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INVITED PAPER

A Model Casino Law for Japan

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Abstract Casinos are legal in nearly every country in the world. Japan is the largest remaining noncasino market. Japan has been debating whether to permit casinos for years. Successful integrated resorts (IRs) could significantly stimulate tourism and Japan's economy. Experience elsewhere, however, has shown that IRs are risky investments for both the owners and the government. In this case, the Japanese market's great size and the massive IRs it would support raise both the potential benefits and risks for the Japanese government. We demonstrate that the casino law Japan adopts will largely determine whether its IR industry succeeds or fails. We review the successes and failures of the large, diversified, and capital-intensive casinos in Las Vegas, Atlantic City, Macau, and Singapore. From a statistical analysis of casino economics in these gaming markets, we derive the essential elements of a successful casino law in Japan. This paper provides recommendations on laws, regulations, and related matters, which include the goals, requirements, and approach to IRs the Japanese government should consider in drafting an IR law.

Keywords Japan, Integrated resort, IR, Casino, Gaming, Gaming regulation & control, Gaming markets, Las Vegas, Atlantic City, Macau, Singapore

Introduction

Japan's continuing debate about casino gaming focuses on a particular kind of casino, the integrated resort (IR). Japan's 2014 Integrated Resort Promotion Bill defines an integrated

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Exhibit 1 Statewide casinos with gaming revenue greater than $1M (FY 2014)

Number of casinos	270
Cost of fixed assets	$61,204,278,222
Total revenue	$23,895,954,169
Employees	169,167

Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*. Statistics from fiscal year 2014 (July 1–June 30) income statements for "Statewide Casinos with Gaming Revenue of $1,000,000 and over." Retrieved from http://gaming.nv.gov/index.aspx?page=144

resort "as a privately owned and operated complex including convention, recreation, exhibition, lodging, and most notably, casino facilities" (White & Case, 2014). The capital and operating requirements of IRs dictate important parameters of a successful Japanese casino law. To compete in the global market for destination gaming tourism, developers need to commit substantial investments to construct IRs. The parameters of a successful implementation prescribe that the government should require casino companies to make these investments in the initial or growth phase of the Japanese gaming market which the Integrated Resort Promotion Bill seeks to create.

The IR

IRs originated in Las Vegas, Nevada. In its 1931 Gaming Act,[1] the State of Nevada established a U.S. monopoly on casino gaming (and other forms of gambling excluding lotteries). By licensing private-sector operators to exploit this monopoly, Nevada sought to create an engine of economic development for a State that desperately needed one. In the second half of the 19th century, gold and silver mining provided Nevada with a robust economy. By 1931, however, the mines were exhausted. Aside from small-scale farming and ranching in the Carson River Valley, Nevada had no significant economic activity. With the onset of the Great Depression, the State's fiscal crisis had become acute. In these circumstances, Nevada turned to casino gaming as a solution to its economic and financial needs. Nevada has a relatively low gaming tax rate (about 6.75% of gross gaming revenues [GGR])[2] and modest government-imposed barriers to entry, so the capture of tax revenues, or the creation of IRs by limiting competition, was not its major focus. Instead, in the early years, Nevada focused on maximizing investment and creating jobs through a competitive market. Nevada's stated policy for legalized gaming was simply that, "The gaming industry is vitally important to the economy of the State and the general welfare of the inhabitants."[3]

Nevada's hopes that its pioneering casino law would bring economic benefits to the State in terms of a tourist economy, capital investment, and employment were abundantly realized (Exhibit 1).

[1] A. B. 98, 36th Leg. (Nv. 1931). Introduced by Phil Tobin, an assemblyman from Winnemucca, the bill was signed into law on March 19, 1931, by Governor Frank Balzar.

[2] The Nevada State Gaming Tax is 6.75% of GGR (win). Other taxes and fees result in a combined tax burden of about 7.75%.

[3] NRS 463.010(1)(a).

In 2014, capital investment in Nevada's casino industry totaled $61.2 billion. The State had 270 casinos with annual gaming revenue of $1 million or more, and the gaming industry provided almost 170,000 jobs, by far the State's largest employer. While not anticipated in 1931, IRs are the foundation of Nevada's tourist industry. Nevada's casinos, particularly the diversified resort properties located on the Las Vegas Strip, attract more than 40 million tourists annually, making gaming-related tourism an important driver of Nevada's thriving economy.

IRs are a distinctive subset of Nevada's $23.9 billion casino industry. Las Vegas IRs offer an ever-increasing variety of leisure activities that in scope, diversity, and quality are unequaled by the leisure offerings of any other destination. Las Vegas's enduring success as a magnet for global tourism demonstrates that legalized gaming can, if appropriate government policies are adopted, motivate license holders to invest substantial amounts of capital in nongaming amenities, to stimulate tourism, promote sustainable economic development, or for other public-policy purposes. Nongaming amenities may include theme parks, lavish retail outlets, elaborate restaurants, spas, bars, and nightclubs, and capital-intensive resort recreation facilities such as golf courses, swimming pools, tennis courts, movie theaters, movie studio tours, zoos, aquatic animal attractions, and similar leisure entertainments. Singapore's two IRs are successful examples of this approach to a gaming industry in Pacific Asia.

Phases in the Development of Gaming Markets

Casinos differ from other goods and services in that there are typically significant barriers to entry to gaming markets. This statement is not true for widgets, newspapers, restaurants, or lawyers, where demand will call supply into being and supply/demand relationships will eventually balance. Casinos are different. Historically, casino gaming has generally been illegal. This fact gives government the power to encourage (or even, as in the case of Singapore, require) gaming license holders to make extraordinary investments in new IRs. In the act of legalizing gaming, government can ensure that casinos operate in an unusually favorable market environment by issuing monopoly or oligopoly licenses. These artificial quotas allow government to manipulate economic rents (or set equilibrium quantities) above (or below) what a competitive market with unregulated supply would produce. By limiting supply, government allows its licensees to exploit a monopoly, or quasimonopoly, on gaming. Monopolies give casinos extraordinary pricing power: fewer games may be available to the players, which allows casinos to set higher prices by offering poorer odds, establishing higher table limits, or making other conditions of play more favorable to the casino. In limited license markets, higher consumer prices should translate into greater casino profitability.

The development of gaming markets typically conforms to a well-established pattern. Exhibit 2 illustrates this pattern using the development of gaming markets in Atlantic City, New Jersey, and Macau, China.

Following legalization, gaming markets are grossly undersupplied. The first casinos to open report steadily increasing GGR, and the market grows rapidly: GGR increases at faster rates than the growth in the general economy. Other things being equal, casinos continue to outperform other goods and services as long as the market remains undersupplied.

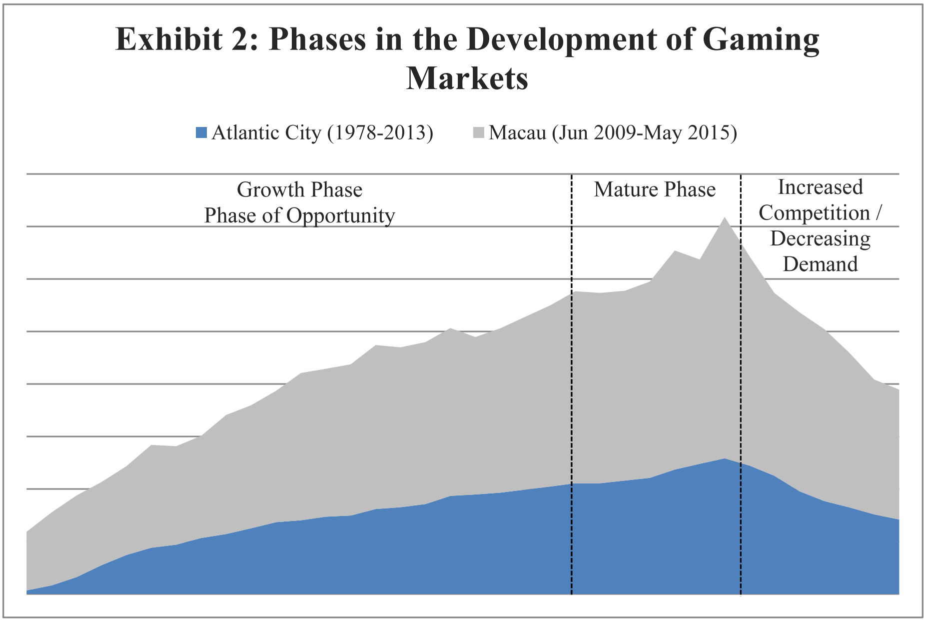

Exhibit 2 Source(s): Gaming Inspection and Coordination Bureau Macao SAR, "Monthly Gross Revenue from Games of Fortune." Retrieved from http://www.dicj.gov.mo/web/en/information/DadosEstat_mensal/index.html
New Jersey Division of Gaming Enforcement. Annual operating statistics for Atlantic City casinos. Retrieved from http://nj.gov/oag/ge/historicalstatistics.html

For IRs, the initial phase of gaming market development, which involves rapid growth in undersupplied market conditions, is the stage of greatest opportunity. This initial phase is when above-average returns justify above-average capital investment, and when investment in a sustainable, diversified leisure economic engine is feasible. Las Vegas remains the best example of a casino industry successfully taking advantage of the phase of opportunity to construct diversified IRs. As discussed later herein, Singapore provides a similarly successful example of diversified IR construction during the initial phase of gaming market development.

Eventually, gaming markets mature, and their growth phase ends. Supply and demand for gaming approach balance, and casinos, in terms of their market economics, become like everything else. The reasons for market maturation vary. Demand may slow due to economic recession or contraction in the general economy. New competition (additional supply) in the same or nearby jurisdictions may dilute casino market economics. Government policy may change. In the case of Macau, People's Republic of China changed government policy by implementing anticorruption measures and more restrictive visa policies, while the government of Macau restricted smoking in casinos. Consumer tastes may change: young people who grew up with mobile phones and other interactive devices appear to be less interested in casino slot machines than their parents were. Regardless of the cause, however, gaming markets sooner or later mature. GGR stops increasing at rates faster than growth in the general economy, and other things being equal, casinos perform more like similar goods and services, with their GGR growing or decreasing at rates commensurate with growth or contraction in the general economy.

The mature phase may last indefinitely: The Las Vegas Strip market during the 1980s is an example. More usually, a phase of contraction and declining GGR follows the mature phase. Reasons again vary. In the case of Atlantic City, the primary cause of decline was the start of gaming in neighboring Pennsylvania in 2006; in Macau, GGR declined following the inception of the anticorruption campaign in 2012. Decline, however, is not inevitable. A market's mature phase may be succeeded by a phase of renewed growth, as was the case in Las Vegas following the opening of The Mirage in 1989. The Mirage administered a positive shock to a stagnant Las Vegas Strip, precipitating successive cycles of new capital investment for new casino resort construction that stimulated increased tourism.

The Market Economics of IRs

In unsupplied or undersupplied markets where substantial demand for gaming is present, the first casinos to open enjoy robust business. Casinos exhibit above-average growth in GGR and generate above-average earnings before interest, taxes, depreciation, and amortization (EBITDA), return on investment (ROI), and profits. Economists call these above-average returns monopoly rents.[4]

Above-average returns that the government does not capture in the form of taxes make above-average capital investments in casino facilities feasible. The prototypes of this class of elaborate casino resort evolved along the Las Vegas Strip in the decades following the end of the Second World War. More recently, enormous, capital-intensive casino hotels have opened in other jurisdictions, including Atlantic City, Macau, and Singapore. The degree to which these properties satisfy the definition of an IR in Japan's Integrated Resort Promotion Bill varies. We will analyze the experience with large casino hotel resorts in each of these markets with a view towards drawing lessons from this experience that apply to the prospects for IRs in Japan.

The Las Vegas Strip

From the enactment of Nevada's Gaming Act in 1931 until 1978 (when the first casino in Atlantic City opened), private-sector casino companies in Nevada enjoyed a national monopoly on gaming in the United States. They used this opportunity to develop Las Vegas into a diversified global leisure destination. Las Vegas survived the erosion of its monopoly through successful diversification, which, in turn, allowed it to recover from the severe recession of 2009–2011. Measured by trends in visitation, Las Vegas continues to prosper.

Exhibit 3 presents GGR for Las Vegas Strip casinos with annual GGR of $72 million or more for the years 1990–2014. GGR increased steadily from 1990 through the year 2000, decreased slightly between that year and 2002, and then climbed to a series high in 2007.

[4] "Monopoly rents are earned by firms that are able to restrict supply and/or increase prices without fear of attracting competitors. The difference between price and long-run marginal cost is a measure of the economic rent, and the sum of the difference across all units sold is the total monopoly rent. This can be higher if *price discrimination* is possible. There are a number of ways in which monopoly rents can be secured, such as government grant of monopoly, through patents, or through (illegal) anticompetitive conduct or collusion. In practice, monopoly rents are often hard to identify and measure." David J. Teece, Monopoly Rents. *The Palgrave Encyclopedia of Strategic Management*, December 19, 2014.

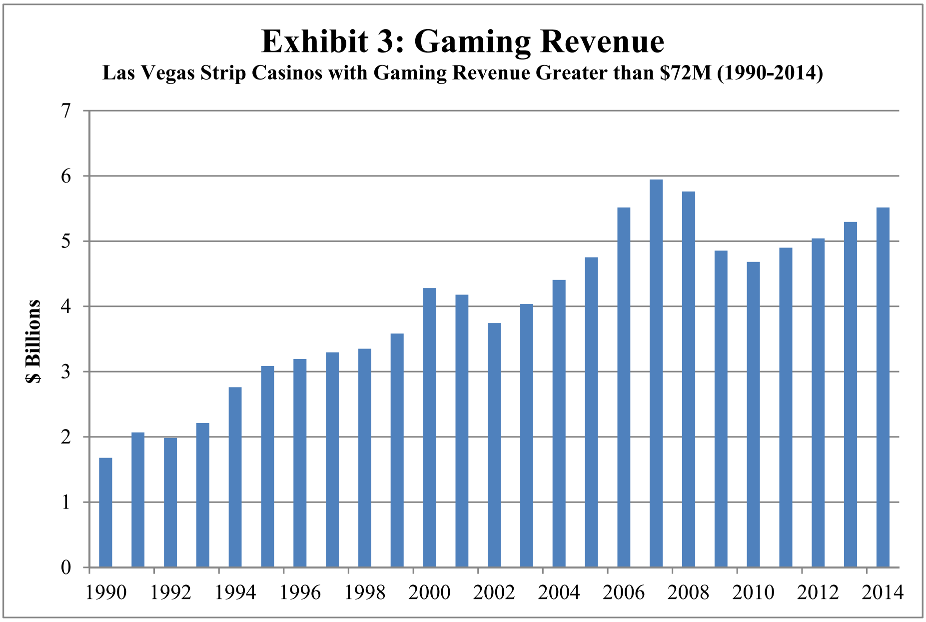

Exhibit 3 Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*. Statistics from fiscal year (July 1–June 30) income statements for "Clark County–Las Vegas Strip Area with Gaming Revenue of $72,000,000 and over." Retrieved from http://gaming.nv.gov/index.aspx?page=144

The fiscal crisis and the ensuing severe recession negatively impacted Las Vegas Strip casinos. GGR dropped sharply from its series high in 2007 through 2010. With the end of the recession in that year and the start of slow recovery in the general economy, GGR increased steadily, although still remaining below its 2007 high in 2014, the most recent year for which these data are available.

Exhibit 4 presents combined gaming and nongaming net income generated by Las Vegas Strip casinos with annual GGR of $72 million or more for the years 1990–2014. Net income reported by Las Vegas Strip casinos with annual GGR of $72 million or more increased steadily from 1990 through 1996 and then declined, falling into negative territory in 2002, before recovering and rising to a series high of $1.5 billion in 2007. The fiscal crisis and the ensuing severe recession severely impacted large Las Vegas Strip casino profitability (as measured by net income). Net income declined in 2008 and plunged to a loss of $3.65 billion in 2009. Net income by Las Vegas Strip casinos with annual GGR of $72 million or more remained in negative territory through 2014, meaning that as of 2014, this subset of Nevada's casino industry had not returned to precrisis profitability.

Exhibits 5 and 6 present ROI, calculated in two different ways, for Las Vegas Strip casinos with annual gaming revenue greater than $72 million for the years 1990 through 2014.

Exhibit 5 defines ROI for this segment of Nevada's gaming industry as EBITDA as a percentage of the cost of fixed assets. After rising to a series high in 1993, ROI by this measure declined irregularly before falling to a negative value in 2009, a precipitous drop

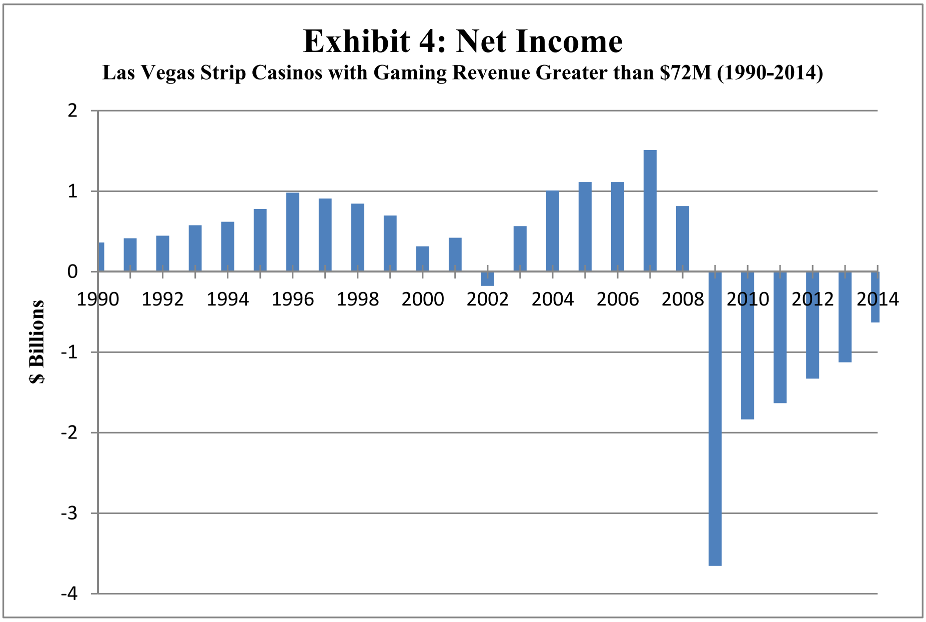

Exhibit 4 Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*. Statistics from fiscal year (July 1–June 30) income statements for "Clark County–Las Vegas Strip Area with Gaming Revenue of $72,000,000 and over." Retrieved from http://gaming.nv.gov/index.aspx?page=144

caused by the fiscal crisis of 2007 and the ensuing severe recession. ROI by this measure returned to positive territory in 2010, trending moderately upward after that year.

Exhibit 6 defines ROI for this segment of Nevada's gaming industry as net income as a percentage of the cost of fixed assets. Measured in this way, ROI reached a double peak in 1993 and 1996 and then decreased steadily through 2002 before recovering moderately through 2007. In 2009, net income as a percentage of the cost of fixed assets plunged deep into negative territory and remained there through 2014. This prolonged period of negative return on investment as measured by net income (as opposed to EBITDA against the cost of fixed assets) suggests that, at least since the fiscal crisis of 2007, this segment of Nevada's gaming industry has been managed to maximize EBITDA rather than net income, perhaps a reflection of the sensitivity of property managers resting on highly leveraged capital structures to the danger of default.[5]

Despite the loss of its gaming monopoly, Las Vegas as a leisure destination remains healthy, attracting nearly 42 million visitors annually, many of whom do not patronize its casinos: Almost 30% of its visitors in 2014 did not gamble, partaking instead in the many and diverse nongambling leisure activities on offer (Exhibit 7).

[5] For a detailed analysis of the financial history of the Las Vegas Strip, see Dean M. Macomber, The Fiscal Forensics of the Las Vegas Strip. Lessons from the Financial Crisis. University of Nevada Las Vegas Center for Gaming Research Occasional Papers Number 17. Las Vegas, NV: University of Nevada Las Vegas Center for Gaming Research. May 2012. Retrieved from http://gaming.unlv.edu/papers/cgr_op17_macomber.pdf.

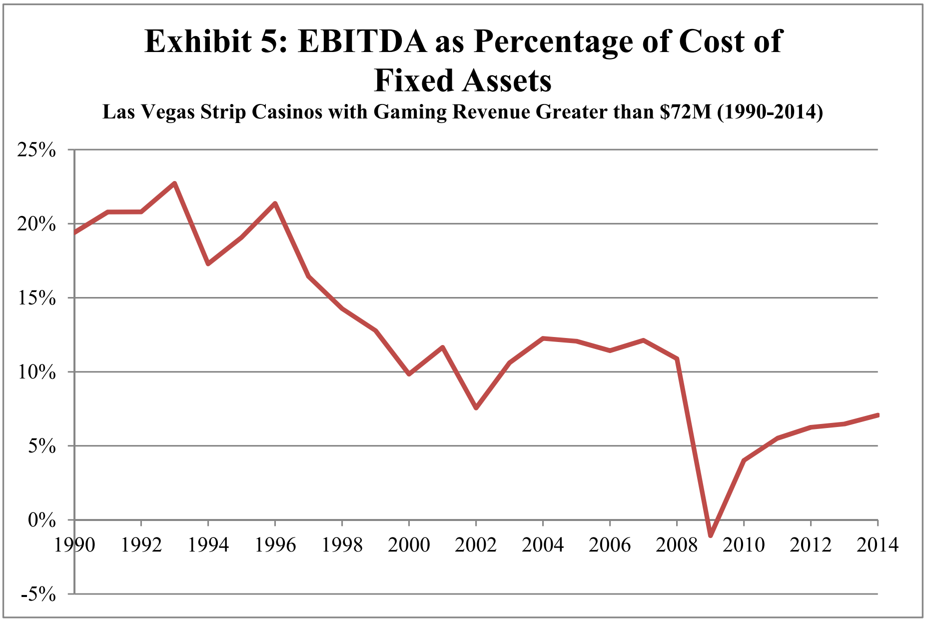

Exhibit 5 Percentages calculated by dividing EBITDA ("Interest Expense" + "Net Income (– Loss) Before Federal Income Taxes and Extraordinary Items" + "Depreciation – Buildings"+ "Depreciation and Amortization—Other") by "Cost of Fixed Assets." Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*. Statistics from fiscal year (July 1–June 30) income statements for "Clark County–Las Vegas Strip Area with Gaming Revenue of $72,000,000 and over." Retrieved from http://gaming.nv.gov/index.aspx?page=144

In recent years, rising visitation has combined with declining participation in gaming to fundamentally restructure Las Vegas Strip property revenue.

Exhibit 8 presents gaming revenue as a percentage of total property revenue for Las Vegas Strip casinos with annual gaming revenue greater than $72 million for the years 1990 through 2014. Gaming revenue as a percentage of total property revenue declined steadily, from 57.7% in 1991 to 36.6% in 2014. In other words, the casino now contributes slightly more than a third of Las Vegas Strip IR property revenue, with the balance, nearly two-thirds, coming from hotel rooms, spas, nightclubs and bars, retail, restaurants, diverse recreations, and other commercial leisure activities.

Exhibit 9 presents total property revenue for Las Vegas Strip casinos with annual gaming revenue greater than $72 million for the years 1983 through 2014, analyzed into gaming and other components. During the 1980s and for most of the 1990s, gaming contributed more than half of total property revenue for Las Vegas Strip casino hotel resorts. In 1999, the percentage contribution of gaming dropped below 50% and has remained below that level ever since.

The defining event in the restructuring of Las Vegas Strip property revenue was the opening of The Mirage in November 1989. Prior to The Mirage's opening, supply and demand for gaming in Las Vegas had reached equilibrium: During the 1980s, there was little growth in gaming revenue; the market was mature and apparently could absorb little, if any, additional capital.

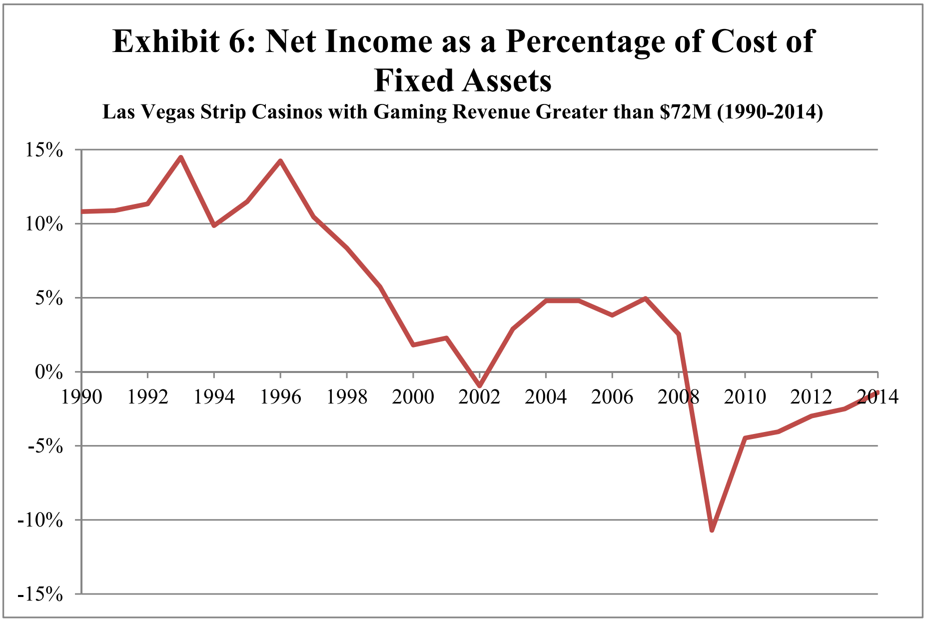

Exhibit 6 Percentages calculated by dividing "Net Income (– Loss) Before Federal Income Taxes and Extraordinary Items" by "Cost of Fixed Assets." Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*. Statistics from fiscal year (July 1–June 30) income statements for "Clark County–Las Vegas Strip Area with Gaming Revenue of $72,000,000 and over." Retrieved from http://gaming.nv.gov/index.aspx?page=144

The Mirage was an unprecedented investment in a gaming resort, costing $620 million to open, more than any previous casino. The Mirage was a risky investment; the debt/equity ratio of its parent Golden Nugget was about 92% in the quarter before opening. The project had many skeptics who predicted it would fail. They were wrong. The Mirage opened to sold-out, standing-room-only business. It administered an electric shock to a sleepy market. Its casino immediately set new industry records. While the Flamingo (opened 1946), Caesars Palace (opened 1966), and Circus (opened 1968) were important predecessors in the creation of Las Vegas, The Mirage was a new casino resort experience, offering diversified entertainment so successfully that it stimulated new kinds of leisure consumption. The Mirage set Las Vegas on the road to becoming the diversified leisure destination it is today.

Atlantic City

Unlike casinos on the Las Vegas Strip, casinos in Atlantic City wasted the phase of opportunity provided by its period of rapid growth. Hobbled by a highly leveraged capital structure, Atlantic City casinos failed to make the capital investments in diversified nongaming amenities and periodic capital refreshment that are necessary for the creation of a leisure destination like Las Vegas.

Exhibit 10 presents gaming revenue, nongaming revenue, and total revenue for Atlantic City casinos for the years 1978 through 2013. From a series high of $6.5 billion in 2006,

Exhibit 7 Population who gambled while visiting Las Vegas

Year	Percent
2010	80
2011	77
2012	72
2013	71
2014	71

Source: Las Vegas Convention and Visitors Authority, "Las Vegas Visitor Profile Study 2014." Retrieved from http://www.lvcva.com/stats-and-facts/visitor-statistics/

total revenue has precipitously declined, falling to $4.1 billion in 2013. Gaming revenue, by far the largest component of total revenue, declined from a series high of $5.2 billion in 2006 to $2.8 billion in 2013. Competition from casinos in nearby jurisdictions is the primary cause of these declines. As slot machines and table games spread throughout the eastern United States, consumers who wanted to participate in these activities no longer had to travel long distances to Atlantic City. Today there are very few ZIP (postal) codes in the eastern United States that are not within 60 minutes travel time of a casino.

In sharp contrast to the Las Vegas Strip casinos, Atlantic City casinos remained almost wholly dependent on casino revenue throughout this period. Exhibit 11 presents gaming revenue as a percentage of total revenue for Atlantic City casinos for the years 1978 through

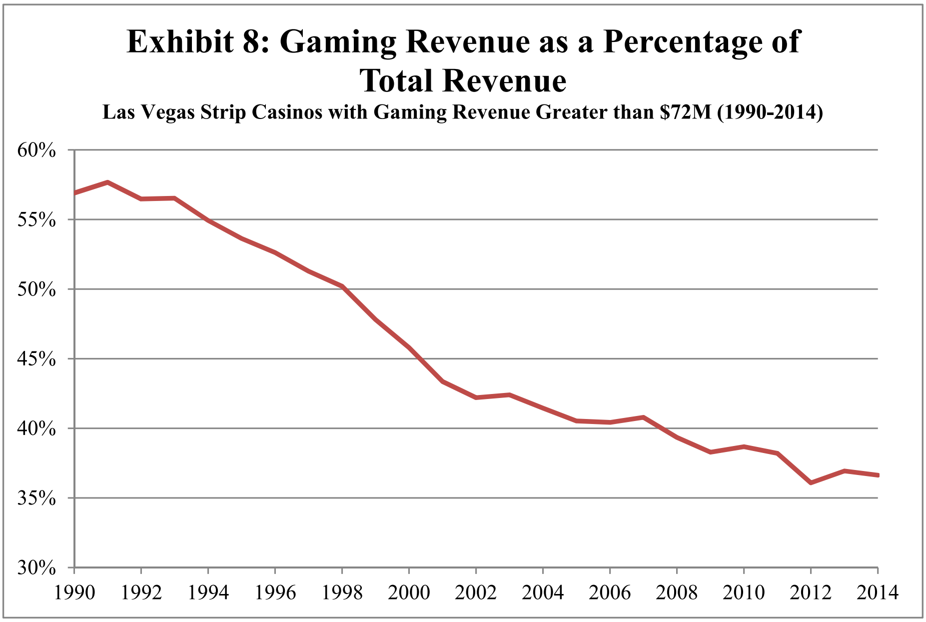

Exhibit 8 Percentages calculated by dividing "Gaming Revenue" by "Total Revenue." Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*. Statistics from fiscal year (July 1–June 30) income statements for "Clark County–Las Vegas Strip Area with Gaming Revenue of $72,000,000 and over." Retrieved from http://gaming.nv.gov/index.aspx?page=144

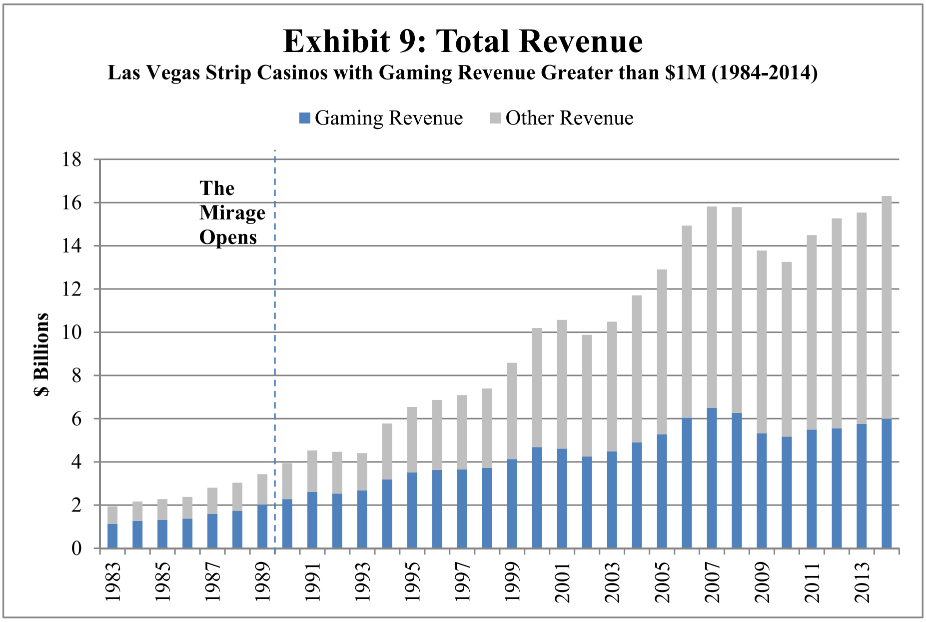

Exhibit 9 The Mirage opened on November 22, 1989. Source: University of Las Vegas Center for Gaming Research, "LV Strip Revenue." Retrieved from http://gaming.unlv.edu/abstract/lv_revenues.html

2013. Although the percentage of total revenue contributed by the casino has declined since 2004, it remained at nearly 70% in 2013, almost twice as high as the casino percentage contribution to total revenue for large Las Vegas Strip properties that year (Exhibit 8).

Exhibit 12 compares Las Vegas and Atlantic City with respect to visitation. For nearly two decades, from 1980 through 1999, more people visited Atlantic City annually than Las Vegas. However, with The Mirage's opening and the subsequent diversification of its leisure offerings, Las Vegas was able to surpass Atlantic City as the top destination for gaming-related tourism.

With only slot machines and table games in obsolete, unrefreshed, and in many cases run-down casino hotels to offer (Borgata is an exception to this description; not coincidentally, Borgata is Atlantic City's most successful property), Atlantic City has lost its raison d'etre. Today, Atlantic City casinos do not generate enough free cash to make the enormous capital expenditures needed to create viable destination resorts on a par with Las Vegas or Singapore. The bankruptcy and eventual restructuring of Revel put this issue to rest. It is too late for Atlantic City to become a premier tourist destination; as far as leisure consumers are concerned, Atlantic City has become irrelevant.

Macau

The casino hotels in Macau resemble casino hotels in Atlantic City more closely than they do the diversified resorts along the Las Vegas Strip. Macau has made comparatively little capital investment in leisure offerings beyond baccarat, hotel rooms, and retail. In

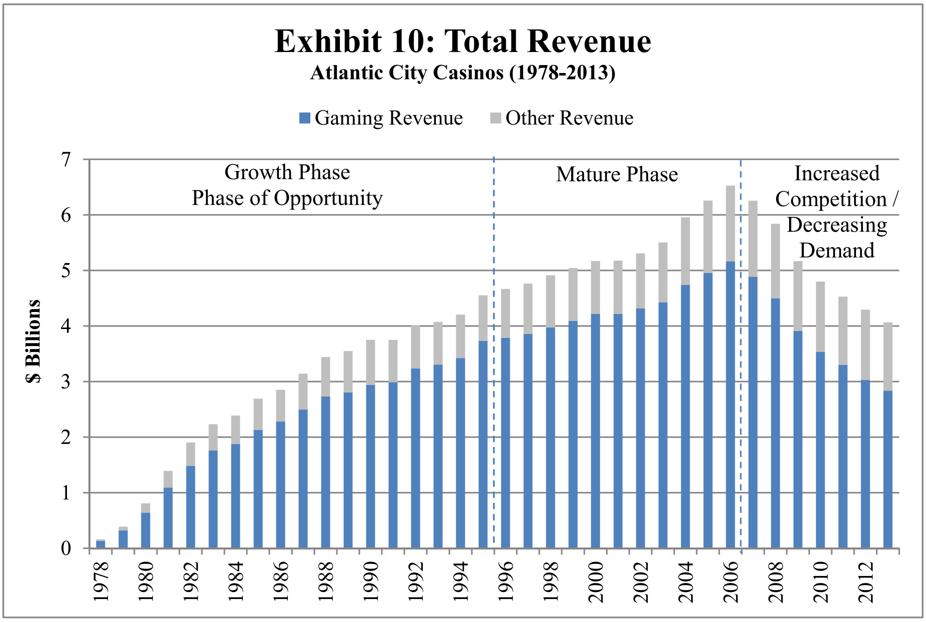

Exhibit 10 The graph is divided into three different phases. When the percent change in average annual gaming revenue falls consistently below 9% the growth phase ends. When the percent change in average annual gaming revenue falls consistently below 0%, the mature phase ends. Source: New Jersey Division of Gaming Enforcement. Annual operating statistics for Atlantic City casinos. Retrieved from http://nj.gov/oag/ge/historicalstatistics.html

December 2014, this narrow investment focus prompted China's president, Xi Jinping, to suggest that Macau diversify its economy and lessen its dependence on gaming revenue: "Focus on building a global tourism and leisure centre ... promote the Macanese economy's appropriate diversification and sustainable development. This is of great importance for the interests of the people of Macau," (Jim, 2014). Macau's Chief Executive, Fernando Chui, has also called for Macau's casinos to diversify their leisure offerings to attract more foreign tourists (Macau Cuts, 2015).

Macau's vulnerability to changes in demand for gaming is illustrated by Exhibits 13 and 14.

Exhibit 13 presents Macau annual gaming revenue for the years 2002 through 2014. Gaming grew slowly during the early years of this period, reflecting the slow buildout of Macau's casino plant following the decision to open this market to foreign casino companies in the year 2000. In 2009, growth accelerated, rising sharply to a series peak of $45 billion in 2013.

Exhibit 14 presents Macau's monthly gaming revenue for January 2009 through April 2015. The trend in this indicator closely resembles trends in Atlantic City GGR over a longer calendar time period (Exhibit 10).

Macau's monthly GGR increased sharply from 8.6 billion patacas in January 2009 to a series high of 38 billion patacas in February 2014.[6] Following the start of the Republic of

[6] The pataca (MOP) is the unit of Macau's currency. The pataca is pegged to the Hong Kong dollar at the rate of $1 HK = MOP $1.032.

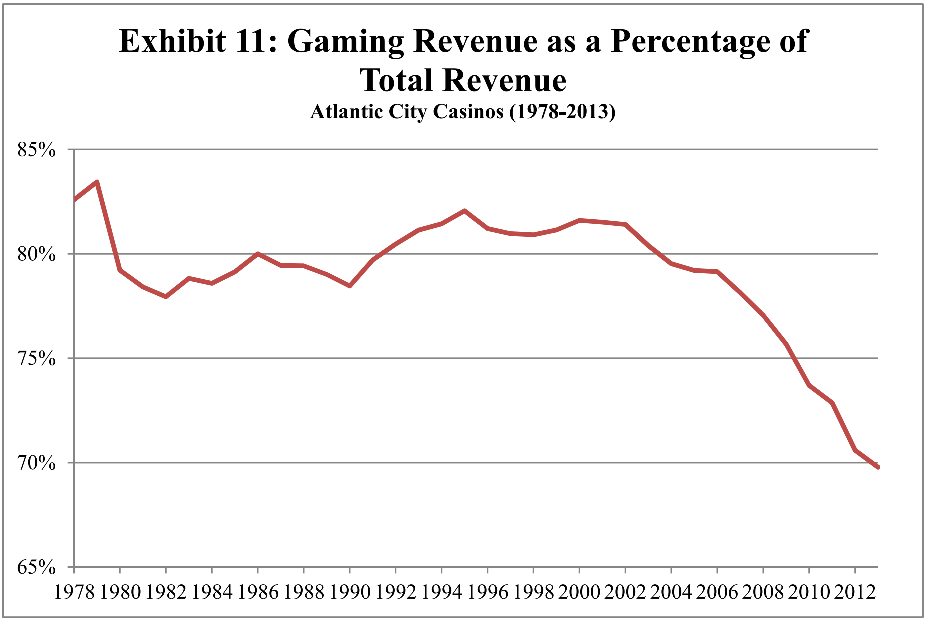

Exhibit 11 Percentages calculated by dividing "Gaming Revenue" by "Total Revenue." Source: New Jersey Division of Gaming Enforcement. Annual operating statistics for Atlantic City casinos. Retrieved from http://nj.gov/oag/ge/historicalstatistics.html

China's anticorruption campaign, which discouraged wealthy Chinese from displays of wealth, including gaming in Macau casinos, monthly gaming revenue dropped precipitously, falling to 19.2 billion patacas in April 2015. Macau gaming revenue continues to decline. Like Atlantic City, Macau casinos are largely dependent on gaming, with casinos contributing around 90% of Macau's total revenue from its resorts, pointing up Macau's lack of attractive nongambling offerings (Master, 2015). Like Atlantic City, and in sharp contrast to Las Vegas, Macau's resorts do not have enough diversification to attract the tourists needed to compensate for the crippling anticorruption policies of China's government.[7]

Exhibit 15 shows notable capital investments in Macau since 2007. The most recent capital investments, such as Galaxy Macau's Phase II, have attempted to create diversified leisure products. However, these investments, while large, may have come too late considering the current market economics of Macau.

Singapore

In contrast to Macau, Singapore's diversified IRs are successes that Japan might emulate.

[7] For a skeptical view of Macau's ability to transform itself into a diversified leisure destination like Las Vegas, see Brook Yang, (2015). Lack of Infrastructure Hinders Local Diversification. *Macau Daily Times*, June 26, 2015, summarizing a speech given by Kate O'Keeffe, who covers gaming for *The Wall Street Journal*, to the France Macau Business Association.

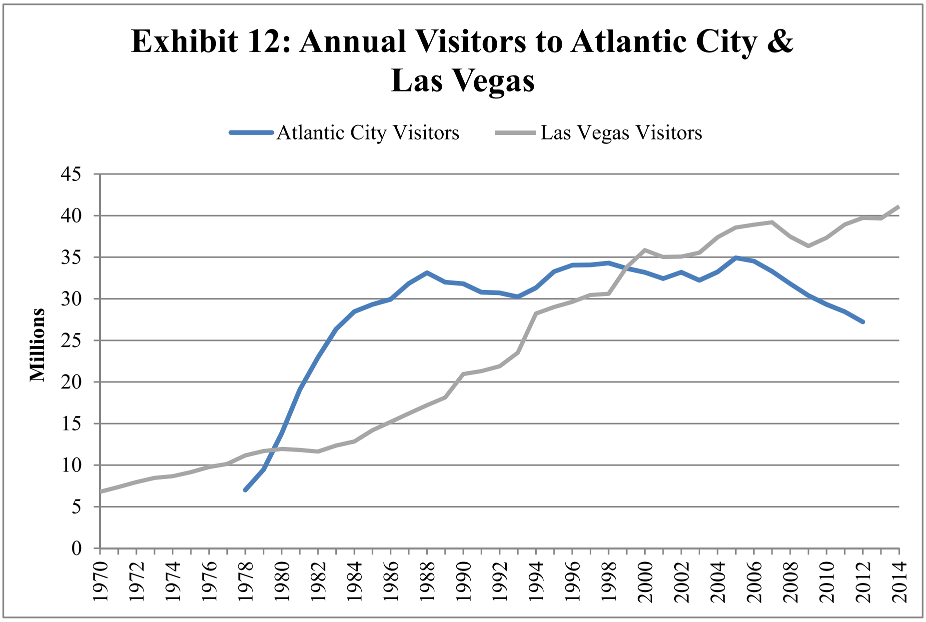

Exhibit 12 Source(s): 1. University of Las Vegas Center for Gaming Research, "Atlantic City Annual Comparison." Retrieved from http://gaming.unlv.edu/abstract/ac_annual.html. 2. Las Vegas Convention and Visitors Authority, "Las Vegas Visitors Statistics." Retrieved from http://www.lvcva.com/stats-and-facts/visitor-statistics/

In a previous paper by Christiansen and Hua (2014), the Singapore experience with IRs was summarized as:

Singapore legalized casinos in 2006.[8] Two licenses, each for a multi-billion-dollar integrated resort, were also granted in 2006. Gaming was permitted for the specific purpose of attracting substantial capital investment in destination resorts designed for long-distance tourists. The terms of the licenses limit the casino area and stipulate that the casino can be only one component of a diversified resort incorporating elaborate and capital-intensive non-gaming leisure attractions, including hotels, restaurants, retail shopping, convention centers, museums, spas, recreational facilities and theme parks. Effectively the license terms limit the percentage of property revenue contributed by gaming.

To illustrate the specific license terms and conditions Singapore sought to impose, the following is a summary of key specifications of the Request for Proposals for one of the two Singapore licenses, for an integrated resort on Sentosa Island.[9]

[8] Singapore Casino Control Act (CHAPTER 33A). (Original Enactment: Act 10 of 2006).

[9] See also http://archivesonline.nas.sg/speeches/view-html?filename=20051104981.htm (showing the Request for Proposal for an Integrated Resort at Marina Bay).

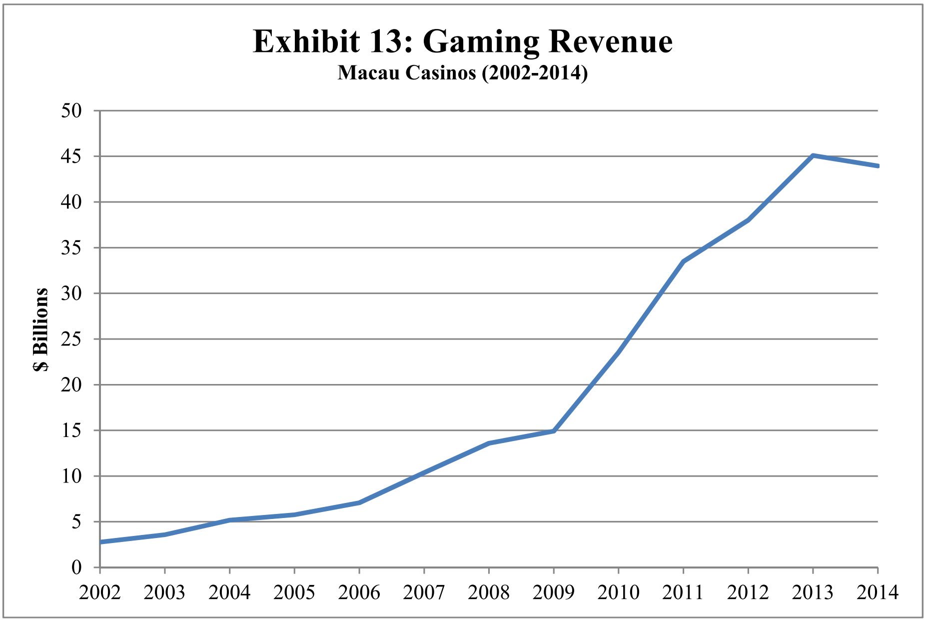

Exhibit 13 Source: University of Las Vegas Center for Gaming Research, "Macau Gaming Summary." Retrieved from http://gaming.unlv.edu/abstract/macau.html

By granting only two licenses, Singapore tried to ensure that licensees would enjoy quasimonopolies in a very large gaming market. The Singapore government sought to use the above-average ROIC and profits generated from this lucrative quasimonopoly "as an engine for strengthening Singapore as a long-distance tourist destination, not a day-trip or locals' casino market."[10]

Singapore imposed a two-tiered gaming privilege tax rate: 5% of gross gaming revenue (GGR) derived from premium players, and 15% of gross gaming revenue derived from other players.[11] The purpose of this tax rate was two-fold: to create an incentive for licensees to market to high-income premium players; and, since the combined or effective tax rate is about 12%, to create a consumer price advantage for Singapore casinos with respect to casinos in Macau, where the effective gaming privilege tax rate is nearly 40%.[12]

[10] William R. Eadington and Eugene Martin Christiansen, (2009). Tourist destination resorts, market structure, and tax environments for casino industries: An examination of the global experience of casino resort development. In *Integrated Resort Casinos Implications for Economic Growth and Social Impacts*. Reno: University of Nevada Institute for the Study of Gambling and Commercial Gaming.

[11] Singapore Casino Control Act, supra note 13, at Part IX, § 146(2).

[12] Guihai Huang, Ph.D., Macau Polytechnic Institute, (2010). Casino Taxation in Macau, Singapore and Las Vegas. In 8th European Conference on Gambling Studies and Policy Issue, September 15, 2010. Retrieved from http://www.easg.org/media/file/vienna2010/presentations/Wednesday/1330/P5/1_Guihai_Huang.pdf.

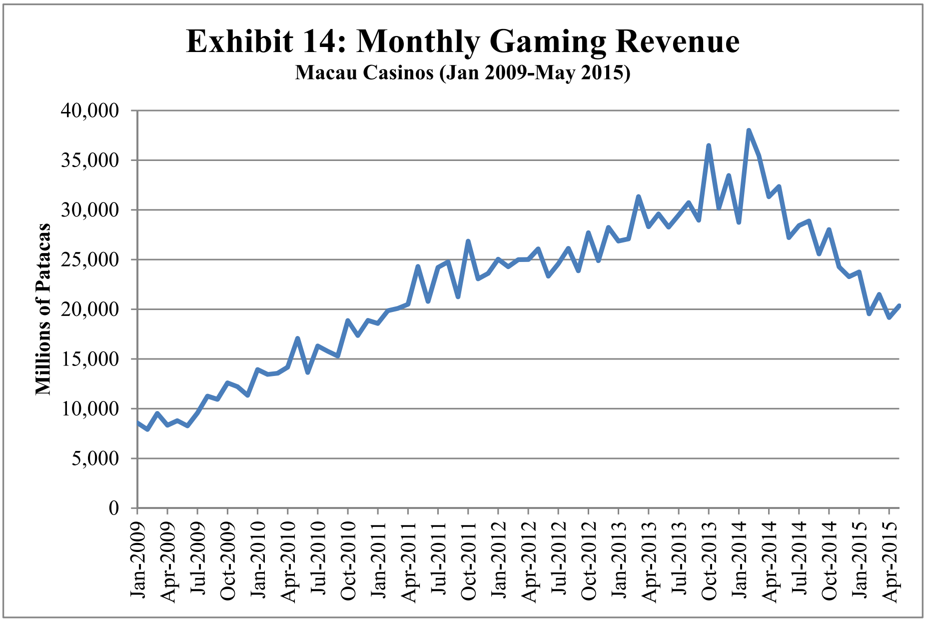

Exhibit 14 Source: Gaming Inspection and Coordination Bureau Macao SAR, "Monthly Gross Revenue from Games of Fortune." Retrieved from http://www.dicj.gov.mo/web/en/information/DadosEstat_mensal/index.html

> While as general rule casinos that operate in quasi-monopoly market conditions can afford to pay high rates of gaming privilege tax, Singapore was willing to forego a portion of fiscal benefits of casino gaming (i.e., gaming privilege tax receipts) in the interests of creating long-term economic benefits in the form of long-distance tourism. Singapore's two integrated casino resorts represent a combined capital investment of approximately $7.1 billion (exclusive of land acquisition and other costs, which when added to the sunk costs of the two resort properties raise the two licensees' aggregate investment to more than $10 billion).

Importantly, item no. 10 of the Request for Proposals (RFP) issued by the government of Singapore, "commencement requirements," allows the successful bidder to apply for a casino license only when at least half of the committed investment has actually been expended and, moreover, requires the successful bidder to expend 100% of its committed investment by three years after the casino license is issued. In other words, Singapore discouraged temporary casinos and stipulated that the successful bidder had to expend 100% of the capital investment promised when the bid was submitted.

Both of Singapore's IRs opened in 2010. To date (2015), both have proven highly successful. Exhibit 16 presents quarterly gaming revenue for Singapore 1st quarter 2010 through 4th quarter 2014. Gaming revenue increased rapidly from $221 million in 1st quarter 2010 (when Resorts World Sentosa began operations) to $1.2 billion in 1st quarter 2012, fluctuating thereafter in a seasonal pattern, with 3rd and 4th quarter gaming revenue generally coming in below 1st and 2nd quarter gaming revenue.

Exhibit 15 Notable capital investments in Macau since 2007

Casino	Opening date	Cost to open ($)
Venetian Macau	Aug. 28, 2007	2,400,000,000
MGM Grand	Dec. 18, 2007	1,250,000,000
Plaza Casino at Four Seasons	Aug. 11, 2008	905,000,000
City of Dreams	June 1, 2009	2,100,000,000
Galaxy Macau Phase 1	May 15, 2011	1,900,000,000
Sands Cotai Central	Apr. 11, 2012	4,400,000,000
Galaxy Macau Phase 2 & Broadway at Galaxy Macau	May 27, 2015	5,500,000,000
Studio City Macau	In 2015	3,200,000,000
Louis XIII	In 2016	1,100,000,000
Parisian Macau	In 2016	2,700,000,000
Wynn Palace	In 2016	4,100,000,000
Lisboa Palace	In 2017	3,900,000,000
Total		*33,455,000,000*

Source (s): 1. Keith Bradsher, "For Macao, gambling is no guarantee for the future," *The New York Times*, August 27, 2007. Retrieved from http://www.nytimes.com/2007/08/27/business/worldbusiness/27iht-macao.4.7274826.html. 2. PR Newswire, "MGM Grand Macau Announces Grand Opening Celebration," November 12, 2007. Retrieved from http://www.prnewswire.com/news-releases/mgm-grand-macau-announces-grand-opening-celebration-59836987.html. 3. "Strong Start," *Inside Asian Gaming*, March 15, 2010. Retrieved from http://www.asgam.com/cover-stories/item/243-strong-start.html. 4. Frederik Balfour, "City of Dreams: Macao's $2.1 Billion Gamble," *Businessweek,* June 1, 2009. Retrieved from http://www.businessweek.com/globalbiz/content/jun2009/gb2009061_330707.htm. 5. Kelvin Wong, "Galaxy Opens $1.9 Billion Macau Casino after 2-Year Delay," *Bloomberg,* May 15, 2011. Retrieved from http://www.bloomberg.com/news/articles/2011-05-15/galaxy-opens-1-9-billion-casino-in-macau-after-delay-of-almost-two-years. 6. Muhammad Cohen, "Sands Bets Big Again in Macau," *Asia Times*, April 13, 2012. Retrieved from http://www.atimes.com/atimes/China_Business/ND13Cb01.html. 7. Macau Government Tourist Office, "Galaxy Phase II and Broadway Macau Now Open." Retrieved from http://mtt.macautourism.gov.mo/201506/en/contents/4/173.html. 8. GlobeNewswire, "Macau's First Megaclub: Pacha Macau at Studio City," April 28, 2015. Retrieved from http://globenewswire.com/news-release/2015/04/28/729062/10131053/en/Macau-s-First-Megaclub-Pacha-Macau-at-Studio-City.html. 9. Macau Business, "Louis XIII Casino-Hotel Due to Open Mid-2016," November 24, 2014. Retrieved from http://www.macaubusiness.com/news/louis-xiii-casino-hotel-due-to-open-mid-2016.html. 10. Sands China, "Development Projects." Retrieved from http://www.sandschina.com/development-projects.html. 11. Wynn Resorts, "The Resort." Retrieved from http://www.wynnpalace.com/en/resort.html. 12. GGRAsia, "Lisboa Palace ready by 4Q 2017: SJM," February 9, 2015. Retrieved from http://www.ggrasia.com/lisboa-palace-ready-by-4q-2017-sjm/

IRs Are Inherently Risky Investments

Singapore's success makes its IR approach to casino gaming look easy. It is not. Large, capital-intensive casino resorts are perhaps the most complex leisure products ever brought to market. Successful investments, even investments as risky as The Mirage or as large as Singapore's two IRs, should not mislead Japan into thinking that investment size is a guarantee of success.

Exhibit 17 summarizes notable U.S. casino defaults, bankruptcies, and failures following the 2007 credit crisis and the ensuing recession. It shows that large capital investment does not ensure the success of an IR. The risk of failure is real and cannot be eliminated by throwing money at it. Exhibit 17 also shows that investor track record matters. The principal investments in the Cosmopolitan, Fontainebleau Las Vegas, and Revel Atlantic City were made by real

Summary of Key RFP Specifications for the Integrated Resort on Sentosa Island

Key specification	Description
1. Achieving a large-scale iconic development	The integrated resort (IR) on Sentosa is envisaged to be an iconic large-scale development and a "must-visit" attraction for tourists to the region. It shall be a world-class tropical IR that offers the whole family a fun and memorable leisure experience. It shall also play a major role in Singapore's overall tourism strategy that will broaden Singapore's tourism and entertainment options, complement existing tourist attractions, as well as catalyze new tourism investments.
2. Site parameters	• The site area is approximately 49 ha with a maximum gross floor area of 343,000 m^2. The land tenure is for 60 years. • The design and layout of the IR should reflect and respect the local context of the site, specifically its tropical island nature with its lush natural greenery and marine/coastal frontage. This translates to low-rise structures along the waterfront, open spaces, extensive landscaping, preservation of selected trees, and attractive shade structures. Also, the IR shall provide good physical connectivity and integration with the rest of Sentosa.
3. Public facilities	• A visitor arrival center, public promenades along the waterfront, and adequate car parking facilities will be required. The Sentosa Express (to be completed by end 2006) will also provide direct public access to the IR. • Examples of key attractions include thematic attractions, theater shows, edutainment facilities and programs, and shows/performances with international appeal. Given the local equatorial climate, special consideration should be given to the design and planning of the key attractions to enhance the visitors' experience at the IR. An additional 60,000 m^2 of gross floor area for shelters that are only used for weather protection purposes over outdoor attractions and their circulation spaces, outdoor queuing areas and landscaped areas will be allowed. However, no commercial activity will be allowed within these spaces.
4. Casino concession and casino license	The IR operator will have the concession to operate a casino for 30 years. Apart from this concession, the IR operator has to apply to the Casino Regulatory Authority for a Casino License to operate the casino. During the 10 years from the date of the signing of the Sentosa Agreement, only two casino licenses will be issued—one for the IR on Sentosa and the other for the IR at Marina Bay.
5. Law and order requirements	The IR operator must comply with the regulator's requirements and standards in areas such as surveillance systems, security personnel, and anti–money laundering program.
6. Restrictions on gaming area and machines	• The maximum gaming area allowed is 15,000 m^2. • The maximum number of gaming machines allowed is 2,500.
7. Social safeguards	The IR operator must comply with the following: • Prohibit entry to the casino for those below 21 years. • Collection of a casino entry levy of \$100 per day or \$2,000 per year for Singapore residents. • Provision of self and third-party exclusion schemes. • Display on information on problem gambling, help services, rules of games, and odds of winning. • Restrictions on advertising of casino and casino gambling. • Restrictions on extension of gaming credit to Singapore residents, with the exception of premium players. • No automatic teller machines (ATMs) allowed within the casino. • Provision of a system to allow loss limits to be set voluntarily.

Continued.

Key specification	Description
8. Casino tax	• The IR operator shall pay a casino tax of: § 15% on monthly gross gaming revenue from regular players § 5% on monthly gross gaming revenue from premium players. • The government is committed not to raise this casino tax for at least 15 years. • The prevailing Goods and Services Tax will also be applicable to gross gaming revenue.
9. Cross shareholding restrictions	The controlling shareholder of one IR will not be permitted to hold an interest or a management contract for operating the casino in the other IR. The controlling shareholder is defined as the entity that owns the largest direct and indirect interest of at least 20% of the voting shares in the successful proposer.
10. Commencement requirements	The IR operator can apply for the casino license only when at least half of the proposed gross floor area has been completed, at least half of the committed investment has been expended, and at least half of the proposed development area (land area) has been completed. The IR operator is required to expend 100% of its committed development investment 3 years after the casino license has been issued.
11. Evaluation criteria	The evaluation criteria are: • Tourism appeal and contribution (45%) • Architectural, design, and concept excellence (25%) • Level of development investment committed (20%) • Strength of consortium and partners (10%) Weights indicated are approximate.

Source: Singapore Tourism Board

estate developers, hoteliers, and banks with no experience in successfully constructing and operating casino resorts, let alone casino resorts of this magnitude in highly competitive markets. The Las Vegas Aladdin, which opened at a cost of $1.1 billion across the Strip from Bellagio in August 2000 and entered bankruptcy in September 2001, conforms to this pattern: The project was initiated by a real estate trust with no prior experience in casino gaming.

Two factors contributing to the inherent riskiness of multibillion-dollar casino resort investments deserve examination: the difficulty of assessing the feasibility of such investments, and the highly leveraged capital structures that support many large casino resorts, including the failed casino resorts summarized in Exhibit 17.

Feasibility

The process of assessing the feasibility of casino investments can be divided into analytical subsets: sizing the investment in relation to local market population and personal income for regional casinos deriving most of their GGR from local residents; and sizing the investment in destination casino resorts deriving a substantial portion of their GGR from long-distance travelers.

Regional casino markets can be modeled using concepts that William J. Reilly developed in 1931 (Reilly, 1931). Arguing by analogy to Newton's law of gravitation, Reilly proposed that a similar formula could be used to calculate the point at which customers will be drawn to one or another of two competing centers. Applied to the

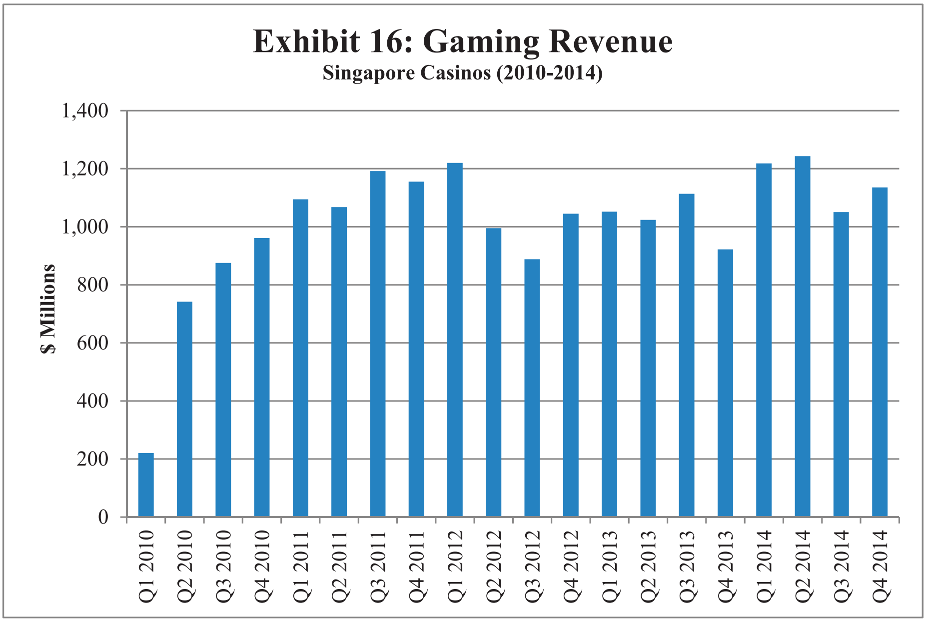

Exhibit 16 Note: Resorts World Sentosa opened in January 2010. Marina Bay Sands opened in April 2010. Source: Susan Sutton, "Singapore Gross Gaming Revenue Analysis," *Casino News Daily*. Retrieved from http://www.casinonewsdaily.com/2015/05/26/singapore-gross-gaming-revenue-analysis/

analysis of regional casino markets, such "gravity models" have evolved through trial and error in many locations over several decades into reliable predictors of regional casino performance. Expertly applied, the output of professionally constructed gravity models yields accurate estimates of the GGR that a proposed regional casino will generate; if the estimated GGR is plugged into pro forma financial statements for the proposed regional casino, its feasibility can be assessed with a high degree of confidence. No excuses exist for a failed regional casino capital investment today.

Assessing the market demand for a destination casino deriving most of its GGR from long-distance travelers is another matter. Destination casino resorts are "full-service entertainment destination casino properties that offer gaming among a range of tourist attractions," (Eadington & Christensen, 2009). Gravity modeling of the kind used to size regional casino markets is applicable only to the extent the proposed destination casino will attract spending from locally resident consumers. Estimating the long-distance component of the demand for a proposed destination casino resort is a more complex problem. Variables including the quality of the resort facility, its fit with target consumer expectations, the size and composition of the proposed destination resort's player database, the quality and effectiveness of its marketing program, management, and human resources, and competition from competing destination resorts around the world have to be factored into the analysis. Although a great deal is known today about destination resort investments, assessing their feasibility remains to a considerable extent as much art as science. The inherent uncertainty in expert assessments of destination casino resort feasibility leaves a significant margin for error, as recent failures of destination casino resorts in Atlantic City and Las Vegas illustrate (Exhibit 17).

The intrinsic riskiness of capital-intensive casino resort investments is offset by their demonstrated ability to yield above-average returns. As a product category, large cap destination resorts include some of the most successful investments in any sector of the leisure economy. The Mirage, a highly risky investment in a largely unproven diversified entertainment-themed destination resort, confounded its many sceptics by proving an immediate and overwhelming success, generating more than enough cash flow to service its highly leveraged capital structure and setting investor expectations for capital-intensive destination gaming resorts that remain indelible today.

These considerations raise an important question: How can the intrinsic risk in investing in destination casino resorts be minimized?

The Mirage provided part of the answer to this question: The destination casino must be diversified. Gaming is too narrow a franchise and too specialized a consumer offering for comfort when committing capital to casino projects on the scale of the successful properties along the Las Vegas Strip or in Singapore—or the failed investments summarized in Exhibit 17. To hedge the inherent risk of building capital-intensive destination resorts, the property should offer consumers more than the table and machine games that have been the gaming industry's staple offerings for generations.

Investments in diversified leisure must be made in the initial growth phase of gaming market development—the phase of opportunity. A common factor in Atlantic City and Macau is that they did not diversify their leisure offerings during the phase of opportunity in the development of these markets. Once these markets did try to diversify, it was too late. Investment in costly diversified leisure after gaming markets mature is futile.

The Atlantic City experience provides a particularly good illustration of this crucial fact. As noted, New Jersey was the second state in the United States to legalize casino gaming, enacting gaming law after voters approved a state constitutional amendment authorizing casinos in Atlantic City in 1976.[13] For more than a decade, Atlantic City enjoyed a monopoly on casino gaming in the eastern United States. The first Atlantic City casino (Resorts International) opened in 1978, in a gigantic market (the eastern seaboard of the United States) that was grossly undersupplied. The imbalance between supply and demand created fantastic business conditions for Atlantic City's first casinos, with people standing in line for hours waiting for a place at gaming tables or slot machines. The early Atlantic City casinos were highly profitable, and, even though they rested on highly leveraged capital structures (i.e., much debt and little equity), they generated enough free cash (EBITDA) to service the expensive debt that was used to build them.

Capital Structure

The Atlantic City casino industry's highly leveraged capital structure had two consequences.

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[13] New Jersey Constitution, Article IV, Section II, Paragraph 2(d). The legislature created the Casino Control Act in 1977. New Jersey Statutes Annotated 5:12-1 et seq. (P.L. 1977, chapter 110).

Exhibit 17 Notable casino defaults following the 2007 credit crisis

Entity	Event
Herbst Gaming	March 22, 2009—Herbst files for bankruptcy. Slot machine and casino operations are placed in separate holding companies. May 23, 2011—Emerges from bankruptcy in December 2010. Name changed to Affinity Gaming LLC.
The Cosmopolitan	January 2008—Developer 3700 Associates defaults on $760 million loan for the $3.5 billion casino resort project. Deutsche Bank forecloses and opens the resort on December 15, 2010. In May 2014, the Cosmopolitan is sold by Deutsche Bank to Blackstone Group for $1.73 billion.
Fontainebleau Resort Las Vegas	June 9, 2008—Fontainebleau Las Vegas LLC and two affiliates halt construction of the $2.9 billion resort-casino project and file for Chapter 11 bankruptcy. January 27, 2010—Carl Icahn wins auction to control Fontainebleau Las Vegas with a bid of $150 million. Icahn has not restarted construction.
Echelon Place	August 1, 2008—Boyd Gaming halts construction of $4.8 billion hotel, casino, shopping, and convention complex. In March 2013, Boyd sells the project to Genting for $350 million.
Tropicana Resort & Casino	April 2008—Tropicana Entertainment, the parent company, defaults on $1.3 billion credit line used to purchase casino in 2006. May 2008—Tropicana Entertainment files for bankruptcy protection. May 5, 2009 – Tropicana Entertainment emerges from bankruptcy.
Station Casinos	July 28, 2009—Station Casinos Inc., taken private by Fertitta family, and Colony Capital LLC, on November 7, 2007, in $5.4 billion leveraged buyout, files for Chapter 11 bankruptcy. June 2011—Station Casinos exits bankruptcy.
Revel Atlantic City	April 2, 2012—Revel Atlantic City opens. March 26, 2013—Revel files for Chapter 11 bankruptcy. June 19, 2014—Revel files for bankruptcy once again. As of June 2015, the property remained shuttered.

Source(s): 1. Caroline Bleakley, "Affinity Gaming Drops Herbst Name in 'Fresh Start'," *Las Vegas Review-Journal*, May 23, 2011. Retrieved from http://www.8newsnow.com/story/14698876/affinity-gaming-drops-herbst-name-in-fresh-start. 2. Reuters, "UPDATE 1-Herbst Gaming files for Chapter 11 protection," March 22, 2009. Retrieved from http://www.reuters.com/article/2009/03/22/herbst-bankruptcy-idUSN2254367720090322. 3. Reuters, "Deutsche Bank still seeks partners for Vegas resort," August 7, 2008. Retrieved from http://www.reuters.com/article/2008/08/07/cosmopolitan-lasvegas-idUSN0736042720080807. 4. Jennifer Robinson, "Analysts' projections sour," *Las Vegas Review-Journal*, August 2, 2008. Retrieved from http://www.lvrj.com/news/26204219.html. 5. Steve Green, "Fontainebleau developer files for bankruptcy; more jobs cut," *The Las Vegas Sun*, June 9, 2009. Retrieved from http://www.lasvegassun.com/news/2009/jun/09/fontainebleau-developer-files-bankruptcy/. 6. Arnold M. Knightly, "Icahn wins auction to buy Fontainebleau for $150 million," *The Las Vegas Review-Journal*, January 27, 2010. Retrieved from http://www.lvrj.com/news/breaking_news/Icahn-82795542.html. 7. Jonathan Keehner and Bradley Keoun "Defaults in Las Vegas turn investment banks into decorators," *The New York Times*, June 23, 2008. Retrieved from http://www.nytimes.com/2008/06/23/business/worldbusiness/23iht-deutsche.4.13924936.html. 8. Arnold M. Knightly, "Company emphasizes need to restructure debt; casino operations unaffected," *Las Vegas Review-Journal*, July 28, 2009. Retrieved from http://www.lvrj.com/business/51922932.html. 9. Julie Triedman, "After Two Rocky Years, Station Casinos Exits Bankruptcy," *The Am Law Daily*, June 20, 2011. Retrieved from http://amlawdaily.typepad.com/amlawdaily/2011/06/stationcasinosexit.html. 10. Wayne Perry, "'Upscale' Revel N.J. Casino files bankruptcy," *USA Today*, March 26, 2013. Retrieved from http://www.usatoday.com/story/money/business/2013/03/26/revel-casino-bankruptcy/2020377/. 11. Tom Corrigan, "Atlantic City's Revel Casino Files for Bankruptcy Again," *Wall Street Journal*, June 19, 2014. Retrieved from http://www.wsj.com/articles/atlantic-citys-revel-casino-files-for-bankruptcy-again-1403212625

First and most importantly for the Atlantic City casino industry's future, substantially all of the cash Atlantic City casinos generated in the market's growth phase was used to service debt, or it was returned upstream to parent companies that were themselves highly leveraged. Consequently, insufficient cash remained to refresh the casino hotels. Heavily used public buildings, airports, popular hotel resorts, and similar facilities must be periodically refreshed with new capital spending if they are not to become shabby and obsolete and fall below consumer expectations for the experience they provide. For casinos, which provide discretionary leisure experiences, the need for constant capital refreshment is acute: A rule of thumb is that heavily used casinos require capital refreshment equal to the cost to open the property every 7 years. If this is not done, a casino resort will be superseded in the consumer's eye by newer, more elaborate casinos or new leisure offerings of other kinds. This is true, of course, of other kinds of commercial entertainment: For example, silent movies were made obsolete by the introduction of sound circa 1929, forcing movie industries into ruinous capital spending on costly new sound production and exhibition technologies, a brutal process that bankrupted producers and exhibitors and lowered overall movie industry profitability for years.

Second, the Atlantic City casino industry's leveraged capital structure made it vulnerable to changes in financial markets. A previous paper by Christiansen and Hua (2014) observes:

> The construction of Atlantic City's casinos in the late 1970s and 1980s was largely financed with debt, including high yield ("junk") bonds. Drexel Burnham Lambert Inc., which pioneered the use of this form of debt, was a prominent source of this financing: Between 1978 and 1987 Drexel raised $851.2 million for the Atlantic City casino industry.[14] The resulting industry capital structure was highly leveraged. A substantial portion of the cash generated by Atlantic City casino operations was consequently needed to service the industry's debt. Drexel's worsening problems with Federal authorities and the unexpected collapse of the junk bond market in 1989 precipitated a financial crisis in the Atlantic City casino industry. Suddenly, the debt in the industry's capital structure could not be re-financed, destabilizing the industry's financial foundation.
>
> This change in the industry's financial environment coincided with an unanticipated maturing of the Atlantic City gaming market. Atlantic City gaming's early years had been characterized by rapid growth. From 1978 through 1985, Atlantic City casinos' average growth rate (in gross gaming revenue) was 55.07%. In 1985, however, year-over-year growth in Atlantic City gross gaming revenue dropped below 10%; in 1989 the year-over-year percentage growth in this crucial indicator fell to 2.64%.[15] The conjunction of constricted credit and falling demand resulted in a wave of casino restructurings and bankruptcies. To its embarrassment New

[14] Rick Gladstone, (1987). Drexel required to obtain license by New Jersey Gambling Authority. *Associated Press*, August 14, 1987.

[15] UNLV Center for Gaming Research, (2013). Atlantic City Gaming Revenue 1978–2012. March 2013. Retrieved from http://gaming.unlv.edu/reports/ac_hist.pdf. State of New Jersey Casino Control Commission, Historical Statistics, 1978–2004. Retrieved from http://www.nj.gov/casinos/financia/histori/docs/casino_facility_stats_1981_to_2004_years.pdf.

> Jersey's gaming regulatory agency, the New Jersey Casino Control Commission, discovered that it did not have a definition of casino financial stability to rely on in dealing with this crisis. In 1991 the Commission engaged consultants to supply it with a definition of financial stability.[16]

The Atlantic City casino industry remained essentially unchanged through the 1990s and 2000s. Only one new resort, Borgata (opened July 2003), was built during this long period prior to the disastrous opening of the $2.3 billion Revel (April–May 2012). The inevitable consequence was that when neighboring States legalized casino gaming and ended Atlantic City's regional monopoly, Atlantic City's aging, unrefreshed casino hotels were vulnerable to competition from newer casinos closer to population centers. The tipping point for Atlantic City was the legalization of slot machines (and subsequently house-banked table games) in Pennsylvania in 2004. Pennsylvania awarded its first six gaming licenses in 2006, and these new properties quickly impacted Atlantic City. The onset of the global fiscal crisis in mid-2007 and the ensuing severe recession, which greatly reduced consumer spending on gaming, accelerated the contraction of Atlantic City GGR, which collapsed from a peak of $5.2 billion in 2006 to less than $2.9 billion last year and continues to fall (Exhibit 10). Atlantic City's problems were thrown into relief by the catastrophic history of Revel, a misconceived design, which, after a troubled development process, finally opened, at a cost of approximately $2.4 billion, in April/May 2012 and closed following bankruptcy in September 2014, an experience summarized in Exhibit 17 along with other notable casino credit defaults (Schwartz & Christiansen, 2012).

A Model Casino Law for Japan

The casino law that Japan adopts will largely determine whether the IR industry Japan hopes to create will succeed or fail. The prospective Japanese market already faces challenges. Macau's casinos may have already satisfied a substantial portion of the demand for gaming in Pacific Asia. Moreover, casinos will spread throughout the Pacific region, just as they have spread throughout the United States. Inevitably, the spread of casinos will further impair the market economics for Japanese casinos.

An opportunity for Japan does, however, exist to attract tourists by entering the Pacific Asian market for IRs, which has not reached its mature phase. As noted, Macau did not emulate Las Vegas and use the opportunity (or growth) phase of its gaming market's evolution to diversify its leisure offerings. As a result, Macau may find itself in Atlantic City's predicament: dependent on the narrow consumer offering of baccarat and other casino games in a world where consumers increasingly allocate their leisure time to nongambling activities on mobile phones, tablets, and interactive social media. Regardless of decisions made in Japan, Pacific Asia's leisure economy will diversify, offering leisure consumers more and better things to do with their leisure time and budgets. This desire for new entertainment products may be to Japan's advantage, provided Japan does not make poor decisions in the process of enacting casino law.

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[16] Codified at New Jersey Casino Control Act and Commission Regulations, Chapter 43, Subchapter 4. Financial Stability of Casino Licensees and Applicants. Retrieved from http://www.nj.gov/casinos/actreg/reg/docs_chapter43/c43s04.pdf.

The Singapore, Las Vegas, and Atlantic City casino industry experiences presented here suggest parameters for a Japanese casino law that would ensure the long-term success of Japanese IRs. Just because Las Vegas is a success, Singapore is an initial success, and Atlantic City is a failure, Japanese policymakers should not rush to adopt a Las Vegas or Singapore model or any other "model," however. Every time a government has "adopted" another government's "model," the resulting casino law has been a failure at some level, although the failure has often been initially masked by undersupplied market conditions.

Four types of failure are common: knowledge failure, instrument failure, implementation failure, and motivation failure.

1. Knowledge failure occurs when the government has insufficient knowledge (a) to identify what gaming regulation and control are attempting to accomplish and (b) to design appropriate laws or regulations or identify noncompliance.
2. Instrument failure occurs when the laws or regulations (the instruments) are inappropriate or unsophisticated.
3. Implementation failure occurs when enforcement mechanisms fail to accomplish policy goals.
4. Motivation failure occurs when regulators are insufficiently motivated to enforce the law because of inaction, corruption, or the allocation by government of insufficient resources. Because factors outside of legislative enactment are primarily the cause of motivation failure, the topic is not addressed in this article.

Given these hazards, what is a reasoned approach for government to undertake?

1. Government needs to study the gambling industry and, if it decides to permit it, to understand its benefits and problems. Government needs to be as smart as the industry it intends to legalize (i.e., it needs to avoid information and knowledge failure).
2. Government needs to define policy goals that are appropriate to what it hopes to accomplish through regulation (i.e., it needs to avoid instrument failure).
3. Government needs to design regulations and regulatory systems that are both sophisticated and consistent with its unique expertise, structure, and capabilities (i.e., it needs to avoid implementation failure).
4. Government must have the expertise, training, and motivation to regulate properly (i.e., it needs to avoid motivation failure and regulatory capture).

With so many opportunities to fail, most governments do fail on some level, even if an enormously profitable industry masks regulatory deficiencies.

Avoiding Knowledge Failure: Knowledge Building

Knowledge building creates the components of the gaming regulatory regime. It is the cornerstone of effective gaming regulation. Sadly, however, this component is often missing. All too frequently, those who make and implement gaming regulatory policy have little or no background in the gaming industry. As California Gaming Commissioner Richard Schuetz has observed, "Inexperience possesses the risk of imposing a regulator-ignorance tax on the industry." Commissioner Schuetz (2014) went on to explain:

> One would anticipate these ignorance taxes to be highest with new agencies when the regulatory actors are at the beginning of the learning curve. They possess little

> understanding of the industry they are regulating, and they carry with them a strong desire not to be wrong and appear to be important. This posits a perfect scenario for over-regulation. When Atlantic City allowed legal casino gaming, the industry was subjected to incredibly strong regulatory controls; controls that damage the industry substantially through additional costs and lost revenues. Such examples include the requirements that: casinos close daily in Atlantic City, as a measure to protect the players from becoming captured within the gambling moment, and that casinos were staffed full-time with regulatory agents always accessible to the public. The regulations also established limits on reel strips, established denomination mix requirements, and even specified the machine mix requirements by manufacturing source. The point is, the Atlantic City experience was offering a dramatically more rigorous regulatory environment than was existent in Nevada and this is attributable to the lack of experience held by the initial regulators, and a strong desire to avoid the risk or making a mistake. In other words, it was heavily influenced by ignorance and fear. The evolution of the New Jersey experience in the years since opening has been a movement away from these, and other rigorous regulations, and towards a much more business friendly regulatory environment (pp. 132–133).

Avoiding Instrument Failure

A starting point in avoiding instrument failure is a carefully constructed statement of the public policy that Japan is attempting to accomplish by authorizing IRs. Public policy should guide Japan's implementation and regulatory decision making. A critically important factor to effective regulation is clear communication of Japan's public policy regarding gaming. Without a clear statement of public policy, Japan's intention in legalizing IRs to achieve specific economic goals, such as stimulating tourism, may be subsumed by legislative self-interest, or a regulator's undefined preferences, or the gaming industry's ability to persuade regulators that their interests should prevail over the intent of the Japanese government. Experience has shown that this is a difficult task.

Statement of Public Policy

A clear public policy is one reason why Nevada was successful and New Jersey was not. The overwhelming policy goal in Nevada was to use gaming as an economic engine to drive employment, construction, and tourism. To accomplish this policy, Nevada adopted a different economic approach to casinos than, for example, Singapore. As noted, Nevada retained a very low gaming tax rate (a maximum of 6.75% of GGR) and imposed modest government-imposed barriers to entry, meaning the capture of economic rents by limiting competition was not its major focus. The statement of public policy in Nevada recognizes that the state is most interested in preserving the economic contribution of casinos to Nevada's economy. The first policy statement is clear and simple: "The gaming industry is vitally important to the economy of the state and the general welfare of the inhabitants."[17] All laws, regulations, and their implementation and interpretation should recognize this goal.

Economics is not Nevada's only public policy concern, however. Partly for historical reasons, integrity was and remains of paramount importance. Between 1931 and 1978,

[17] NRS 463.0129(1)(a).

Nevada was the only state with legal casino gaming. In the late 1950s, Nevada made Herculean efforts to keep criminals out of its gaming industry. It feared that the federal government would outlaw casino gaming if organized crime used Nevada-based operations to finance, or conceal profits from, other illegal activities. Once the threat of direct federal intervention receded, grounds for excluding unsuitable persons were broadened in the interests of helping the industry's development by enlarging the player base and improving access to financial markets. Increased regulation helped create the perception that criminals were not involved in casino operations and that the games were honest. Keeping the criminal element out also helped the government ensure proper accounting for tax revenues. As Nevada learned through this experience, the gaming industry faces eradication if the public perceives the industry as dishonest or associated with organized crime. As a capital-intensive growth industry, gaming needs the support of capital markets, such as banks and stock exchanges. Access to these markets is often contingent on favorable perceptions of the gaming industry by these institutions.

The public policy of Nevada is brutally honest as to its goals. The second policy statement includes this language: "The continued growth and success of gaming is dependent upon public confidence and trust that licensed gaming and the manufacture, sale and distribution of gaming devices and associated equipment are conducted honestly and competitively… and that gaming is free from criminal and corruptive elements."[18] While subtle, this policy statement focuses on public confidence and trust as opposed to assuring the honesty of the games for strict player protection purposes. The Nevada experience has shown that the best way to assure that the public perceives the games to be honest is through effective gaming regulation and control.

Failure to establish clear and internally consistent public policy from the outset can lead to the adoption of ineffective gaming laws and regulations that lead to larger failure. For example, New Jersey wanted gaming to revitalize Atlantic City by increasing tourism, stimulating construction, providing new jobs, and generating additional tax revenues (Cohen, 1982). Had this been the only policy goal, casino gaming might have had a different history in New Jersey. At the time of legalization, however, an additional set of policy considerations was adopted. New Jersey decided that government had a duty to protect players from exploitation by preventing casinos from stimulating demand. In this respect, New Jersey was attempting to emulate the 1968 Gaming Act of Great Britain, which prohibited the stimulation of demand. The British act considered the social impacts of legalizing gambling to be more important than its positive economic contribution to Britain's tourist industry. The act's three major goals were to diminish the presence of organized crime in the gambling industry; limit the profits of operators; and provide a controlled environment to satisfy unstimulated demand for gambling. Pursuant to these policies, the act included draconian provisions prohibiting credit and entertainment and required players to notify casinos (which had the legal status of membership clubs) that they would be gambling at least 48 hours ahead of time.[19]

The conflicting policy goals of New Jersey's Casino Control Act reflect a fundamental ambivalence regarding casinos. On the one hand, New Jersey was uneasy and even hostile to the casino industry; on the other, it hoped that casinos would revitalize Atlantic City's

[18] NRS 463.0129(1)(b).

[19] For a concise summary of the British Gaming Act, see Commission on the Review of the National Policy toward Gambling (1976). *Gambling in America*, 100–101.

vanished tourist business while minimizing the social costs of gaming—and be strictly controlled. Casinos were not an end but a means to fulfill worthwhile goals (Ranson, 1992). Unfortunately for New Jersey, its casino law tried to serve conflicting public policies: protecting patrons from an industry that the government regarded as essentially predatory while trying to encourage investment and employment in that industry. New Jersey gaming regulators served two masters. What emerged through the political process was a compromise on virtually every aspect of casino operations.

The New Jersey Casino Control Act was replete with conflicting provisions. For example, instead of either allowing credit or not allowing it, government allowed unlimited credit but required casinos to deposit the instrument promptly. This frustrated player protection goals because players could play on credit, and it frustrated economic goals because the credit terms in Atlantic City were less favorable to the patrons than their competition in other jurisdictions, with the result that Atlantic City casinos steadily lost business to casinos operating under less restrictive credit policies.

Whether or not to allow patrons to play on credit is a good example of a policy decision legislators must address in enacting casino law. A substantial experience base of various casino credit policies exists today. Jurisdictions contemplating gaming legalization can study this experience. They can also study the diverse practices and programs in place in gaming jurisdictions around the world designed to ameliorate the social costs of compulsive gambling. This experience provides lawmakers with empirical support for casino credit and compulsive gambling policies of proven effectiveness. Through careful study of experience in other jurisdictions, lawmakers can compare the costs of allowing casino credit with the benefits, or they can consider whether other alternatives can create a more optimum cost/benefit ratio. As New Jersey discovered, choosing the wrong alternative can be a factor in whether the industry is a success or failure.

The public policy questions that casinos raise do not have simple *right* and *wrong* answers. Devising an optimum Japanese casino law is not as simple as mimicking Nevada, or Singapore, or Macau. Unlike Nevada, Japan intends to start with capital-intense IRs, and it does not intend to allow casinos in every urban environment, as Nevada does. Singapore's experience with gaming is in its early stages, and consequently its regulatory system has not been fully tested. New Jersey's experience shows that initial economic success created by large unmet demand and lack of competition may mask ineffective or contrary regulatory policies. Macau is trying to deal with similar issues now.

Primary public policy goals for Japan should reflect the economic reasons for authorizing IRs. Primary public policy goals include:

1. Diversified IRs should promote tourism and convention visitors.
2. IRs shall be limited in both number and geographic location.
3. Gaming privilege tax rates and other levies, if any, shall be maintained at levels designed to encourage maximum capital investment and periodic refreshment reinvestment.
4. While casinos are permitted as an amenity to an IR, operators must build and maintain an IR designed and operated to generate tourism and convention visitors.
5. There shall be no temporary casinos. Capital investment promised when bids are submitted must be expended in total within 3 years, or licenses will be revoked.
6. Licenses shall be granted only to companies that have demonstrated fiscal probity and financial capability and stability.

7. Licenses shall be granted only to applicants demonstrating superior experience in the design, construction, and operation of successful world-class IRs.

Several additional goals that have a secondary impact on achieving the economic goals should be considered. Secondary goals include:

1. The success of IRs is dependent upon public confidence and trust that licensed gaming and the manufacture, sale, and distribution of gaming devices and associated equipment are conducted honestly and that gaming is free from criminal and corruptive elements.
2. Alternative forms of gambling tables and devices that compete with IRs should be clearly unlawful, and the prohibitions should be strictly enforced.
3. Player protection should be an important policy goal for Japan.

Secondary policies need to be carefully considered. As the New Jersey experience shows, when casino law tries to accomplish multiple purposes, and no one policy has priority, both policies tend to fail.

Player Protection

Player protection is a common theme in the legislative debate regarding casinos and IRs, but it is not typically accomplished successfully, despite being a stated objective in casino laws. For example, the Pennsylvania General Assembly provided this guidance when establishing its policy goals: "[t]he primary objective of this part to which all other objectives and purposes are secondary is to protect the public through the regulation and policing of all activities involving gaming and practices that continue to be unlawful."[20] Pennsylvania makes apparent that its leading goal is protecting players and the community, but in direct contradiction to this purpose, Pennsylvania taxes gaming at 55% for gross slot machine revenue and 16% for table game gross revenue. Pennsylvania collected gaming tax receipts of $1.456 billion in 2011 (Daniels, 2012). It also created regional monopolies/oligopolies for licensees. Where exactly does Pennsylvania think these revenues come from? Would a government, as an example, permit only two stores to sell televisions and then issue an RFP to award these exclusive rights? If it did, what would a retailer pay to have monopoly rights to sell televisions in, say, Philadelphia, and what effect would that monopoly have on the price of televisions? Pennsylvania does essentially this with gambling. It pursues this policy not for reasons of player protection but because it is able to reap the economic rents that come from granting regional monopolies by charging extremely high tax rates. Pennsylvania public policy, as implemented, is not and never was based on protecting the public, but rather it exploits the public through the Commonwealth's monopoly powers to permit gambling, access an enormous tax, and grant exclusive franchises.

Another more nuanced approach applies different goals to distinct behavior. This occurs where government wants the benefits of casino gambling but feels that gambling may have negative consequences for certain classes of its citizens. If, for example, Pennsylvania acknowledged that costs of problem gambling were unacceptably high for a small segment of players, it could declare that the major purpose of legalized gambling is to create tax revenues but with a narrow exception to protect a vulnerable subset of the population. Ohio adopted this approach in its casino law.

[20] 4 Pa. Cons. Stat. § 1102.

The process of formulating public policy in problematic areas has been generalized in theories that attempt to quantify the costs and benefits of various problematic activities, such as granting credit, advertising, or alcohol consumption. Lawmakers can look for the least burdensome alternatives when the costs associated with the creation of externalities exceed the benefits. If alternatives are available that produce greater benefits than costs, lawmakers can choose one that maximizes the cost/benefit ratio. If none exists, then the activity can be prohibited.

This can be stated as a policy goal as follows:

> Protections designed to protect vulnerable players from the impacts of problem gambling should consider where fact-based evidence shows that the benefits of such protections exceed their financial impacts and less burdensome alternatives are not available.

Avoiding Implementation and Motivation Failure

After adopting clear public policies, government should design regulations and regulatory systems to avoid implementation failure. These laws and regulations need to be sophisticated, given the unique expertise, structure, and capabilities of the particular government. Below are some areas the Japanese government should consider in implementing public policies best suited for a successful IR industry.

Considerations for Selecting an Applicant

Choosing an owner/operator for an IR with a regional monopoly is far more important than granting a license in a competitive environment such as Las Vegas, where the number of licenses is not limited. In jurisdictions where the number of licenses is not limited, if an owner fails to complete a project, a casino fails, or government revokes a license, the economic impact is less severe than these events would be in a regional monopoly. Las Vegas has experienced all of these scenarios with minor impacts. If the only IR in Tokyo, as an example, failed or had its license revoked, it could be a devastating blow to tourism and employment. Consequently, the selection of the right owner, operator, and project is critical. The following should be considered:

1. Temporary licenses. Government should avoid issuing temporary licenses. What is built during the growth phase of the Japanese gaming market is likely to be permanent. Japan should emulate Singapore and require fully completed IRs.
2. Minimum criteria for the IR. The Singapore model versus the Las Vegas model: Nevada adopted a laissez-faire approach to creating destination IRs: It granted unrestricted gaming licenses and left decisions as to what to build up to private-sector license holders. Singapore adopted a statist approach to the same question by stipulating in considerable detail the size and kind of casino resort facility that a licensee is required to build. A statist approach, however, does not mean that the ideal Singapore IR is the same as the ideal Japanese IR. An IR means a resort with a variety of amenities, including shopping, hotels, restaurants, entertainment, health and fitness, conventions, and casino gaming. What the government should require for each of the defined aspects of the IR will depend on what it hopes to accomplish by granting a license, as well as the needs of the surrounding community. For example, if government wants to promote

conventions and has inadequate local convention facilities, it may emphasize that aspect in the RFP. If the community has significant local tourist attractions, it may be less interested in iconic amenities such as art museums, aquariums, or gardens in the IR. Regardless of the optimal mix of amenities, the RFP and the law should specify the minimum requirements or ratios between each amenity.

3. Financial stability. The failed IR investments summarized in Exhibit 17 demonstrate that financial stability is, potentially, a Japanese regulatory concern. Different gaming jurisdictions address financial stability differently. Nevada does/does not regulate in this area; New Jersey does. This is an issue for Japanese lawmakers to consider; there may be no clear right-and-wrong answer. Financial considerations in accessing an applicant may include:
   (a) a history of stable financial background;
   (b) demonstrated financial ability to financially ensure the design, construction, and operation of the IR;
   (c) commitment to secure completion bonds on the construction of the IR; and
   (d) demonstrated business ability and ability to operate an IR and experience in regional and global marketing and promotion of tourism related to IRs.
4. Background suitability. If a jurisdiction awards a regional monopoly to an owner or operator who is later determined to have background issues, the impact on the success of the IR industry can be substantial. For example, if the owner is found to be a shell for hidden interests associated with organized crime, government would be confronted with a host of very difficult decisions. If it closed the casino, there could be devastating consequences for employees and vendors, local communities, and the tourist industry. If government took over the casino operations, it would be in the difficult position of operating an asset that it has limited experience with, and moreover it would create a conflict of interest between being a regulator and the regulated. Comprehensive background investigation based on established criteria is critical *before* awarding a franchise to a bidder. To illustrate this point, California's Gambling Control Act addresses an applicant's qualifications in these terms:

> No gambling license shall be issued unless, based on all of the information and documentation submitted, the Commission is satisfied the applicant is a person:
>
> (a) of good character, honesty, and integrity;
> (b) whose prior activities, criminal record, reputation, habits, and associations do not pose a threat to the public interest of this state, or to the effective regulation and control of controlled gambling, or create or enhance the dangers of unsuitable, unfair, or illegal practices, methods, and activities in the conduct of controlled gambling or in the carrying on of the business and financial arrangements incidental thereto;
> (c) that is in all other respects qualified to be licensed as provided in this chapter.[21]

These stringent qualifications are not unique to California, but they are standard across most jurisdictions that offer regulated gaming.[22]

[21] Cal. Bus. & Prof. § 19857.

[22] See NRS 463.170; N.J Stat. Ann. § 5:12–86.

Requirement for Reinvestment

A requirement for reinvestment is necessary to maintain the competitiveness of the gaming product over time. IRs, like other heavily used public facilities, must be periodically refreshed with capital spending if they are not to become shabby, worn-out buildings that fail to meet consumer expectations for the leisure experiences they offer. Japanese lawmakers should bear in mind that IRs differ from heavily used public facilities like hotels or airports in that their patronage is optional: People have to use airports and hotels, but they do not have to patronize resorts unless they choose to allocate leisure time and discretionary income to this activity. Consumer expectations for leisure entertainment inexorably rise. IRs or theme parks that were cutting edge 10 years ago are *passé* today; IRs or theme parks that are cutting edge today will be *passé* 10 years from now; and so on. It follows that refreshment capital spending is distinct from, and much greater than, simple maintenance capital spending. Without specific statutory reinvestment criteria, the casino operator may be inclined to use profits from the IR for other corporate purposes, such as to pay debt or operating expenses for other projects, or to invest in other markets with a perceived higher ROI. A rule of thumb is that capital spending equal to the cost to build and open a globally competitive IR must be applied to the property every 7 years if it is to keep abreast of consumer expectations.

For example, New Jersey established a standard for reinvestment that is based on a percentage of net revenue. It provides:

> The ability to make necessary capital and maintenance expenditures in a timely manner which are adequate to ensure maintenance of a superior, first-class facility of exceptional quality pursuant to subsection i of section 83 of P.L.1977, c.110 (C.5:12–83). A casino licensee or applicant shall be presumed to have met this standard if it demonstrates that its capital and maintenance expenditures, over the five-year period which includes the three most recent calendar years and the upcoming two calendar years, average at least five percent of net revenue per annum, except that any casino licensee or applicant which has been in operation for less than three years shall be required to otherwise establish compliance with this standard.

This standard, however, may result in inadequate capital expenditures where the financial performance of the property is poor. Japan should consider a minimum required amount based on the overall cost of the project or a percent of revenue, whichever is greater.

Tax Structure

Deciding the optimal tax structure for a jurisdiction is difficult. IRs are capital-intensive, and a Japanese casino law intended to foster investment in these costly properties must recognize this. Rates of gaming privilege tax should be set with this consideration in mind.

Three major considerations support a low tax environment with a single (monopoly) casino or limited number of casinos (oligopoly).

The first reason is that a low tax rate should maximize capital investment in a limited number of resort/casinos.[23] Casino franchises are typically awarded through a RFP similar

[23] This failed to happen in Atlantic City, where the failure of gaming license holders to refresh properties with major capital spending is a serious problem. As noted above, the Atlantic City casino industry's highly leveraged capital structure, with debt service obligations that absorbed much of the free cash flow generated by Atlantic City casinos, was an important cause of the industry's failure to make the necessary refreshment capital spending.

to a bidding process. A potential casino operator will adjust its bid based on the defined governmental tax rate, as it will directly impact profits. A low tax rate will encourage the largest bids in terms of committed investment for monopoly protection. This may help to realize a government goal to create an iconic destination or promote convention or tourism. This consideration dictates a low rate of gaming privilege tax. Nevada, which in Las Vegas has the world's most enduringly successful gaming resort destination, has the lowest rate of gaming privilege tax of any major gaming jurisdiction: 6.75% of GGR (win) and other taxes that result in a combined tax burden of about 7.75%.

The second major reason is that the casino games offered by IRs in Japan must be priced competitively with the casino games offered in competing jurisdictions: Macau, South Korea, Singapore, and Las Vegas. As previously noted, in jurisdictions that permit operators to set the consumer price of the games they offer, high gaming taxes may be passed onto patrons in the form of either worse odds, higher table limits, or "harder" slot machines.[24] These are direct pricing considerations that patrons take into account when choosing destinations.

The third major reason is that government's fiscal interests, which may be best served by higher rates of gaming privilege tax, must be balanced with the ongoing capital reinvestment requirements discussed earlier.[25]

In balancing fiscal and economic needs, legislators should try to ensure that the tax rate is fair to government. By granting a regional monopoly or oligopoly, government is granting the rights to collect economic rents above competitive market levels to the IR owner/operator. The expectation is that these economic rents will be applied to higher investment in the IR facilities: increased capital expenditures over the life of the project, and more competitive behavior versus competing operators in other jurisdictions. If, however, government grossly underestimates the market demand, along with the lack of competition, and sets a low tax rate, the result can be similar to Singapore, where the owner/operators achieved windfall profits despite massive investments in the projects themselves.

Stable Tax Rate

The tax rate is an important factor in determining investment. Changing tax rates after the market is established presents problems. Suppose you have a competitive industry that reached an equilibrium based on a tax rate of 10%. If you then raise the tax rate to 20%, the industry almost certainly needs to raise prices to stay profitable, which reduces demand. Lower demand results in an oversupply and the closure of some suppliers. Colorado provides an example of this sequence of events when Colorado raised its gaming taxes to 20% of GGR. This raised the variable costs for the casinos, making it unprofitable for many

[24] Raising the consumer price of casino games, or other forms of gambling such as lotteries, may be impossible for statutory reasons: In some jurisdictions, operators may be able to raise or lower the consumer price of the games they offer; in others, operators may be prohibited by law or regulation from passing gaming privilege taxes on to players through increasing the consumer price of gambling. Law governing the consumer price of gambling is specific to both the jurisdiction and the game (i.e., slot machines, house-banked table games, and so forth), and varies considerably.

[25] The relationship of gaming privilege tax rates and casino investment requirements, sometimes formulated as government fiscal vs. economic policy, is reviewed in Eugene Martin Christiansen, *The Impacts of Gaming Taxation in the United States*, American Gaming Association White Paper. Retrieved from http://www.americangaming.org/sites/default/files/uploads/docs/whitepapers/the_impacts_of_gaming_taxation.pdf.

casinos to operate, and this resulted in multiple closures. Besides a stable tax environment, the bidders for the IR franchises will look for stability in other areas.

Creating a Stable Environment

The best environment for potential bidders for a competitively restricted IR is to have certainty regarding all major variables that could impact the calculation of the maximum investment available to assure a fair ROI. Much of this is dependent on clear legislation and stable economic environment.

License Duration

Government should clearly establish the license term and put into place adequate protections that, absent revocation for cause, the legislature will not change the law that makes gambling at IRs legal without just compensation.

Geographic Franchise Rights

If Japan limits the number of gaming licenses, the selection of sites or locations is an important, albeit probably politically charged, issue. Maryland, New York, and Massachusetts offer recent examples of how these three jurisdictions went about the process of deciding where a limited number of gaming licenses would be located. Japanese lawmakers should consider this recent experience in the context of Japanese governmental institutions and Japanese society. Once established, the locations should be set for the duration of the casino license.

Clear Intentions Regarding Competing Gambling Products

Prospective casino owners and operators must make economic decisions regarding the extent of their investment in an IR based on many variables, competition being among the most important. These decisions require investigation not only of other IR competitors in the same and other markets, but also potential substitute products in the same market. Some potential problems are easily rectified. For example, laws regarding illegal casinos are already in place, and operators need only the assurance that they will be enforced. Less tractable issues are posed by permitted products. In Japan, the most obvious example is the pachinko/pachislo industry. Pachislo is machine gaming that will directly compete with the IR's slot machine offerings. To remove uncertainty regarding this competing machine game, government needs to be clear as to its intentions regarding the pachinko/pachislo industry. This could be to (a) statutorily recognize it, (b) statutorily recognize it but cap the number of devices and locations, or (c) clearly make the industry illegal. What form this decision takes will impact the value of the bids for the IRs.

Less important from an economic impact are other gambling products that are less competitive to the casino offering. Nevertheless, certainty as to the legality of Japan's important parimutuel horseracing industry (Japan Racing Association) and the Japan Lottery, and smaller parimutuel sports, such as bicycle racing, should be a component of the new casino law.

Stable Operational Rules That Impact Gaming Revenue Potential

Certainty in key operational areas is necessary for prospective owners to determine capital investment. Moreover, these are important considerations in determining whether the IR product can successfully compete in regional gaming markets. Issues include:

1. Admittance policy. Simply, can locals play? Will entrance fees be charged for residents or nonresidents?
2. Hours of operation. Will the casino be able to operate 24 hours a day or have restricted hours of operation?
3. Credit. Can credit be extended? What are credit policies regarding amounts, types, enforcement restrictions? Will credit be legally enforceable in Japanese courts?
4. Junket policies. Can the casino use junket representatives or independent very important person (VIP) room operators to drive players? If so, what are the operational/licensing restrictions on such junket representatives or operators? How can they be compensated? Can junket representatives be compensated based on play loss?
5. Alcohol policy. Can alcohol be served on the casino floor? Can the casino operators provide the alcohol on a complementary basis?
6. Advertising restrictions. Will there be any restrictions on advertising, signage, billboards, or local versus nonlocal restrictions?
7. Entertainment policies. Is entertainment allowed? Are there any restrictions? Are any other businesses excluded on the premises of the resort?

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