

Online Gaming in Pennsylvania? Not Worth Pursuing

Recently the Pennsylvania House of Representatives' Committee on Gaming Oversight considered a bill to allow internet gaming in the Commonwealth. While the idea of internet gaming in Pennsylvania has been bandied about for a couple of years, House Bill 649 lays out specific details as to how it could work. For the time being the bill seems to be in a holding pattern.

We broached this topic late last year (*Policy Brief Volume 15, Number 51*) by looking at the experience in New Jersey, which had authorized internet gaming in 2013. It is worth noting that HB 649 was first introduced to the Committee in February 2015 and had been laid on the Committee's table four other times before being laid on the table once again and promptly removed in late May of this year. Nonetheless, we can use the scheme spelled out in HB 649 along with data from New Jersey to answer the question as to whether or not the bill deserves any further consideration. This *Brief* evaluates what the legislation would mean in terms of revenue as well as potential downside risks.

In 2006 the Unlawful Internet Gambling Enforcement Act was passed by Congress, and signed into law by the President, prohibiting the use of financial instruments for *interstate* internet gambling. However, it did not prevent *intrastate* internet gambling. This law opened up the concept of internet gaming within states. Currently only three states sanction online gaming: Delaware, Nevada, and New Jersey.

According to the New Jersey Casino Control Act, only New Jersey residents, physically located in New Jersey at the time they decide to gamble online, can access internet gaming. Their presence is to be verified through an IP address, local wireless connections mapping, and cellular data. Also, the physical servers and equipment used to conduct internet gaming must be located on casino property. In order to not run afoul of national law, Pennsylvania would have to follow New Jersey's lead and limit internet gaming to Pennsylvania residents, who are physically in state at the time of wagering.

Since only Pennsylvania residents would be permitted to gamble online, there will be no inflow of money from outside the state. When gaming was first approved in Pennsylvania, the argument was that it would not only keep Pennsylvanians from spending their gaming money out of state, but also entice out of state residents to gamble in Pennsylvania. At that time (2005) Pennsylvania joined neighboring New Jersey and West Virginia in permitting gaming parlors. Since then two other neighbors, Maryland and Ohio, have joined the gaming

ranks. While gamblers can physically cross state lines to visit a casino, this is not an option for online gamblers.

HB 649 requires that online gamblers set up an online account and that “no account shall be established for an individual under 21 years of age.” Furthermore, the bill states that mechanisms shall be developed to “...exclude from interactive gaming persons not eligible to play by reason of age, identity or location...” But the question is how will this be accomplished? When someone gambles in the casino, they can be visually checked by casino security. What is to prevent someone who is underage from gaining illegal access into the system? What is to prevent a person who is over 21 from setting up an account, logging in and letting a minor gamble? How many minors have had persons of legal age buy alcohol or tobacco for them? While fake IDs exist, it is much easier to prevent those under age from entering a casino than it is to monitor them online.

There will be costs associated with online gaming including; monitoring the system that could involve tens of thousands of online gamers, acceleration of the creation of compulsive gamblers, and preventing minors from using this form of gaming to name a few. These costs have not yet been estimated by proponents.

What benefits will the state obtain from online gaming? The obvious and most important reason for Pennsylvania lawmakers to pursue online gaming is tax revenue. Another reason is the money the state will receive from the sale of licenses. The language of HB 649 would set the gaming authorization fee at \$8 million. If all twelve current casinos opt to get into the online gaming business, the state will garner \$96 million for the initial authorization fees.

Considering that the casinos typically do not have internet gaming expertise, they usually pair with an online gaming company (as is the case with casinos in New Jersey) to offer the service. HB 649 goes on to say that “each interactive gaming operator or an affiliate of an interactive gaming certificate holder...shall pay a one-time nonrefundable authorization fee in the amount of \$2,000,000.” Assuming one provider per casino adds another \$24 million in upfront fees.

HB 649 has taken a cue from New Jersey as it will also impose an annual renewal fee for an interactive certificate holder (casino) of \$250,000 and each interactive gaming operator will be charged a \$100,000 renewal fee. The Pennsylvania fees will be deposited into the general fund.

HB 649 stipulates a tax rate of 14 percent on gross interactive gaming revenue, which will be deposited into the state’s general fund. It also mandates a two percent local share tax for a total tax rate of 16 percent. A portion of the state tax will be deposited for compulsive and problem gambler treatment programs—\$2 million or 0.002 multiplied by the gross interactive gaming revenue, whichever is greater. A similar amount will be used for alcohol and drug addiction. The two percent local share tax will be distributed by the state “...to be used exclusively for grants to all counties in this Commonwealth, to economic development authorities or redevelopment authorities within each county...”

New Jersey’s tax rate is 15 percent on internet gaming gross revenues. The first full year of internet gaming, the total gross revenue was \$122.8 million (2014) which then climbed by 21 percent to \$148.9 million in 2015. Through the first four months of 2016, gross revenues

from online gaming are projected to reach \$185.6 million—an increase of 24 percent over the 2015 level. The total tax collections for 2014 and 2015 were \$18.5 million and \$22.4 million while 2016 collections project out to \$27.9 million.

We can use per capita gaming revenue from New Jersey (population of 8.9 million) to estimate Pennsylvania's state revenue collections (population 12.8 million). In 2014, the per capita gross revenues for New Jersey came in at \$13.80. For 2015 that number was \$16.72 which is projected to grow to \$20.85 in 2016. Generously using the highest figure of almost \$21 per capita and multiplying it by Pennsylvania's population, total gross revenue from online gaming is projected to be \$269 million. A tax rate of 14 percent (the state share) will generate a mere \$38 million in revenue for the state's general fund with another two percent or \$5.4 million collected for grants to counties. Keep in mind these revenue projections will depend on how many Pennsylvanians decide to participate in online gaming and how much they play. Then too, how much the tax collections will add on net to the general fund will depend on the level of costs incurred in administering and monitoring what will be a complex system.

Some additional questions that need to be answered before the state goes down this road: How will participation in online gaming affect attendance and the amount of play at the state's twelve casinos? Will it pull gaming out of the casinos, where taxes are higher on slots and table games and reduce the casino contribution to state coffers? Will casinos need fewer employees?

To be sure, the never ending quest to find more sources of state revenue will keep the notion of online gaming alive. But there are many issues of major concern that must be answered before this legislation proceeds any further. Most importantly, the prospect of bringing in a net increase of annual revenue of no more than \$40 to \$45 million from a revenue source with the potential to have very negative unintended consequences makes online gaming a low payoff, high risk gamble.

Consider that the state budget is \$30 billion. A spending reduction of 0.01 percent (one thousandth of the budget) would obviate the need for the meager revenue online gaming promises to bring in.

Logic tells us this is an idea whose time has passed.

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