CONGRESSIONAL BUDGET OFFICE
INTERGOVERNMENTAL MANDATES STATEMENT

July 6, 1998

S. 474
Internet Gambling Prohibition Act of 1997

As reported by the Senate Committee on the Judiciary on October 23, 1997

SUMMARY

S. 474 would prohibit gambling conducted over the Internet or an interactive computer service. State, local, and tribal governments that operate lotteries, simulcast and off-track racing facilities, and Internet gaming sites would have to cease these activities if S. 474 is enacted. This prohibition would be an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), and CBO estimates that the net cost of this mandate would total more than \$6.5 billion in 1999 and would grow to almost \$8 billion by 2003.

INTERGOVERNMENTAL MANDATES CONTAINED IN BILL

S. 474 defines an interactive computer service as any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server. This definition is sufficiently broad that it would encompass computer networks used in a number of gaming activities currently operated by state, local, and tribal governments. Electronic lottery systems would be prohibited, as would any off-track, simulcast betting at race-tracks where data are gathered through a computer network. Prohibiting these activities on the part of state, local, or tribal governments would be an intergovernmental mandate as defined by UMRA.

Additionally, if S. 474 is enacted, providers of Internet services could be required by law enforcement agencies to block access by subscribers to Internet gambling websites. Because some of these providers are state and local governments, including universities, such a requirement to block access would also be an intergovernmental mandate.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE, LOCAL, AND TRIBAL GOVERNMENTS

Do the Direct Costs Exceed the Statutory Threshold ($50 Million in 1996, Adjusted Annually for Inflation)?

Yes.

Total Direct Costs of Mandates

CBO estimates that the mandate prohibiting interactive gaming would impose direct costs on state, local, and tribal governments, in the form of lost revenues, totaling more than $6.5 billion in 1999 and increasing to almost $8 billion in 2003. CBO considers the cost of this mandate to be the net revenues that state, local, and tribal governments would lose from gaming activities prohibited by the bill. Net revenues are the funds remaining from total bets after associated operating expenses are paid, payments are made to winners, and, in the case of racing, purses are awarded to owners.

In preparing this estimate, CBO contacted officials from national associations that represent horse and greyhound racing interests, state lotteries, and Indian gaming. We also contacted officials from local horse and greyhound racing tracks, tribal leaders, state attorneys general, and federal officials from both the Department of the Interior and the Department of Justice.

CBO is uncertain how many state and local governments provide Internet services and what tools would be available to them to block Internet access to gambling sites. If total costs are near the middle of the range for all Internet service providers, as estimated in CBO's private-sector mandate statement ($1.0 billion in 1999, growing to $2.3 billion in 2003), state and local governments would have to bear about 5 percent of those costs in 1999 and about 2 percent of the costs in 2003 for the intergovernmental threshold to be exceeded. However, it is not clear that such governments make up that much of the market, and CBO's best estimate at this time is that costs of this particular mandate would be less than $50 million a year.

<u>State Lotteries</u>. Currently, 37 states operate lotteries with some form of electronic gaming, either lotto games or video gaming with an interactive component. CBO assumes that the bill would not affect scratch card games because no interactive computer component is involved beyond verifying the validity of the card prior to awarding a prize. Net revenues to these 37 states from interactive lottery games totaled approximately $5.6 billion in 1997, after adjustments for payouts and administrative expenses. Assuming sales of these lottery

games continues to grow at the recent rate of almost four percent, the losses to states as a result of S. 474 would increase from over $6 billion in 1999 to more than $7 billion in 2003.

It may be possible for states to implement an alternative form of lottery games that involves using the mail rather than an electronic system. However, CBO cannot predict the likelihood that states would implement such systems, how quickly they could do so, and how much revenue they could generate. In the absence of electronic lotteries, participation may increase in other lottery games unaffected by S. 474. But different types of games tend to have different kinds of participants, so this may not be a significant shift.

<u>Simulcast and Off-Track Betting</u>. Forty-three states allow various forms of horse racing, and most tracks in those states offer some form of off-track or simulcast betting. Simulcast betting occurs when a bet is tendered on a race that occurs off the grounds of the betting facility. Bets are taken at a number of locations, and a central computer gathers the data, processes it and calculates pay-outs. At least four such tracks are owned by state or local governments. CBO estimates that revenue losses to these governments as a result of enacting S. 474 would total approximately $40 million annually.

Similarly, fifteen states allow greyhound racing, and 35 tracks in those states offer simulcast betting. Two of these tracks are owned by local governments. CBO estimates that revenue losses to these local governments as a result of enacting S. 474 would total approximately $1 million annually.

<u>Tribal Gaming</u>. Over fifty Indian tribes allow some form of wagering on racetracks. The vast majority of these tribes allow simulcast or off-track betting, but specific net revenue data on this form of Indian gaming is limited. However, given the number of tribes involved, CBO estimates that Indian tribes could lose up to $500 million annually if they could no longer offer simulcast or off-track betting.

Tribal use of Internet gaming could also be affected by this bill. Of all intergovernmental entities, Indian tribes have shown the greatest interest in using the Internet as a forum for raising gaming revenues. Many of these activities have been subject to court challenges, the results of which are still pending. Consequently, the potential for future revenues, even in the absence of this legislation, is uncertain. Currently, the amount of gaming on the Internet is still relatively small, but one tribe has indicated that in coming years, it expects to realize revenues of approximately $8 million annually. Additionally, a cooperative effort among tribes operating through a private entity may also result in a significant increase in revenues to tribes from Internet gaming. Because of these uncertainties, CBO cannot estimate the potential revenues from this type of operation, but in the absence of this bill, they could be significant.

Blocking Access to Gaming Sites. State and local governments that provide Internet services could be required to block access by subscribers to Internet gambling websites. CBO assumes that these governments most likely would contract with firms that identify gambling sites on the web and provide filtering services.

Because the technology and market for providing such filtering services is changing rapidly, CBO can only provide a broad range of the potential costs for implementing such a system. It is also unclear how many state and local governments act as Internet service providers and thus would be affected by this requirement. If total costs for blocking access to gaming sites are near the middle of the range identified in the private-sector mandate statement for all Internet providers ($1.0 billion in 1999 and $2.3 billion in 2003), state and local governments would only have to bear about 5 percent of the total in 1999 and about 2 percent of the total in 2003 for costs to exceed $50 million in at least one year. However, it is not clear that such governments make up that much of the market, and CBO's best estimate at this time is that the costs of this particular mandate would not exceed the threshold established in UMRA.

APPROPRIATION OR OTHER FEDERAL FINANCIAL ASSISTANCE PROVIDED IN BILL TO COVER MANDATE COSTS

None.

OTHER IMPACTS ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

With the exception of tribally owned tracks, all racing facilities pay some form of state or local tax on their gaming activities. CBO estimates that the prohibitions resulting from S. 474 would result in lost tax revenue of well over $400 million annually to state and local governments. Nearly $375 million of this is attributable to simulcast and off-track horse racing activities, and over $36 million from greyhound racing activities. Additionally, by prohibiting simulcast betting, the bill could result in the closure of many tracks that depend on those revenues to supplement other, less profitable activities. If that occurs, the loss of tax revenues to state and local governments would be even greater.

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