.
3 Question 2, Maryland 2008 Ballot, http://www.elections.state.md.us/elections/2008/questions/statewide.html.
4 *Ibid.* The 2012 legislation adds funding to expand public early childhood education programs as an eligible use of the Education Trust Fund, Senate Bill 1, p. 27, lines 28-29.
5 *Ibid.*
6 Question 1, Maryland 2008 Ballot, http://www.elections.state.md.us/elections/2008/questions/general/Statewide_Ballot_Question_Results.html.
7 "Update of the Legislators' Guide to Video Lottery Terminal Gambling," Department of Legislative Services, December 2008, p. 14.
8 *Ibid.* p. 13.
9 Gary Haber, "Maryland table games, if approved, could be live in August," *Baltimore Business Journal*, August 23, 2012, http://www.bizjournals.com/baltimore/news/2012/08/23/maryland-table-games-if-approved.html.
10 Ibid.
11 Question 7, Maryland 2012 Ballot, http://www.elections.state.md.us/elections/2012/ballot_question_language.html#state7.
12 Senate Bill 1, p. 51, lines 4-11 sets the tax rate at 20 percent, dedicated to the Education Trust Fund. All studies and scenarios discussed in this paper assume this rate remains static.
13 Question 7, Maryland 2012 Ballot.
14 Senate Bill 1, p. 47, lines 34-35. Under existing law, casino hours are limited to 8 a.m. to 2 a.m., Sunday through Thursday, and 8 a.m. to 4 a.m., Friday and Saturday. Increased hours are expected to increase gross revenues by $85.3 million by Fiscal Year 2017. ("Fiscal and Policy Note, Revised," Department of Legislative Services, Maryland General Assembly, 2012 Second Special Session.
15 Senate Bill 1, p. 63, lines 15-19.
16 *Ibid.*, p. 69, lines 30-33.
17 *Ibid.*, p. 63, lines 9-13.
18 *Ibid.*, page 52, lines 25-27.
19 "Gambling bill to allow sixth casino clears Senate committee," *CapitalGazette.com*, August 9, 2012.
20 "Fiscal and Policy Note," p. 2.
21 See "Overview of the Impact of Video Lottery Terminals in Prince George's County and Table Games in Maryland," Presentation by the Department of Legislative Services in consultation with PricewaterhouseCoopers to the Workgroup to Consider Gaming Expansion, June 12, 2012 (PwC Presentation).
22 PwC Presentation, pp. 4-8.
23 *Ibid.*, p. 13.
24 BREA Study.
25 *Ibid.*, p. 3.
26 "Overview of Video Lottery Terminals in Maryland and Gambling in Surrounding States: Presentation to the Workgroup to Consider Gaming Expansion," Department of Legislative Services, Office of Policy Analysis, June 1, 2012 (DLS Presentation), p. 7.
27 The issue is of some importance to Maryland since it has been the owner of the property, which has lost $41 million in an attempt to build another world-class tourist destination. (Michael Dresser, "State poised to cut Rocky Gap losses," *Baltimore Sun*, June 19, 2012.)
28 "Gambling bill is a bad bet for Maryland's students," Maryland Budget and Tax Policy Institute, September 5, 2012 (MBTPI 2012 Study), p. 3.
29 "Fiscal and Policy Note, Senate Bill 1, Revised," Department of Legislative Services, Exhibits 3, 5, 10.
30 MBTPI 2012 Study.
31 Senate Bill 1, p. 25, lines 1-2. Because they are already operating under the old rules, the provisions for Anne Arundel and Cecil counties do not take effect until March 31, 2015 (Senate Bill 1, page 22, line 14-17.)
32 *Ibid.*, p. 24, 30-33.
33 *Ibid.*, p. 22, lines 5-13.
34 Maryland Statutes, Section 9-1A-21(a)(1). This has been superseded by Senate Bill 1.
35 PwC Study, p. 33.
36 *Ibid.* p. 27.
37 "Maryland study endorses 6th casino," That's Amore Stable blog, June 12, 2012, formerly available at http://www.thatsamorestable.net/blog/index.php/maryland-study-endorses-6th-casino.
38 PwC Study, p. 33.
39 "Summary and Fiscal Impact," Senate Bill 1, Second Special Session of 2012, revised, August 14, 2012, p. 9.
40 In an example of how money is fungible, this probably only refers to the reduction in the allocation of VLT revenues for administrative costs, which goes from 2 percent to 1 percent of gross VLT revenues (Senate Bill 1, p. 24, lines 5-10), rather than the 9 percent in excessive costs referenced by the PwC study.
41 These numbers differ from the $90.5 million estimate given in the "Fiscal and Policy Note" (p. 26) because the latter starts with different estimates of gross revenues and are for Fiscal Year 2017. The PwC estimates are for an undesignated year when all authorized casinos are fully open. The PwC numbers in this table also do not include Prince George's. The PwC estimates are used because they allow for a comparison of state revenues with and without the Prince George's facility.
42 Senate Bill 1, p. 25, lines 5-10.
43 PwC Study, pp. 12-13.
44 Senate Bill 1, p. 49, lines 22-25.
45 *Ibid.*, p. 53, line 20 to p. 54, line 19.
46 *Ibid.*, p. 50, lines 15-17.
47 PwC Presentation, p. 20.
48 "Fiscal and Policy Note," pp. 19, 21.
49 BREA study.
50 BREA assumes that Baltimore will also be a destination casino and that the Prince George's facility will operate 4,750 VLTs. The referendum limits the Price George's facility to no more than 3,000 VLTs.
51 BREA study, p. 8. MGM has signed an agreement with National Harbor's developer to build a much more expensive facility, but this depends on many things falling into place. ("MGM Resorts International and Peterson Companies Announce Intent to Develop a Resort Casino at National Harbor," press release, MGM Resorts International, June 15, 2012.)
52 BREA Study, p. 25.
53 Senate Bill 1, p. 61, lines 4-8.
54 *Ibid.*, lines 9-14.
55 *Ibid.*, p. 44, lines 8-11.
56 Brian Witte, "Md. Governor Signs Measure Expanding Gambling." *Bloomberg Businessweek*, August 16, 2012. http://www.businessweek.com/ap/2012-08-16/md-dot-governor-signs-measure-expanding-gambling.
57 It should be noted that the General Assembly does not need voter approval to lower the tax rates on casinos, even if lower rates bring in more gross revenues.
58 BREA Study, p. 29.
59 *Ibid.*, p. 32.
60 *Ibid.*, p. 33.
61 Senate Bill 1, p. 50, lines 15-17.
62 MBTPI 2012 Study, p. 8.

ABOUT THE MARYLAND PUBLIC POLICY INSTITUTE

Founded in 2001, the Maryland Public Policy Institute is a nonpartisan public policy research and education organization that focuses on state policy issues. Our goal is to provide accurate and timely research analysis of Maryland policy issues and market these findings to key primary audiences.

The mission of the Maryland Public Policy Institute is to formulate and promote public policies at all levels of government based on principles of free enterprise, limited government, and civil society.

In order to maintain objectivity and independence, the Institute accepts no government funding and does not perform contract research. The Maryland Public Policy Institute is recognized as a 501 (C) (3) research and education organization under the Internal Revenue Code.

The Maryland Public Policy Institute

One Research Court | Suite 450 | Rockville, Maryland 20850 | mdpolicy.org