

THE ISSUES REGARDING POSSIBLE INTERNET POKER AUTHORIZATION IN CALIFORNIA

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The purpose of this discussion is not to support or oppose legalization of intra-state internet poker in California, but rather to point out some of the economic realities about the activity, the pros and cons of legalization, and suggestions for a structure that would be acceptable should the Legislature and policy makers decide to go forward with such an action.

I am not going to address many of the challenging legal or technical issues that will likely be discussed at this hearing. Others will certainly give adequate attention to such things as whether such a law would be compatible with Federal law, whether it would violate the exclusivity dimensions of tribal gaming compacts, whether potential out-of-state customers can be effectively precluded from participating in a California internet poker network, etc. Nor am I going to address the important questions of how large the internet gaming industry is on a national or a global basis. Rather, I would like to make a number of observations on what policy-makers, and the citizens of California, might expect should internet poker be legalized within the State.

ARGUMENTS IN FAVOR

First, it is important to evaluate the arguments that would support such a course of action. There are presently a large number of Californians who participate in internet poker, using off-shore providers based in jurisdictions with moderate to very limited regulations and protections. The Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) makes it illegal for vendors to provide internet gambling services, or for financial intermediaries to facilitate financial transactions between customers and vendors.

However, UIGEA does not make it illegal for consumers to gamble on internet gaming sites. Furthermore, the difficulties of implementing portions of UIGEA have left a number of gaping loopholes that allow more dedicated players to get their money into and out of the games. Thus, it is not out of the question that the number of active California internet poker players, and the amounts they spend (lose) with offshore internet gambling websites on an annual basis, are dramatic.

Furthermore, it is also likely that legalization of an attractive, well-regulated, and effectively operated internet poker industry in California would generate substantially greater participation and spending from Californians than currently takes place. The patterns with regard to demand for gambling services that we have observed for the past four decades has been consistent: when gambling is legalized and legitimized, especially in an attractive format, the extent of demand manifests itself at multiples of what an illegal or grey-area market previously generated.

It has to be noted that the penetration of internet gambling in various jurisdictions, including the United States, is still quite low, but is responsive to changes in legal status. In the United Kingdom, for example, under a legal and regulated environment, only 9.9% of the adult population used the internet for gambling in 2009, in comparison to 68% of the adult population who participated in some form of gaming that year.¹ Furthermore, the extent of participation in “remote gambling” (including internet, mobile phones, PDAs, and television) has been increasing rapidly (from 7.2% in 2006) since the industry was legalized by the Gaming Act 2005.

A primary argument for going forward with legalization is that participating in internet poker is something that adults should be freely able to do without the coercion of the State to prohibit such activity. Since so many other forms of gambling are legal in a wide variety of venues in California, it is somewhat arbitrary to constrain and stigmatize this activity, while permitting casino gaming, lottery, race track wagering, bingo, card room poker, and a variety of other gaming activities in the State. Proper legislation authorizing internet poker within California would improve the quality of the choices available to California consumers who want to play internet poker, and improve the safeguards that would (theoretically) protect them from unintended negative side effects associated with it. (These will be addressed in more detail below.)

A secondary argument for legalization of internet poker in California is the potential tax revenue the State could collect from internet poker. As this issue is examined, it is important to understand the nature of the competitive market structure for internet gaming in general. Because vendors can locate anywhere in the world (as long as client jurisdictions do not block their ability to deliver their offerings into those jurisdictions), the world of internet gaming and internet poker is highly competitive. The ability of jurisdictions to attract and host internet gaming websites is enhanced with lower tax rates and more lenient regulatory constraints. Thus, there is an environment that encourages a “race to the bottom” with respect to tax rates. The ability of any one jurisdiction to impose even moderate taxes on internet gambling is constrained by other jurisdictions offered comparable business environments with less onerous tax and regulatory regimes. Thus, in the United Kingdom, a number of internet and remote gambling companies located elsewhere in the EU (such as the Channel Islands, Gibraltar, or Malta) but still sell into the UK market. This is largely due to the relatively high tax rate imposed by the U.K. in comparison to the other jurisdictions.

Nonetheless, many consumers would prefer to gamble with an internet company situated in a well-understood domestic legal market than with one from a “grey area” somewhat mysterious overseas jurisdiction. Thus, as long as tax rates were not so onerous as to discourage players from participating in light of their potential for winning, it is quite

¹ Gambling Commission, Industry Statistics 2008/09, p. 15, at <http://www.gamblingcommission.gov.uk/pdf/Gambling%20Industry%20Statistics%202008%202009%20-%20update%20-%20October%202009.pdf>

possible that the State of California could generate meaningful revenues from ongoing intra-state internet poker operations.²

ARGUMENTS AGAINST

Perhaps the strongest argument against permitting intra-state internet poker in California from a public policy perspective is the fact that it substantially expands the geographic presence of available commercial gaming in the State. At present, most legal gaming in California is venue-specific; an individual must travel to a venue whose purpose of business is to offer gaming services (such as a casino, a race track, a bingo parlor, or a card room); one exception is lottery products that are sold through commercial retail outlets. The opportunity for gambling from home, or from Personal Digital Assistants (PDAs) are still quite limited in California.³ Introduction of intra-state internet poker would substantially broaden the horizon of availability of a popular form of gambling in the State.

So far, there is no definitive research that clearly indicates whether internet gambling in general would increase the amount of problem and pathological gambling in society. Indeed, some evidence on prevalence rates in the United Kingdom indicate that, in spite of the expansion of a number of forms of popular gaming, including convenience gaming (in the form of Fixed Odds Betting Terminals) and remote gaming, the incidence of pathological gambling in the United Kingdom remained constant (at 0.7%) between 1999 and 2007.⁴ Nonetheless, there is a legitimate concern about whether widespread availability of legal and attractive internet poker would become problematic with specific subgroups in the population, such as young males. It is not hard to see how internet poker can become as obsessing as other non-gambling gaming options on the computer; when the potential for significant monetary losses are added to the equation, there will be people who are unable to cope responsibly with such options.

Other concerns about legalizing internet poker fall into the realm of competition. Will consumers gravitate away from other similar products, such as tribal casinos or lottery sales because of a preference for internet poker, and should this be a concern for policy makers? In general, good public policy largely ignores such shifts in consumer choice, noting that unless there is a compelling reason to prohibit or severely constrain an activity from consumers (such as a high incidence of directly related pathological gambling), changes in consumer spending patterns should be up to the consumers, not up to policy makers to protect the economic interests of competitors.

² Suppose for example the law imposed a \$0.10 assessment per player hand played. If California had 2 million active poker players playing an average of 4 hours per week and 10 hands per hour, this fee could generate about \$400 million per annum, or about \$200 per player per year.

³ Horse race wagering via the internet is presently legal in California.

⁴ Heather Wardle et al., British Gambling Prevalence Survey 2007, National Centre for Social Research, Prepared for the Gambling Commission, September 2007, <http://www.gamblingcommission.gov.uk/pdf/British%20Gambling%20Prevalence%20Survey%2007%20-%20Sept%202007.pdf>, p. 10.

It can be noted, however, that unlike other forms of gambling legalization, internet gambling does not lend itself to creation of obvious economic benefits, outside of those that accrue to the consumers who enjoy participation in the activity. Destination resort casinos, such as many of the tribal casinos that have emerged in California in the past decade, generally involve capital investments in the hundreds of millions of dollars and job creation in the thousands of positions, as well as generating substantial income flows for shareholders (tribes) and tax payments (contributions) to the State. With internet poker, the tax generating capabilities are constrained as discussed above, capital investments are far less, and employment generation is going to be quite limited. Thus, the typical arguments that are often used to justify legalization or expansion of permitted gaming in a jurisdiction are not nearly as strong for internet poker, or internet gaming in general.

RECOMMENDATIONS FOR REGULATORY STRUCTURE

In light of the above discussion, if the State of California decides to go forward with legislation authorizing internet poker, it should hold to the following principles and guidelines. First, it should limit the number of licenses to a small number, perhaps three, and establish a transparent and objective competitive bidding process among qualified companies and organizations, in order to allocate the licenses available. Potential qualified licensees should be required to meet minimum standards of experience, integrity and probity, as well as minimum requirements regarding the financial capabilities of the organizations.

Such a process would allow the State to capture some of the economic rents that would be created through legalization, and it would allow potential competitors the opportunity to assess the market's potential and to bid accordingly.⁵ Retention of ownership of the right to offer internet poker by the State in the form of a renewable franchise by winning bidders to offer internet poker services for a specified period of time might create the right balance in a public-private partnership.

Legislation should also specify stringent protections against problematic and pathological gambling. I would recommend that California seek out "state of the art" protections that would be specific for internet gaming, but draw from the experience of other jurisdictions and other gaming industries.⁶ Such controls should include prohibitions against credit, and prior deposits of funds for gambling. A registration system for players should prohibit the ability of non-registered customers to play on another person's account. Such a system should be effective in applying self-banning strategies, as well as

⁵ Such a bidding process has its parallels in the allocation of limited licenses for casinos in some jurisdictions. See, for example, Stephen Martino and William R. Eadington, "Allocation of Gaming Licenses and Establishment of Bid Processes: The Case of Kansas, 2008 and 2009," Working Paper Series, University of Nevada, Reno, February 2010.

⁶ The City-State of Singapore, which is opening two Integrated Resort Casinos in 2010, has been very aggressive in establishing consumer protection plans aimed at mitigating the unintended negative consequences associated with excessive and irresponsible gambling. How well they do may provide interesting insights for other jurisdictions with similar concerns.

involuntary exclusions of players who demonstrate (in well-defined manners) an inability to participate responsibly with the internet poker offerings. They should also be effective in excluding minors.

Finally, the State needs to be sensitive to the extent to which they can levy taxes and still retain customers relative to the possible off-shore choices they presently have. In general, internet gaming customers are going to be very sensitive to the prices charged for their participation. Any taxes or levies imposed by the State on either the players or the licensees need to be set at a level that will not encourage players to go elsewhere. Careful analysis of such tax regimes would be an important consideration for successful legislation.

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