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Pennsylvania and the Very High Cost of Regulation

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By Ken Adams

The regulation of casinos is labor intensive and expensive. Each state has its own standards and needs a full staff to conduct license investigations, monitor casino compliance and enforce state laws and regulations. The funding mechanism varies from state to state, except license investigations which are almost always charged back to the prospective licensee. The other staffing requirements are dependent on an outside source of funding. Often it is provided by the state as part of the annual operating budget. In some states, however, casinos are charged directly by the regulating agency; casinos in those states are vulnerable to new fees and charges.

Pennsylvania is one of those states. The regulators in Pennsylvania now want more money so they raised the fee that casinos will pay for regulation. The new fee will be 2 percent of the slot revenue after the increase takes effect in July; the previous fee was 1.5 percent. Now, regulating is indeed a noble and necessary function and it should be funded. But in a state that already charges a 55 percent tax on slot revenues, one might think regulation would be included. But it is not and the regulators insist they need more money to pay for pensions and contracted pay raises. The agency does not need legislative approval; it has the authority to impose the fee with the existing legal structure.

Pennsylvania's 12 casinos are protesting a proposed 33 percent hike in the assessment on their gambling revenues that pays that state's cost for regulating the industry. The casinos estimated in a letter Thursday to Pennsylvania Secretary of Revenue that the increase would cause their regulatory costs to jump to $75 million from $56 million. Harold Brubaker, Philadelphia Inquirer, 4-28-16

To add insult to injury, Governor Tom Wolf is asking the legislature to impose a tax on "free play." In both instances, it is traditional government in action. They are pushing for increased taxation and fees in the face of escalating competition and operating costs. In April, the slot win in Pennsylvania was up a mere 1.5 percent to $208.9 million from which the state collected $111.5 million. The remaining 45 percent is what the casinos have to spend on the necessities of operations. It goes to service debt, pay the utility bills, buy new slot machines, advertise, update the properties and pay employees; it is hardly enough at today's costs. And as those costs go up, it is not likely there will be any left over to give employees regular raises or contribute to their retirement. Further, the increasing taxes and cost of doing business make it even more unlikely that the casinos will be able to return a profit to investors.

The casino industry in Pennsylvania is entering into an extremely difficult period. It faces intense competition from other states and more is on the way. Even now, the casinos are being choked by the tax rate; in the coming years it will be impossible to pay those taxes and remain competitive. Needless to say, the casinos are protesting the new fees and the suggested free play tax. Listening to the governor and the regulators, one would think the casinos have no value except as a cash cow for government. However, the casinos are extremely important to the local economies. Aside from the $1.2 billion in slot taxes the casinos paid to the state and local governments in 2015, the 12 casinos in Pennsylvania employed approximately 18,000 people and the casinos buy locally, spending millions and millions of dollars on food, alcohol, toilet paper, power, garbage, insurance and a myriad of other products. And of course, all of those 18,000 employees are also spending their wages locally. However, the industry gets little sympathy from government. The common perception or myth says casinos mint money and therefore can afford any tax burden. It is a very unsympathetic attitude, and it is not limited to Pennsylvania.

Delaware, in its own small way, is doing the same thing. It is trying to squeeze the last drop of cash out of its casinos. The casinos in Delaware have been trying for some time to get a reduction in the tax rate with no luck. Dover Downs has been particularly vocal. In a recent earnings call, the company's CEO said "The gaming revenue share imbalance between the state and casinos in Delaware is the root cause of our lack of profitability. This quarter, Dover Downs gave $22 million to the state, the horseman and the slot machine vendors, yet we're stuck with a net loss."

Dover Downs Gaming & Entertainment brought in slightly more revenue during the first three months of 2016 than a year earlier. But it was not enough to keep Kent County's second largest private employer from losing money. Scott Goss, Wilmington News Journal, 4-28-16

Ironically, at the same time the Pennsylvania regulators were raising fees and the governor was calling for new taxes, a legislative committee was meeting to discuss ways to help the state's casinos stay competitive. The lawmakers recognize there is a threat and they realize that regulation and taxation are important elements in the equation.

The state House Gaming Oversight Committee has opened a series of hearings this month on how Pennsylvania casinos can remain competitive. As gambling continues to expand in neighboring states, casino operators across the commonwealth are warning state lawmakers about enacting laws and policies that would hurt their ability to compete. That includes smoking bans and Governor Tom Wolf's proposed tax on promotional credits. Brad Christman, WITF – radio, 5-3-16

The lawmakers will hear lots of ideas including sports betting, online gambling and fantasy sports. But unless they address the tax rates they are wasting the tax payers' money. Gaming in the region has reached saturation levels. Competition for every gambling dollar is going to become increasingly more intense. To remain competitive, casinos are going to have to make significant reinvestment and Pennsylvania's current tax rates make that virtually impossible.

Conditions were very different when the taxes and fees were originally imposed; there was no competition. The taxes were high, but the casinos managed to pay them and still operate successfully; time has changed things. Not only is there competition, the casinos are aging and need constant reinvestment and updating. After paying the taxes, there simply isn't enough left over to keep up with a fast moving industry. Think about Donald Trump in Atlantic City. He went bankrupt three times. When he left, his properties were in shambles. Why? Debt is the simple answer. From the beginning Trump had too much debt and paid a very high premium on the junk bond funds. After the debt payments there was never enough money left over to properly run the business. So, the casinos got farther and farther behind the other casinos in Atlantic City slipping into ever accelerating downward revenue spirals. Pennsylvania and Delaware are putting their casinos in exactly the same position, except the burden is tax, not debt.