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April 1, 1998

Hon. Daniel E. Lungren
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Connie Lemus
Initiative Coordinator

Dear Attorney General Lungren:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative statutory amendment entitled "The Charity and Business Wagering Equality Act of 1998" (File No. SA 98 RF 0012). The measure amends the California Business and Professions and Penal Codes to (1) provide for the regulation of charitable gambling (bingo), (2) modify the state license fee for horse racing, (3) permit electronic gambling devices for certain gambling establishments, (4) enact a new state license fee to provide additional funding for education, and (5) potentially limit the expansion of gambling in some localities in California. As Section 9005 directs our review addresses the potential effects of the measure on state and local government revenues and costs.

BACKGROUND

In California, the State Constitution has provisions covering most types of gambling. Specifically it (1) authorizes the California State Lottery but prohibits any other lottery, (2) allows wagering on horse races, (3) allows bingo for charitable purposes, and (4) prohibits Nevada- and New Jersey-style casinos. The Constitution does not specifically mention card rooms. Existing statute, however, permits the play of any card game

not otherwise prohibited. Basically, the law allows card games where the card room operator has no stake in the outcome of the game.

Gambling on Indian lands is regulated at the federal level through the Indian Gaming Regulatory Act (IGRA) of 1988. The IGRA separates gambling activities into three distinct classes and applies different restrictions on each class. Essentially, the IGRA authorizes Indian tribes to operate any gambling that is otherwise legal in the state, although the operation of some forms of gambling is subject to a negotiated agreement (compact) with the state.

PROPOSAL

This measure makes several substantive amendments to the Business and Professions and Penal Codes.

Charitable Bingo. The measure provides for state regulation of charitable bingo operations and permits the Attorney General's Office to charge a fee for this regulation. The measure also increases the per game limit on bingo prizes from the current \$250 to \$5,000 and requires the state Gambling Control Commission to adopt regulations limiting the portion of bingo proceeds that can be used to pay specified administrative costs.

Horse Racing and Lottery. The measure requires the California Horse Racing Board and the State Lottery Commission to work jointly to develop and implement programs designed to make use of "new technologies" in order to increase the available funding for education and horse race purses. The measure does not define "new technologies." Additionally, the measure changes the allocation of horse racing revenue and specifies that the license fee for horse racing in California shall be no more than the average of the license fees charged in New York, Kentucky, and Florida.

Electronic Gambling Devices. The measure legalizes electronic gambling devices in specified card rooms and horse racing tracks. It specifies that, with certain limitations and subject to local approval, card rooms may operate five devices for each gambling table in operation and privately owned race tracks can operate no more than 700 machines at each track.

Additionally, the measure provides for fees/taxes on the "drop" or "hold" from each device. The Gambling Control Commission would regulate operation of the devices, and ensure that the devices return at least 90 percent of the total wager to the players.

Indian Gambling. The measure does not address Indian gambling. Existing federal law (the Indian Gaming Regulatory Act of 1988) authorizes Indian tribes to operate any gambling that is otherwise legal in the state for any purpose, subject to a negotiated agreement with the state. Thus, the expanded games and wagering authorized under the measure could also be allowed at Indian gambling establishments. Currently, agreements for off-track horse racing betting and certain lottery games have been negotiated between the state and certain Indian tribes.

Limits on Gambling. The measure amends the Penal Code to limit expansion of gambling only to those localities that, as of January 1, 1996, had authorized legal gaming. We are uncertain as to which forms of gambling would be included in the interpretation of "authorized legal gaming." If "authorized legal gaming" includes those localities that have permitted single event bingo nights, then this provision probably would not measurably limit gambling expansion. However, if "authorized legal gaming" is interpreted to be only those localities that have authorized permanent gambling establishments, such as card rooms or horse race tracks, then the provision would substantively limit future gambling expansion.

FISCAL IMPACTS

State and Local Revenues

Increased Economic Activity. The legalization of gambling devices in California would likely result in an overall increase in the amount of gambling taking place in California. To the extent this additional gambling represents *new* spending to the state and local economies, there would be a corresponding increase in state and local tax revenue. However, the net impact on individual local economies would vary and some could even experience a decrease in economic activity (and thus, in tax revenue) should spending move from areas that do not offer the expanded gambling to those areas that do.

In the longer term, the measure could result in a significant increase in economic activity and resulting tax revenues in California. This would occur if over time there is a large diversion of gambling activity and associated spending from other states to California.

State Education Funding. The measure establishes a 10 percent license fee on the drop, or hold, from the gambling devices and mandates that this license fee revenue be used solely for enhancing education. The terms drop and hold are not defined in the measure and are commonly used to refer to two different statistics. The drop commonly

refers to the total amount wagered. The hold refers to that portion of the wager retained by the casino (the drop less prize payouts). The hold is typically a small portion of the drop—about a tenth.

The amount of money associated with these terms is significantly different. Thus, the fiscal effect of this measure is dependant on which amount is used to determine the fee. If the license fee is calculated on the drop, state funding for education could increase by hundreds of millions of dollars annually. On the other hand, if the fee is applied to the hold, then state funding for education could increase by tens of millions of dollars annually.

Horse Racing License Fee. Changing the method of calculating the state license fee on horse racing would result in a decrease in state revenues—probably in the low tens of millions of dollars. This estimate is based on the average of the current license fee rates of Kentucky, Florida, and New York as compared to current California license fee rates for thoroughbred meets only. For all other types of meets, the California license rate is less than the average of the three other states.

Additional Local Tax Revenue. The measure permits local jurisdictions to tax up to 1 percent of the drop from the machines. Thus, this measure could result in additional tax revenue to local jurisdictions in the tens of millions of dollars annually.

State and Local Regulatory Costs

By requiring the Gambling Control Commission to regulate the gambling devices in operation at both card rooms and race tracks, the measure would result in increased state regulatory/administrative costs—probably less than \$1 million annually. The measure does not specify the funding source for this regulation (presumably this cost would be borne by the General Fund).

The state regulation of charitable bingo operations, while a new function of the Attorney General's Office, could be offset by fees charged to the regulated entities. Thus, this would not result in net costs to the state.

Local Costs

Depending on the level of gambling activity, the measure could result in increased local law enforcement costs. The magnitude of these costs is unknown.

SUMMARY

The measure would have the following major fiscal impacts:

- State revenues from license fees on electronic gambling devices, ranging from tens of millions to hundreds of millions of dollars annually. These funds would be dedicated to education.
- Potentially significant long-term increase in state and local revenues to the extent there is a large diversion of gambling activity from other states to California.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Craig L. Brown
Director of Finance