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Mississippi Gaming Taxes

Why the existing regulatory environment works.

Published April 15, 2011

This summary paper was completed by Gulf Coast Business Council Research Foundation. The goal of this research is to assist Mississippi's lawmakers and policy shapers who are tasked with assessing the implications of raising taxes on Mississippi's commercial casinos. This study provides a brief overview of how gaming impacts Mississippi, compares and contrasts the regulatory environments of other states that have commercial casino gaming, and explores the potential consquences of increasing gaming taxes in Mississippi. When appropriate, information sources were cited, but the Gulf Coast Business Council Research Foundation conducted the analysis independently. For questions about this paper, please contact the President of the Gulf Coast Business Council, Jack Norris, or the Director of Policy & Research, Scott King, at (228) 897-2020. This paper is available for download in its entirety at www.msgcbc.org.

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Why the Existing Regulatory Environment Works

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Executive Summary

The Mississippi Gaming Control Act of 1990 legalized gaming in Mississippi, and in 1992 the first commercial casinos opened in the state. By 2005, the state of Mississippi represented the third largest gaming market in the United States, behind only Nevada and New Jersey. The recession has taken its toll on Mississippi's gaming industry, as it has virtually every non-emerging market in the nation. Mississippi has also been impacted by increased competition in the southeastern United States. Over the last three years, Mississippi's 30 commercial casinos have experienced revenue declines of more than $300 million, and as a result gaming tax collections in Mississippi are down by over $60 million. As of 2011, Mississippi is now the nation's fifth largest market for commercial gaming, as both Indiana and Pennsylvania have surpassed Mississippi's annual revenue generation.

In 2012 and in future years, lawmakers in Mississippi's House and Senate will likely be asked to consider an increase in the state's existing 12% gaming tax. The Gulf Coast Business Council Research Foundation began researching this matter in late 2010, and after a comprehensive research effort, presents the following findings:

- Many proponents for a gaming tax increase compare Mississippi's annual tax receipts to those of other states with significantly higher tax rates, **but the states with higher tax rates are ALL states that employ "limited license" regulatory environments which effectively grant casino operators monopolies within the states or greatly limit competition within the states**. When comparing Mississippi to states with "unlimited license provisions", Mississippi's existing tax rate is HIGHER than the aggregate effective tax rate of 9.0%.
- Casinos that operate in states with restricted licenses have a substantially higher "revenue per square foot" of gaming space than Mississippi does. As a result, individual operators earn a higher rate of return per dollar invested and can absorb the higher tax rates.
- There is a direct correlation between accessible regional population and the ability for a casino in an unlimited license state to pay high taxes. Regional populations (in markets with significantly higher tax rates than Mississippi) are two to three times higher than the regional population surrounding Mississippi. Louisiana is a limited license state. Higher populations translate into higher demand, and when supply is restricted (it is not in Mississippi), higher tax rates are feasible.
- There is an inverse correlation between tax rates and jobs. The higher the tax rate, the lower the capital investment, and job creation is limited. Mississippi's gaming industry has created substantially more jobs than states with higher tax rates. Additionally, casinos which operate in states with limited licenses typically create fewer "non-gaming" jobs than those located in states with unlimited gaming.

- Mississippi's gaming industry cannot sustain even a 1% tax increase. In addition to the potential for over 1,000 jobs that will be lost as a result of increasing the existing 12% tax rate to 13%, Mississippi's recovery from the recession will be thwarted, and chances of new capital investment will be diminished.
- With new competition increasing in surrounding states such as Arkansas, Florida, and Alabama, Mississippi will need to offer more destination resort-style amenities that can attract customers from these and other nearby states.
- Short term revenue streams are not worth more than long-term jobs. A tax increase on the gaming industry is a short term approach that may yield short-term revenue streams, but will have a negative impact on revenue streams in the mid-term while inhibiting future development.
- Since the first casinos in Mississippi opened, Mississippi has outpaced the national ten-year-growth rate in per capita income for 16 out of 17 years. Leading up to 1992, Mississippi trailed the national average for nine consecutive years.
- Leading up to 2005, legalized gaming had created 28,736 direct gaming jobs and the state's non-gaming tourism industry grew by over 66%, or 24,964 jobs.
- The annual direct tax (state and local) impact of gaming in Mississippi is roughly $500 million.
- Studies, including one published by the University of Southern Mississippi in 2004, demonstrate that the introduction of gaming in Missisisppi has grown sales tax bases within communities where investments have been made, and the state's overall sales tax base has also grown.

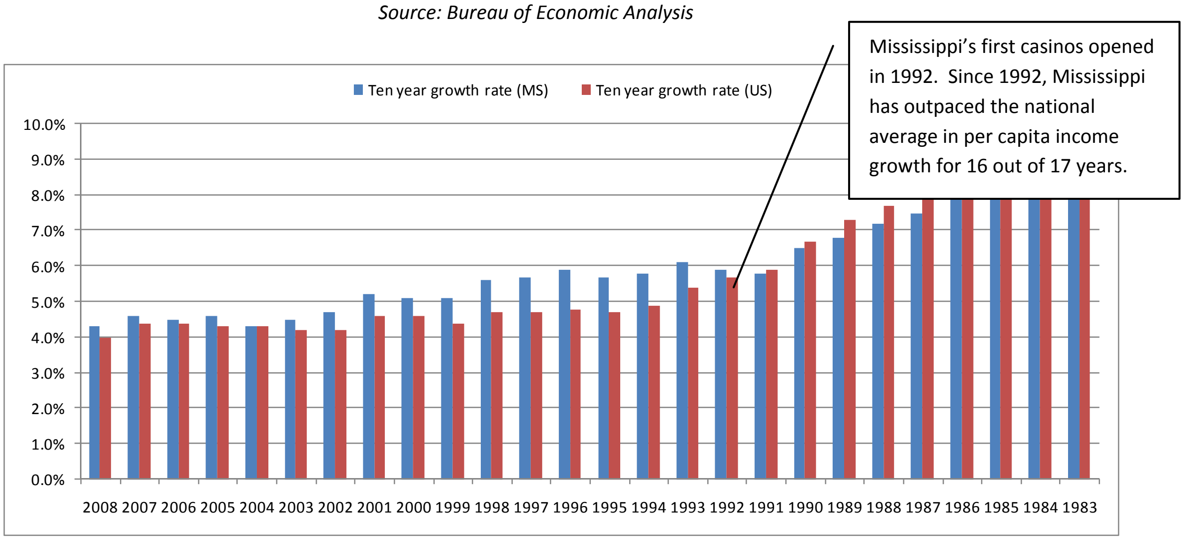
Purpose of the Study

Despite the widely held belief that Mississippi's current 12% gaming tax rate has been a critical component of the long-term, sustainable success of the state's gaming industry, it is not uncommon for some legislators, policy-shapers, and other interest-groups to periodically suggest increasing the state's gaming tax rate in order to fund new initiatives or to offset budget deficits. While the likelihood of any tax increase passing both the House and the Senate and being signed by Governor Haley Barbour is said to be doubtful in 2011, it is important that the impacts of raising gaming taxes in Mississippi be investigated. To help the reader better understand any implications of raising taxes on Mississippi's commercial casinos, this effort will provide a brief overview of how gaming already impacts the state, compare and contrast the regulatory environments of selected other states that have commercial casino gaming, and explore the potential consquences of increasing gaming taxes.

Part 1: Mississippi's Commercial Gaming Industry Has Historically Benefited the State.

Leading up to the passage of the Mississippi Gaming Control Act of 1990, Mississippi's overall economy was relatively stagnant. The impacts of legalized commercial gaming were immediately realized. From a jobs standpoint, the 12,000 new jobs that were created by the legalization of gaming in Mississippi contributed to Mississippi's lowest unemployment levels reported in 22 years[1]. The initial impacts of gaming contributed to growth of the state's surplus by over $300 million, with the direct gaming taxes and fees accounting for over a third of that amount[2].

Chart 1: Historic ten-year-growth rates in per capita income: Mississippi vs. U.S. Average
Source: Bureau of Economic Analysis



When compared to the United State's average of ten year growth rates in per-capita-income, the overall state had trailed the national average for nine straight years. Since the first commercial casino opened its doors in 1992, Mississippi has outpaced the national average in per capita income growth for 16 out of the last 17 years. The impacts have been even greater where casinos where built, as growth in per-capita-income in Harrison and Tunica counties outpaced the state average significantly between 1990 and 2008.

Eighteen years later, in fiscal year (FY) 2010, Mississippi's gaming industry accounted for 34% of Mississippi's 78,485 direct travel and tourism jobs[3]. Perhaps even more impressive, the state's total tourism payroll in FY 2010 was $1.66 billion; the state's commercial casinos accounted for roughly 44% of all Mississippi Travel and Tourism payrolls.

Chart 2: FY 2010 Travel and Tourism Jobs
Source: Mississippi Development Authority

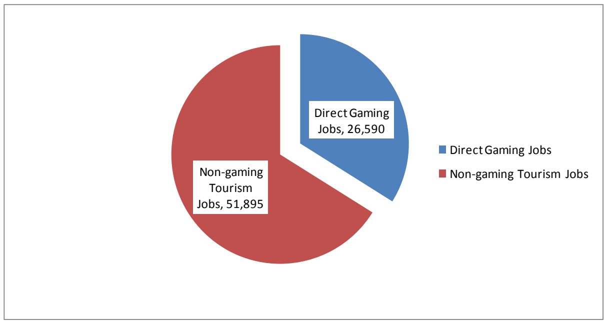
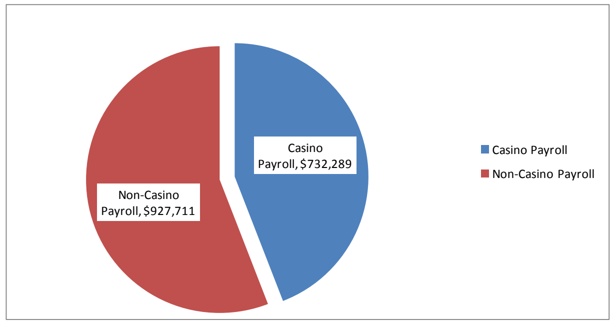


Chart 3: FY 2010 Travel and Tourism Payrolls ($000)
Source: Mississippi Development Authority



The information communicated in the above charts is even more compelling when considering the fact that the employment multiplier for tourism in Mississippi is 1.41[4]. In other words, the 78,485 direct travel and tourism jobs in Mississippi in FY 2010 created or induced an additional 32,130 job, while the casinos in the state created 10,901 jobs. Later in this paper one of the topics for discussion will be: **will increasing the taxes (and subsequently lowering profit margins) on an industry that is responsible for nearly 40,000 jobs in Mississippi have negative long-term impacts?**

Commercial gaming's impact to Mississippi goes well beyond job creation. While historic direct contributions to the state (via gaming taxes) have typically ranged from $275 million to $350 million over the last eight years, it's very important to note that the overall positive impacts to the state have been closer to $500 million. A 2004 University of Southern Mississippi impact study and a 2009 State of the State Annual report published by the Mississippi Casino Operators Association underscore this in the table below.

Table 1: Recent Economic Impacts of Gaming in Mississippi
Source: University of Southern Mississippi and the Mississippi Casino Operators Association

	University of Southern Mississippi 2004	MCOA Annual Report 2009
Direct Gaming Taxes & Fees	$327,817,463	$312,123,981
Sales Taxes	$48,766,565	$46,431,982
Tidelands Lease & Levee Fees	$9,237,155	$9,237,155
ABC Taxes	$693,911	$660,692
Personal Income Tax	$41,928,052	$37,934,860
Hotel Taxes	$4,449,430	$4,236,424
Property Taxes	$68,690,411	$78,993,973
Total Economic Impact	$501,582,987	$489,619,066

Not reflected in Table 1 is the impact that gaming has had on the state's overall travel and tourism industry. In 1990, the state reported 38,000 travel and tourism jobs; prior to Hurricane Katrina and the recession, the number of travel and tourism jobs in Mississippi was 91,700 jobs. Based on the fact that in 2005 gaming accounted for 28,736 tourism jobs, it can be implied that non-gaming tourism jobs in the state grew by 66% between 1990 and 2005.

Figure 1: Tourism Job Growth Since 1990

While some might focus on the direct gaming tax impacts on Mississippi's General Fund, it is important to remember that gaming is vital to the state's overall travel and tourism industry. The aggregate tourism industry has a substantial impact on the state's economy, as it ranks 5th overall in private statewide employment and accounts for more than 8% of all general fund receipts[5].

With regards to any arguments that money spent at Mississippi casinos by local residents comes at the expense of businesses in the state where Mississippi residents might alternatively make purchases, consider the following three points.

1) Roughly 70% of visitors who patronized Mississippi's commercial casinos in FY 2010 were from out-of-state[6].
2) In a 2005 study[7] that estimated the effects of casino wagering on state sales tax revenue (utilizing data from 1985 to 2003), it was found that for every dollar of adjusted gross revenue (AGR) in Mississippi, sales taxes increased by $0.09.
3) Samples of sales tax collections in two cities in Mississippi that added a casino (Biloxi and Greenville) demonstrate that the sales tax base grew after the addition of new casinos. The state's overall sales tax collections also expanded.

Chart 4: FY sales tax collections – before and after Beau Rivage
Source: Mississippi Department of Revenue

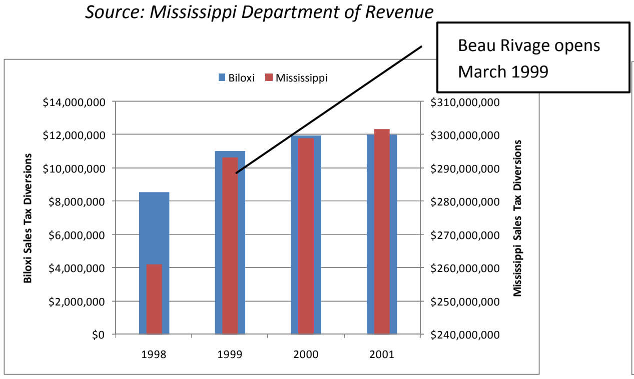
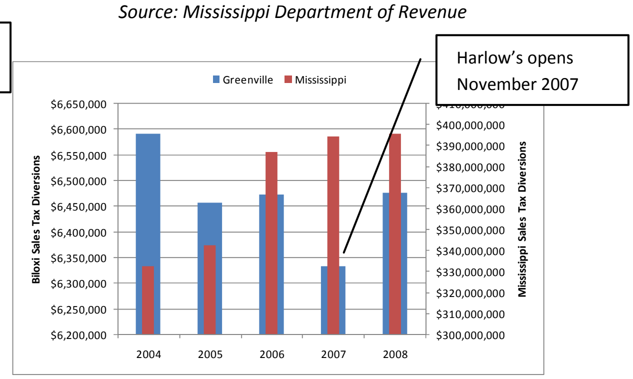


Chart 5: FY sales tax collections – before and after Harlow's Casino
Source: Mississippi Department of Revenue



Notably, it is worth considering that both the Beau Rivage Casino Resort and Harlow's Casino Resort are both examples of casino success stories in the state. These examples are not intended to suggest that opening a casino will guarantee a positive economic impact to the area which it is developed, much in the same as opening a new bank in a city guarantees long-term benefits to that municipality. There is, however, a common denominator to ponder: the success of any business hinges on several factors, such as location, management, quality of product or service, and the regulatory environment in which said business operates. **If gaming taxes are raised in Mississippi, and subsequently gaming operators are forced to cut expenses in order to maintain profitability, will the ability for casinos (existing and new) to continue to have a positive impact in the state be diminished?**

In the following section Mississippi's existing tax structure will be explored and it will be compared and contrasted to tax structures in other states. Among the topics that will be discussed will be why Mississippi's gaming industry has been successful historically and why historic progress may never have been made without the favorable tax environment that Mississippi originally employed.

Part 2: Comparing and Contrasting Mississippi to Other States with Gaming.

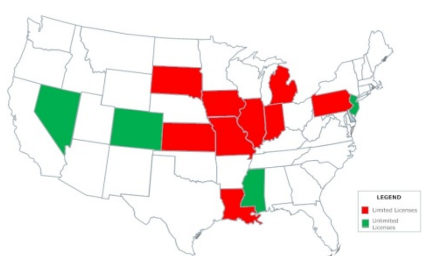
Conventional wisdom leads many to compare Mississippi's gaming tax rate with rates in other states that offer commercial gaming, but in most cases doing so at first glance is like comparing apples to oranges. There are two principal considerations to make when comparing Mississippi's gaming regulatory environment to those of other states:

1. Limited vs. unlimited licenses.
2. Invested capital, not high tax rates, creates jobs.

<u>*Limited vs. Unlimited Licenses.*</u>

The first step in the process of vetting the limited vs. unlimited debate is to determine which of the 13 states that currently offer commercial gaming restrict the number of casinos and which do not. Operators who obtain a gaming license in states with limited gaming effectively have a guarantee that the supply of competition will be limited. As figure 2 illustrates, **Mississippi is one of only four states (with commercial gaming) that does not restrict the number of casinos that may operate within the state.**

Figure 2: States with Limited and Unlimited Licensing



"Mississippi's tax rate is higher than the average effective tax rate amongst the states which have unlimited license regulatory environments."

Table 2: Tax Rates of Unlimited License States
Source: John C. Stennis Institute of Government

State	Effective Tax Rate	2009 Gaming Tax Collections	2009 GGR
Mississippi	12.0%	**$296,340,000**	**$2,465,000,000**
New Jersey	8.8%	$347,620,000	$3,943,000,000
Nevada	8.0%	$831,750,000	$10,393,000,000
*Colorado***	*13.8%*	*$101,530,000*	*$734,590,000*
Totals	8.8%	$1,475,710,000	$16,801,000,000

**Colorado limits gaming in several ways, including maximum wagers, the number of licenses one operator may have, and the requirement to conform to building standards set forth by historical districts where gaming is located. The typical gaming facility in Colorado is much smaller than the typical gaming resort in Mississippi.

As Table 2 demonstrates, **Mississippi's existing 12% gaming tax rate is actually higher than the average effective tax rate for the combined five states (9.0%).** Not included in the list is Iowa, which employs a licensing process that might be considered as a hybrid between unlimited vs. limited (referred to later in this paper as "quasi-limited"), as the Iowa Racing and Gaming Commission often utilizes subjective criteria[8] to limit the new licenses that it will consider at a given time and in the past has issued self-imposed moratoriums on new license issuance while waiting for existing approvals to materialize.

Also worth noting is that when comparing the gaming resort product typical to Mississippi (hotel quality, food and beverage, amenities) to the resort products of limited license states with higher tax rates, it is clear that Mississippi offers a significant premium. **States (with unlimited licenses) with the lowest tax rates also have the highest gaming revenues; the ability for an industry to hire a workforce is ultimately dictated by earnings potential.**

While it is clear that Mississippi's gaming tax rate is adequate when comparing it to other states with unlimited licenses, one might still ponder why some states with limited gaming have been able to levy taxes on their casino operators at such high levels. There are many approaches to analyzing why states with limited licenses are able to impose higher tax rates on their casinos, but it all boils down to supply and demand. If supply is restricted then demand will ultimately drive price up. Casinos become profitable when people spend more time on table games and at slot machines. A gaming jurisdiction which has 10,000 slot machines and 20,000 people who want to play them will outperform a gaming jurisdiction which has 20,000 slot machines but only 15,000 who want to play them. Further, an individual casino that operates in a gaming jurisdiction with limited gaming supply will experience higher profit levels because more people will spend more time on that casino's slot machines, whereas a casino in a jurisdiction with unlimited supply must compete with other casinos for its share of limited demand. Table 3 provides an excellent example of how states with limited licenses have (in many cases) significantly higher adjusted gross revenue dollars per square feet of gaming space. **Central to the limited vs. unlimited argument is the fact that casinos that build in limited license states typically earn a significantly higher return on every construction dollar invested (before gaming taxes are factored in) than Mississippi does.** Therefore, casinos which operate in limited supply states can afford to pay a much higher gaming tax rate than those that operate in markets which do not regulate supply.

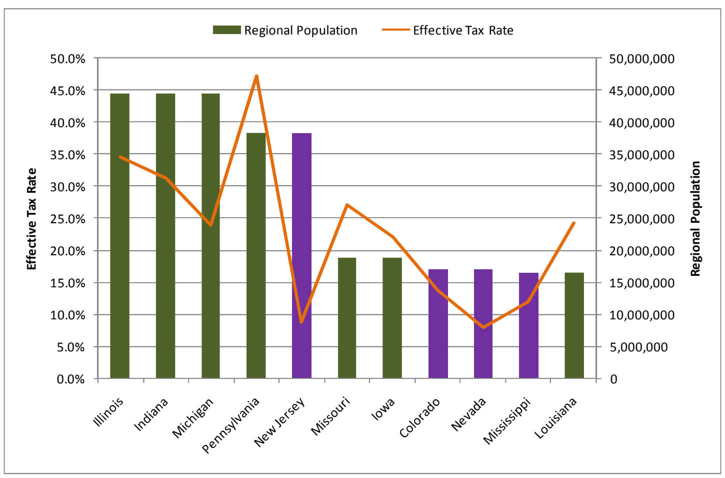
Table 3: AGR per square foot of gaming space
Source of AGR and Gaming sq. ft.: Louisiana Gaming Control Board, 2009-10 Annual Report

State	Operators	Gaming Sq. Ft.	FY 2009 AGR	AGR/Foot	Effective Tax Rate	Licensing
Illinois	9	297,535	$1,474,460,000	$4,956	35%	Limited
Indiana	13	573,492	$2,663,955,493	$4,645	31%	Limited
Louisiana	13	415,000	$1,763,914,052	$4,250	24%	Limited
Iowa	14	402,838	$1,412,817,242	$3,507	22%	Quasi-Limited
Missouri	12	774,800	$1,703,637,656	$2,199	27%	Limited
Mississippi	**30**	**1,353,052**	**$2,584,890,618**	**$1,910**	12%	**Unlimited**

"Central to the limited vs. unlimited argument is the fact that casinos that build in limited license states typically earn a significantly higher return on every construction dollar invested (before gaming taxes are factored in) than Mississippi does. Therefore, casinos which operate in limited supply states can afford to pay a much higher gaming tax rate than those that operate in markets which do not regulate supply."

Though not necessarily directly correlated to either limited or unlimited license states, the overall size of the regional population also plays a role in determining whether a gaming jurisdiction can absorb a high tax on gaming. Accessible population ultimately dictates the overall size of regional demand, which is crucial for virtually every gaming market outside of Las Vegas. When determining optimal tax rates, the amount of supply, whether it be restricted or unlimited, should be compared to regional population before determining a state tax rate. States located in the Mid Atlantic Region, which includes New Jersey, New York, and Pennsylvania, have more than double the regional population than Mississippi does. As evidenced in Chart 6, states that are located in regions which are served by lower population typically have lower tax rates, and states with unlimited gaming licenses also employ lower tax rates.

Chart 6: Regional Population vs. Effective Tax Rates
Source for population: U.S. Census Bureau



Note to chart: states with unlimited licensing are designated by purple shading (population measure).

Underscoring the information presented in the above chart is the fact that Mississippi currently has more casinos than Illinois and Indiana combined, as well as more casinos in operation than New Jersey and Pennsylvania combined. Yet from a population standpoint, Illinois, Indiana, New Jersey, and Pennsylvania have access to a population that is greater than 200% more than Mississippi has access to.

Corruption is also less likely in states with unlimited licenses. States which "auction off" limited licenses are often subject to bribery. States such as Iowa, Illinois and Louisiana, all of which limit licenses, have documented instances where public officials have been offered money in exchange for favorable gaming outcomes. In 2011, eleven people, including elected officials, will stand trial for a bribery scheme in Alabama involving legislation which would have legalized (and limited) gaming in that state.

To sum up the limited vs. unlimited license argument, two statements can be made: 1) casinos located in limited license jurisdictions are willing to pay higher tax rates in exchange for effective monopolies, and; 2) casinos are not willing to pay higher tax rates when the threat of new entrants jeopardizes their survival.

Invested capital, not taxes, creates jobs.

When the Mississippi Gaming Control Act was established in 1990, the individuals who shaped that legislation included a provision that five other states (Illinois, Indiana, Iowa, Louisiana, and Missouri) which legalized gaming between 1990 and 1995 opted not to do: create an unlimited license regulatory environment[9]. Though this paper does not attempt to delve into the thought process of the people who crafted Mississippi's gaming regulatory structure, it is apparent that they made the correct decision.

The current level of capital investment in Mississippi is greater than $5 billion[10], more than double that of Louisiana's Riverboat market. Because Mississippi does not restrict casino licenses, the threat of new entrants is ever-present. As a result of this constant risk of new competition, Mississippi's casinos offer high quality hotel rooms, food & beverage choices, and other amenities at prices that are very competitive. In a recent *Golfweek* publication, Mississippi has 7 casino golf courses that rank amongst the top 50 in all of America. The only state with more casino golf courses in the top 50 is Nevada (the lowest gaming tax rate in the nation), which has eight. In states with limited gaming licenses, casino operators are not as motivated to reinvest in their facilities because there are no new entrants threatening to compete with them.

As mentioned earlier in this report, Mississippi's overall travel and tourism industry has also grown. In FY 2010 over 19.5 million people visited, or traveled in, Mississippi, with the out-of-state segment spending on average $1,610 for every man, woman, and child living in Mississippi, or 87% of the estimated $5.5 billion[11]. The presence of a competitive casino product has motivated non-gaming tourism operators to increase the quality of their offerings, resulting in an overall improved tourism product since 1992 that can compete with better known tourism destinations.

In 2005, an American Gaming Association white paper found that gaming industries in Nevada, New Jersey, and Mississippi supported over 266,000 jobs, or 76.2% of U.S. gaming industry employment[12]. In that same report, it was estimated that over $53 billion had been invested in U.S. commercial casinos and racetracks casinos since 1989 – the states with the three lowest tax rates (Nevada, New Jersey, and Mississippi, accounted for 75% of all capital projects between 1989 and 2005. **When lawmakers set gaming tax rates, they effectively decide what type of gaming facility that will be built.**

Because capital investment creates jobs, Mississippi's lawmakers need to ask themselves whether short term revenue streams are worth more than long-term jobs. In Table 4, the relationship between tax rates and casino jobs is inverse. Casinos that operate in states with lower tax rates are able to invest more in their facilities and hire more people.

Table 4: Casino Jobs – 2008 Est.
Source: American Gaming Association

State	Jobs	Effective Tax Rate
Nevada	177,397	8.0%
New Jersey	36,377	8.8%
Mississippi	25,739	12.0%
Louisiana	17,610	24.4%
Indiana	15,857	31.4%
Missouri	10,961	27.1%
Iowa	9,241	22.2%
Pennsylvania	9,126	47.3%
Michigan	8,122	23.9%
Illinois	7,083	34.7%

"Mississippi's lawmakers need to ask themselves whether short term revenue streams are worth more than long-term jobs."

When states employ unlimited license provisions and low tax rates, increased capital investment is more likely to occur. In part because of the threat of new competition, casino operators are motivated to offer non-gaming amenities that will provide them with advantages over their competition. When comparing Mississippi's 30 casinos to Indiana's 13 and analyzing data from 2009, Mississippi typically staffed 16% more people per available gaming position that Indiana did, suggesting that there were more non-gaming staff required to run Mississippi casinos.

Over the last two decades, Mississippi has made tremendous economic progress. Had Mississippi opted to enact gaming legislation with a high tax rate, the gaming industry would have never become what it is today, nor would the state's travel and tourism industry be the state's fifth largest private employer and be responsible for nearly 10% of the state's General Fund. The state has recently been dealt a triple blow via the nation's worst natural disaster in history, the great recession, and the nation's worst man-made disaster on record. Primarily as a result of the recession, Mississippi's FY 2011 tax transfers are projected to be roughly $450 million less than they were in FY 2008, or a 10% decline over a two year period. Raising taxes during a recession is never a good idea, and isolating a specific industry that has seen revenue declines of greater than 15% over the last three years will not have a favorable outcome for either the overall state or the gaming industry.

Part 3: The Consequences of Raising Gaming Taxes in Mississippi.

For the purpose of not duplicating arguments, this section will not go into any great detail concerning the limited vs. unlimited case which has already been presented in this study. Generally speaking, the focus of this section will gravitate towards a central theme: raising gaming taxes in Mississippi is an investment that will have negative returns.

What do casinos do with all of their revenues?

The first order of business should be to clear up any misconceptions that might exist about the cash flows that casinos enjoy. In a March 2004 study published by the University of Southern Mississippi[13], a survey of 25 participating properties found that the average earnings before interest, taxes, depreciation and amortization (EBITDA, or operating income) was roughly 19%. After factoring in depreciation and amortization and paying interest expenses, the remaining cash flows would then be used to pay taxes (USM assumed a 35% tax rate) and debt service. Regarding debt service, it is important to remember that the average capital investment in a Mississippi Casino is greater than $170 million, and assuming that 65% of that amount is financed, paying back the principal alone will cost more than $10 million annually (assuming a ten year term on senior notes). Below is a very rudimentary exercise that demonstrates how a 19% EBITDA margin can still be inadequate in meeting a casino's goal of achieving positive operating cash flows.

Table 5: Example of inadequate cash flows to meet debt service.

Gaming Revenues	$85,000,000
Non-Gaming Revenues	$15,000,000
Total Revenues	$100,000,000
Operating Expenses	$81,000,000
EBITDA	$19,000,000
Interest Expense (10% on debt)	$11,050,000
Taxes	$934,847
Cash Flow	$7,015,153
Debt Service	$11,050,000

Average Capital Investment	$170,000,000
Percent Financed	65%
Annual debt service on 10 yr. note	$11,050,000

In this example the $7 million in cash flows are not enough to meet the debt service.

Perhaps a better way to explain the 19% EBITDA margin is the generally accepted standard that a highly leveraged business should generate a 20% operating income to justify an investment that has a cost of capital that typically exceeds 15%. In other words, if the cost of capital exceeds the actual returns from the investment, then the investment should be avoided. Notably, other industries that typically operate with high EBITDA margins[14] include Broadcasting (17%), Investment Services (26%), Real Estate Operations (22%), Wireless Telecommunications (17%), Household Products (16%) and Marine Transportation (17%).

While the example on the previous page is just a hypothetical one, it shouldn't come as a surprise that in USM's 2004 study it was projected that increasing Mississippi's gaming tax rate to 15% would result in the closure of 6 casinos. As a result of those six closings, 4,683 direct jobs would be lost. Interestingly, gaming revenues reported at Mississippi's commercial casinos in 2010 were down by more than $300 million when compared to the data sets that USM studied, and estimates based off of quarterly reports posted on the Mississippi Gaming Commission website suggest that the average EBITDA margin in Mississippi is likely between 16% and 20%, while aggregate EBITDA is down by more than $150 million.

What is the current state of the Mississippi Gaming Industry?

Leading up to the recession, Mississippi's casinos were already challenged by an influx of competition. Over the last five years, the supply of gaming has increased in the southeastern United States, while overall demand has leveled off or declined. As a result, revenues for Mississippi's 30 casinos are down considerably since 2007, and as demand picks back up Mississippi casinos will have to spend more marketing dollars to stave off out-of-state competition for its visitors. In the figures below, an overview of Mississippi's competition is provided.

Figure 3: Pockets of Competition *(source: MCOA)*

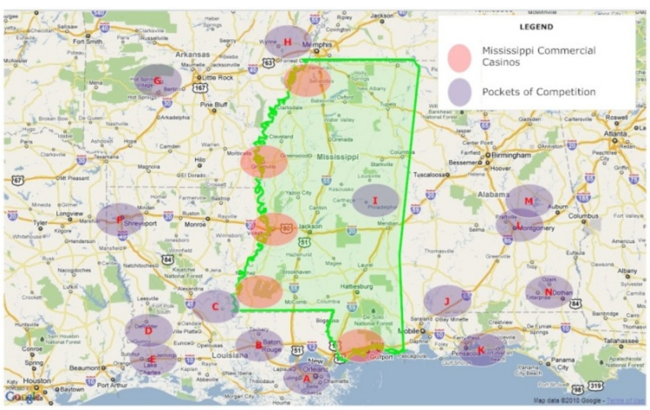
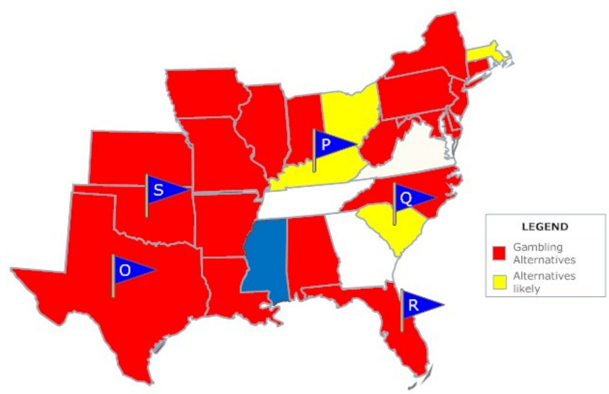


Figure 4: Regional Gambling Alternatives



Index to above figures

A. New Orleans is home to three riverboats, a land based casino, and a racino.
B. Baton Rouge has two commercial casinos and likely one on the way.
C. Marksville is home to a Tribal casino.
D. Kinder is home to a tribal facility.
E. Lake Charles features three commercial casinos and plans are in place for a fourth. Close to Lake Charles one can find racinos in Lafayette and Vinton.
F. Shreveport has five riverboats and a nearby racino in Bossier City.
G. Hot Springs has a horse racing track with casino games similar to slots and other electronic gaming.
H. West Memphis has a greyhound track with casino style games.
I. The Mississippi Band of Choctaws has two casino resorts in Neshoba County.
J. In Atmore, Alabama a tribal gaming facility and resort expanded in early 2009.
K. Pensacola's Greyhound track now has poker.
L. Near Montgomery in Shorter a facility with over 6,500 electronic bingo machines has been shut down since fall 2010.
M. Two tribal gaming facilities operate north and east of Montgomery.
N. A similar facility to that in Shorter opened in late 2009 and is currently non-operational.
O. In Texas, legalization of gaming will be considered in 2011. Texas also offers racetracks and Tribal Casinos.
P. Kentucky's seven racetracks are aggressively lobbying for racino gaming, and Churchill Downs recently purchased a casino in Greenville, Mississippi.
Q. Riverboat gaming (offshore) is likely to materialize in North Charleston in 2011.
R. The Seminole Indians signed a new gaming compact with the state in 2010, and South Florida's racinos posted a 52% gain in revenues in 2010. Further, the state is now considering additional expansions.
S. Oklahoma's 111 Tribal casinos reported over $3 billion in AGR in 2009.

In 2004, USM accurately pronounced the Mississippi gaming industry as one that was a mature market. By definition, a mature market is not experiencing significant growth. With this in mind, and considering that competition continues to grow in the southeastern United States, raising taxes on Mississippi's commercial casinos will make it more difficult for Mississippi to even maintain its existing market share, much less grow it.

To put the current state of Mississippi's gaming industry into another perspective, compare financial performance for the most recent four quarters to levels reported to the Mississippi Gaming Commission in 2007.

Table 6: Comparing 2010 financials to 2007 Financials
Source: Mississippi Gaming Commission

	2010	2007	Difference	% Change
Gross Revenue	$3,161,783,084	$3,628,012,352	($466,229,268)	-13%
Key Expenses				
Payroll	$728,157,990	$833,726,719	($105,568,730)	-13%
Operating Expenditures	$1,746,777,363	$1,931,372,565	($184,595,202)	-10%
Advertising	$81,737,430	$103,350,583	($21,613,153)	-21%
Donations / Public Service	$1,400,668	$2,618,698	($1,218,030)	-47%
Other	$26,060,214	$28,112,739	($2,052,524)	-7%
Total Key Expenses	$2,584,133,665	$2,899,181,304	($315,047,638)	-11%

Note: 2010 data reflects 4Q 2009 through 3Q 2010.

The information presented in Table 6 demonstrates that while revenues are down by over $466 million, Mississippi's casinos have only eliminated $312 million worth of key expenses. Interestingly, advertising budgets and community support (donations and public service) have declined at a rate far greater than which revenues have fallen. The tendency for advertising and community support budgets to decrease at greater proportions than other expenses is not one of choice; rather, these are expenses which a company is able to reduce. Ultimately, a company with declining revenues must also make reductions in payroll.

The first jobs that a company eliminates during a period of declining revenues are typically front-line jobs. This is because the need for front-line workers is dictated by the volume of business. If visitation drops a casino requires fewer table games dealers, hotel front desk clerks, etcetera in order to meet demand. Since 2007, gross payrolls have been reduced by 13%, or $105 million, while the number of employees has fallen by 20%, or 5,683 people. For every five casino jobs that were lost, the state of Mississippi lost an additional tourism-related job, and **because the employment multiplier for travel and tourism in Mississippi is 1.41, it can be inferred that for every five casino jobs that are lost, the state is at risk of losing two jobs.** Notably, between 1990 and 2005, for every casino job that was created, an additional tourism job was also created.

It should also be noted that effective July 1, 2010, the Mississippi Gaming Commission will be funded exclusively via fees and fines levied upon Mississippi's commercial casinos and the licensed manufacturers and distributors that support the industry. Effectively, the body that is charged with regulating and enforcing the laws imposed on Mississippi's commercial casinos has seen its General Fund budget slashed by 100%, or nearly $4 million. Because the Mississippi Gaming Commission historically has operated with a budget of under $10 million, the fees imposed on casinos have been increased by 30% in order to replace the funding from the state which the Gaming Commission previously relied upon.

What will happen if taxes are increased?

All too often, proponents of tax hikes make the incorrect assumption that a tax increase will generate incremental returns on tax receipts. This false assumption is based on the conventional wisdom that revenue levels will remain the same (or even continue to grow) when the new tax is employed. Unfortunately, this is rarely the case. When casino taxes are raised, casino operators must seek out expense reductions in order to maintain profitability. As alluded to in the previous section, the expenses which are typically targeted include advertising and payroll. When advertising and payroll budgets are reduced, a casino loses some of its competitive edge, as it becomes more difficult to reach out to its customer base, provide a high quality product, and offer superior customer service. Exceptions occur when a gaming market is significantly undersupplied, or when demand is great enough exceed supply even when casino offerings are downgraded. When Illinois increased its top tax rate to 50% in July 2002, the state saw its first sustained period of declining revenues in the history of gaming in that state[15], despite the fact that its gaming supply had increased. Illinois again increased taxes effective July 2003 and in the subsequent year experienced a decline in gaming revenues of $136 million. Needless to say, the actual impact of increasing gaming taxes in Illinois resulted in a tax budget shortfall that was substantial ($115 million). In the end, Illinois reduced its tax rate considerably in 2005 and has maintained that level up to date, but it should be noted that current Illinois gaming revenues are down 32% from three years ago while Indiana has grown its market.

Mississippi has already lost 5,683 direct casino jobs during the recession. As a result of the $300 million decline in gaming revenues, operating cash flows have declined considerably and margins have narrowed. An increase n gaming tax from even 12% to 13% actually represents an 8% increase (1/12=.08) in gaming taxes to properties which have, on average, seen revenues decline by greater than 15% over the last three years. Over the last three years, estimated EBITDA for the state's 30 casinos has declined by over $150 million.

When investors evaluate Mississippi, EBITDA earnings potential is a primary factor which is considered, and stability in the regulatory environment is also very important.

Table 7: Estimating correlation between lost EBITDA and lost casino jobs

	2010	2007	Difference
Gross Revenues	$3,161,783,084	$3,628,012,352	($466,229,268)
Estimated Operating Expenses	$2,584,133,665	$2,899,181,304	($315,047,638)
EBITDA	$577,649,419	$728,831,048	($151,181,630)
Lost EBITDA	$151,181,630		
Lost employees	5,638		

For every $26,815 in EBITDA that has been lost, casinos have reduced payroll by 1 person.

When comparing the 5,638 casino jobs lost since 2007 to the $105 million payroll reductions, the average payroll per employee lost is $18,724, confirming that operators are forced to stretch front-line payrolls thin in order to maintain profitability.

At current revenue levels, increasing the gaming tax to 13% would cost the average casino operator an additional $800,000 annually, or roughly $24 million from the aggregate standpoint. **Should Mississippi implement a tax hike, it can be inferred that 900 additional direct casino jobs would be lost, which in turn would result in 350 additional jobs being lost.** Casino payrolls alone would decrease by $16.7 million, and additional cuts in advertising and community service would also be expected. Since 2008, Mississippi has lost over 66,000 jobs[16], and putting downward pressures on the state's ability to rebuild its workforce is not a good strategy.

In addition to the likely job losses, the prospects for new casino investments will diminish if gaming taxes are increased. Since Hurricane Katrina, only three out of 25 proposed developments which have either received a site approval or an approval to proceed from the Mississippi Gaming Commission have materialized[17]. This is due in large part to: 1) the difficulty to obtain financing, and; 2) the fact that other gaming jurisdictions have favorable market growth rates. If gaming taxes are raised, a proposed development will have to consider the effective annual surcharge (via a 1% increase in gaming tax) of anywhere between $800,000 and $1.5 million, which will reduce said development's ability to pay back a loan and invest capital in Mississippi. Existing properties will also be forced to either sideline or reduce planned investments and improvements to their facilities. The bottom line is that capital investment creates jobs, and tax increases reduce capital investment.

<u>What is the economic impact of the industry rebounding to pre-recession levels?</u>

At the surface, increasing gaming taxes to 13% would increase annual tax collections by $24 million. When factoring in lost jobs, decreased capital investment, and lost regional market share when the quality of gaming product declines, that $24 million is reduced significantly. But even if a new tax did generate $24 million in incremental tax revenues, that number is relatively insignificant when considering the **fact that a recovery from the industry's recession (returning to 2007 gaming revenue levels) would restore more than $60 million to state and local coffers**.

Figure 5: Choosing between a tax increase and a recovery from the recession

Option 1: Raise gaming taxes for an unlikely $24 million impact.

- A $24 million net increase is not likely when considering the downward pressures on gaming revenues when Mississippi's casinos become less competitive.
- More than 1,000 people will likely lose their jobs as a result of a tax increase, reducing state income taxes and negatively impacting consumer spending in the state.
- Future prospects of capital investment will be diminished.

Option 2: Allow the gaming industry to recover from the recession and restore $60 million in lost gaming taxes, 5,683 jobs, and $5 million in state income taxes.

- The gaming industry overall has demonstrated progress in recent months towards beginning the path to recovery.
- If no new taxes are assessed, casino operators will not have to reduce marketing budgets and can continue to compete with other markets to re-capture lost market share as the nation's consumer confidence continues to build.
- As revenue levels increase, so will the industry's ability to hire back the 5,683 people who have lost jobs, restoring $105 million in payroll and $5 million in state income taxes.
- With no new taxes and increased revenues, casinos will be purchasing more goods from Mississippi vendors which will have a ripple effect throughtout the state's entire economy.
- Capital investments are more likely to occur at the current tax level, which will in turn stimulate more economic growth in Mississippi.

Without question, 2011 is a difficult time for a legislator in Mississippi to be tasked with balancing a budget that is funded with nearly half a billion dollars less (in tax transfers) than it was three years ago. Legislators have less money to work with, but are receiving pressure from every state agency and interest-group to maintain or even increase historic allocations. There will be many difficult decisions made, but the decision on the gaming tax proposal should not be a difficult one: leaving the state's gaming tax rate at 12% will best position Mississippi's gaming industry to recover from the recession and will allow the state's overall travel and tourism industry to continue its journey to becoming a premier tourism destination in the United States.

Closing Remarks

Many people oppose gaming based on their moral beliefs and the intent of this paper is not to convince people who morally oppose gaming that their beliefs are invalid. In fact, citizens have every right to oppose gaming and by and large, geographic regions of the United States which have populations where a majority of the residents do not favor gaming do not have commercial casino establishments located within them. In Mississippi, there are regions where gaming is not a popular subject; it is no coincidence that these regions do not have casinos that operate in them. In the regions of Mississippi where gaming is legal, however, the majority of the citizenry support and embrace the industry, as the constituents believe that the positive impacts of gaming offset any perceived negative impacts. With regards to problem gambling, the Mississippi Gaming Commission requires that Mississippi's commercial casinos follow a detailed regiment to address the issue, including offering and enforcing self-exclusion lists, training staff on the characteristics of problem gaming, and making literature available and visible to casino patrons. Mississippi's casinos also help to fund the Mississippi Council on Problem and Compulsive Gambling. A 1997 study estimated that between 1.79% and 3.81% of Mississippi residents over the age of 18 are problem gamblers[18]. The national average, according to the National Council on Problem Gambling is somewhere between 2% and 3%. The National Council on Problem Gambling also states that, "The casino… provides the opportunity for the person to gamble. It does not, in and of itself, create the problem any more than a liquor store would create an alcoholic."

The point to be made here is that in jurisdictions where commercial gaming is legal, the majority of the constituents regard casino operators as legitimate corporate partners who play a significant role in contributing to the local economy. Unlike other corporate entities and businesses, however, casinos are assessed special taxes and treated (from a tax standpoint) differently than most other industries. In Mississippi, casinos have adhered to the laws of the state and played by the rules, and have invested over $5 billion dollars of capital into the state and created over 25,000 direct jobs. Other large industries who have invested in Mississippi have received substantial incentive packages, and in most cases have fulfilled their end of the bargain by creating jobs and spurring economic development. The theme again reverts to the fact that invested capital, not tax increases, creates jobs. Gaming is a vital industry to the state of Mississippi and the tax revenue that it generates benefit the entire state, even the regions which do not favor it.

In summary, the Gulf Coast Business Council Research Foundation believes that the existing gaming tax rate in Mississippi is very reasonable and increasing taxes now or at any time in the future is not an option that the state's lawmakers should consider. The opportunity cost of increasing gaming taxes in Mississippi is simply greater than any short-term returns.

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