A Gamble on Sports

States looking to close budget gaps with sports-betting revenue may be disappointed.

BY JACKSON BRAINERD

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You bettor believe it.

The U.S. Supreme Court's ruling last spring in *Murphy v. National Collegiate Athletic Association* paved the way for states to authorize gambling on sports events, booking the topic a slot in future headlines for months to come. New gaming-related opportunities and puns abound.

The court's decision was long in the making.

Congress passed the Professional and Amateur Sports Protection Act, widely known as PASPA, in 1992. It prohibited states from legalizing sports-betting operations, but allowed states already offering sports betting or related games (Delaware, Montana and Oregon) to maintain their current operations. Other states had the opportunity to jump in and offer sports betting at the time, but all declined. For the last 26 years, only Nevada has offered full-fledged sports betting.

When New Jersey passed a law to repeal the state's ban on sports betting in 2014, the move was challenged by the NCAA and a handful of major pro sports leagues as a violation of PASPA. The case made its way to the Supreme Court, which ruled 6-3 that provisions of the act violated the Constitution's anti-commandeering rule. That rule prevents Congress from compelling states to adopt or enforce federal law.

States have since rushed to get in on the action, passing legislation to allow sports betting. Delaware, Mississippi, New Jersey and West Virginia have now joined Nevada in offering sports betting at their commercial casinos. In Delaware, the legal and regulatory framework was already in place; it just needed the governor's approval. Connecticut, New York, Pennsylvania and Rhode Island have also enacted measures legalizing sports betting and are expected to begin offering it soon. In total, 21 states, the District of Columbia and Puerto Rico proposed or enacted measures in 2018 to either legalize and regulate sports betting or form commissions to study the issue.

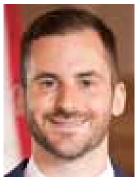
Most of the states leading the way enacted legislation before the Supreme Court decision, allowing them to get a jump on expanded gaming opportunities. Because some of the bills were relatively bare-bones and merely instructed a regulatory authority to investigate sports-betting, several states still must develop rules or pass additional legislation to flesh them out. But the measures in a few states are more comprehensive in their regulatory scope and provide useful insights into how states are approaching the issue. In general, states are grappling with the following policy concerns.

Integrity Fees

To address the question of how to protect sports events from the potential corruption

that results from millions of dollars riding on the outcome of a game, a handful of states have proposed "integrity fees." These would amount to 1 percent of the gross amount wagered and would be paid to professional sports leagues, essentially as compensation for increased self-policing to fight corruption. The amount would not be insignificant. Roughly 95 percent of gross sports wagers are paid out in winnings, leaving only 5 percent in profit for the operators. So, an integrity fee of 1 percent of gross wagers would eat up roughly 20 percent of net profits. Fiscal analysts have questioned whether integrity fees this high would erode states' revenue share to such an extent that sports betting would become cost prohibitive.

Pro sports leagues support the fees, but not all lawmakers like the idea. West Virginia Senate Majority Leader Ryan Ferns (R) says, "There is zero interest in integrity fees or anything else associated with professional sports in the Legislature. I think major league sports were late to the game … It wasn't a partisan issue, I just don't think there was any support for it."

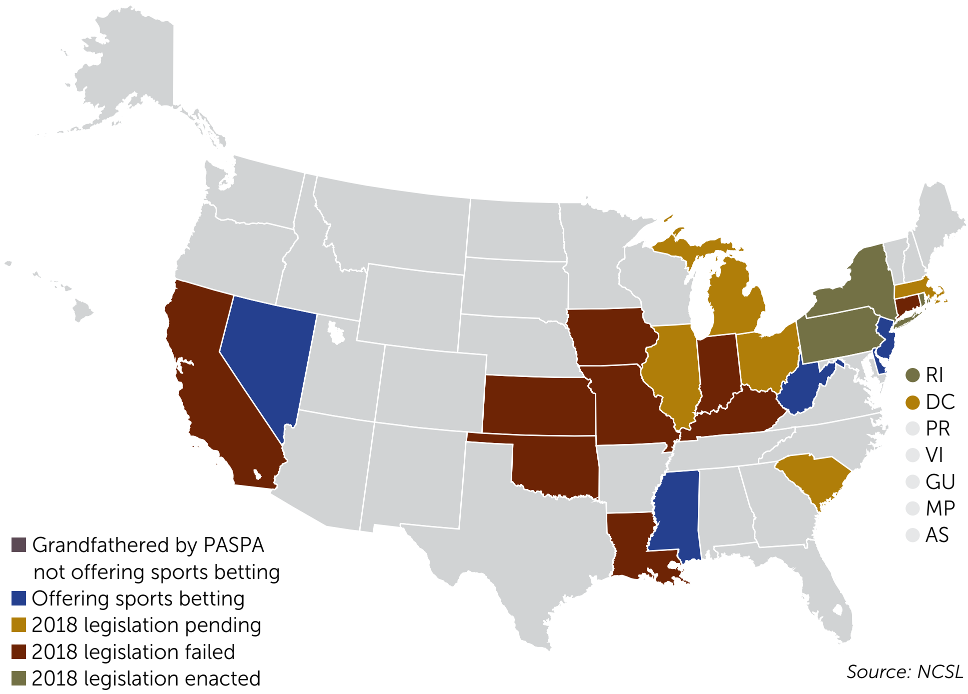


Senate Majority Leader Ryan Ferns West Virginia

Alternate proposals to preserve the integrity of sports contests include one from the American Gaming Association to create an independent Integrity Monitoring Association that would help flag suspect activity surrounding sporting events via information sharing and an enhanced reporting system.

Betting-Eligible Events

Whether to allow betting on collegiate and other amateur sports presents another integrity issue. It's not difficult to see why it might be easier to convince an unpaid collegiate baseball player to deliberately pitch a poor game than it would be to influence a professional being paid millions of dollars to do the same. (That's one of the reasons the NCAA was a plaintiff in *Murphy*.) New York lawmakers enacted a measure that prohibits betting on collegiate sports. New laws in Rhode Island and New Jersey prohibit betting on games played by the states' collegiate teams and on any collegiate event taking place in the state. Other states have either not addressed this or allowed collegiate sports betting to proceed.



Source: NCSL

Online Betting

Even in the year 2018, the gambling world is relatively untouched by the internet. Only a handful of states—Delaware, Nevada, New Jersey and Pennsylvania—have legalized online gambling, in part because it can hurt the casino industry. If people can gamble online, they are less likely to spend their money at a casino. Many states have proposed or enacted legislation allowing sports betting online or through mobile devices, however, in part because both options are more appealing to younger bettors than casinos, which have struggled to attract millennials. A study conducted by Nielsen Sports on behalf of the American Gaming Association found that "44 percent of sports bettors are adults under the age of 35, as opposed to 31 percent of the general population."

Nevada accepts online bets anywhere in the state if the gambler has registered in person at a sportsbook. Pennsylvania and West Virginia have authorized sports betting online or through mobile devices, and a measure pending in New York would allow gaming on a mobile sports-wagering platform.

Mississippi allows bettors to place online sports bets using an app, but only if the bettor is on casino premises. New Jersey appears to have left the decision up to the Division of Gaming Enforcement.

Tribal Concerns

A few states are working to fit legalized sports betting into existing state compacts with tribal governments. In Connecticut, tribal leaders have argued they hold the exclusive right to offer sports betting in the state and have threatened to stop paying the state 25 percent of slot machine revenue ($270 million in 2018), per their existing agreement, should the state allow sports betting elsewhere. In Michigan, efforts have been slowed by tribal concerns about the language in proposed online sports betting legislation. And in Arkansas and Oklahoma, tribes are pushing for legalizing sports betting and allocating a portion of the proceeds to the states.

Tax Rates

Existing and proposed tax rates on sports-betting profits vary widely. States seem to be falling into two camps: those taking a relatively lower cut (rates between 5 and 15 percent) and those taking a larger share (up to a third or more). On the lower end, Nevada takes 6.75 percent of the gross revenue of the licensee. New Jersey will tax gross sports pool revenues at 8 percent but apply a 12.5 percent rate to online sports-betting revenues. Casinos pay a 12 percent tax in Mississippi.

On the higher end, a recently enacted Pennsylvania law set the rate at 34 percent, with an additional local-share assessment of 2 percent. The Delaware Lottery's revenue-sharing agreement with sports-betting operators grants the state 50 percent of total winnings. And in Rhode Island, the state takes 51 percent.

As with any other "sin tax," there is the potential that a rate perceived as being too high will allow the black market to flourish. Pennsylvania casinos were reluctant to offer sports betting due to the state's high tax rate, but at least one is expected to begin providing it this fall.

What will states do with the added revenue? Lawmakers are considering various options. West Virginia will deposit the first $15 million into the state's lottery fund, with any additional revenue going to the Public Employees Insurance Agency Financial Stability Fund. Proposals in New York and West Virginia would direct money to education. And the laws in Pennsylvania and Rhode Island direct revenues to the general fund.

States have been known to direct revenue to programs, including education and pensions, that come with costs that can easily outpace gaming profits. Gambling expansions typically result in an immediate revenue increase that plateaus or even declines over time, until a new game is introduced. States looking to close budget gaps with sports-betting revenue may be disappointed, especially as more states legalize it and take their slice of the market.

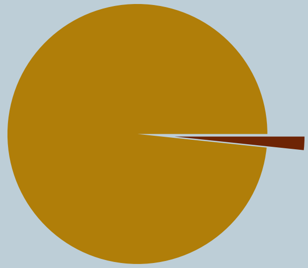
Place Your Bets

The push for legalized sports betting comes at a time of gaming expansion nationwide. Since 2000, seven states have legalized lotteries and 11 have legalized casinos or racinos, or both. In concert with this growth, however, has been a gradual flattening or even decline in state gambling revenues across the country. A 2016 Rockefeller Institute report shows that, between fiscal years 2008 and 2015, 21 states saw their lottery revenues decline, and national lottery revenue grew by just 0.2 percent when adjusted for inflation. The trend results partly from states with newly legalized gambling siphoning off—or "cannibalizing"—gamblers from other states or keeping their own residents from crossing state lines in search of opportunity.

The ability of sports betting to generate revenue for states will also depend in part on drawing gamblers away from the sizable black market. Estimates of the money in the black market range from tens of billions to hundreds of billions of dollars. Unfortunately, billions in total sports-betting wagers do not necessarily translate to huge profits or tax revenue for states. It's hard to say how much revenue sports betting will generate. Most states estimate a couple million to tens of millions of dollars, but nothing resembling a true windfall. Potential annual revenue was estimated to be $3.1 million to $18.8 million in Indiana, $2 million to $2.4 million in Michigan and $5.5 million in West Virginia.

Nevada's 2017 gaming revenues provide a useful example: Of a total $11.6 billion in casino winnings in 2017, only $248.8 million, or 1.7 percent, was attributable to sports betting. The tax rate on those winnings was 6.75 percent, resulting in less than $20 million for the only state with legalized sports betting.

Nevada's 2017 Gaming Revenues After Paying Winners



Total Gaming $11.6 billion
Sports Betting $248.8 million

Source: UNLV Center for Gaming Research

Among the states with recently authorized sports betting, Mississippi took in $54,000 in revenue off $9.8 million in total wagers in its first month; Delaware brought in just over $1 million in its first three months; and New Jersey casinos generated just under $1 million in August, its third month of operation. New Jersey Senate President Stephen Sweeney (D) responded that legalized sports betting "helps our [fiscal] situation but it doesn't fix anything."

Senate President Stephen Sweeney New Jersey

Federal Interference?

The states' varied approaches to regulating sports betting have produced some nervousness at the federal level. In its first hearing on sports betting since the *Murphy* decision, the U.S. House Subcommittee on Crime, Terrorism, Homeland Security and Investigations discussed a possible regulatory framework that could pre-empt state authority. And in the U.S. Senate, Minority Leader Chuck Schumer (D) of New York has proposed a federal framework.

As the voice of the states, NCSL has called on Congress to respect the states' sovereignty to regulate and tax sports gambling. Odds are, whether regulation remains a state-by-state patchwork or the feds step in, sports betting is here to stay.