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Gray Area

The differences between state-run and privately-run video gaming devices aren't so black and white.

Behold a video lottery terminal in its neon glory, and the nickname "gray machine" hardly seems appropriate. Nor does it capture the colorful debate swirling around them. In other ways, though, it's perfectly fitting:

The name was coined to describe the murky legal status of VLTs in several states. They tend to enter under the guise of amusement, with non-cash, low-value prizes -- and then morph into gambling machines that pay cash or tokens redeemable for cash. Their numbers explode, but they're so widely scattered among gas stations and bars that states find them hard to tally, regulate and tax.

While "gray machines" isn't terribly flattering, it's much nicer than the other nickname given to video gaming devices: the "crack cocaine" of gambling. The reason why lawmakers stop short of throwing that stone is that they often seek not to wipe them out -- but to take them over.

This is the trend started by states such as South Carolina, West Virginia, Oregon and Georgia: lawmakers pull the plug on quasi-legal video gaming devices and then start -- or continue -- VLTs or traditional lottery games in their place. The premise is that the games are safer and more socially productive under the state's care. While that's probably true, the differences between state-run and privately-run video gaming aren't so black and white.

It's a little known fact that South Carolina was one of the nation's largest operators of video gaming devices -- between 34,000 and 36,000 -- until a state Supreme Court ruling pulled the plug in July of 2000. Slipped into a budget bill in 1986, the machines proliferated to around 7,000 locations and were making an estimated $163 million in revenue by the time they were shut down. The business was almost completely unregulated, save for a $2,000 annual licensing fee for each machine. Officials also believed that owners were vastly under-reporting their income to avoid paying taxes.

Now the state is leaping into a brand new lottery, scheduled to launch Jan. 7, 2002. Unlike the private video poker machines, officials say that lottery vendors will be closely monitored. Prospective ticket sellers will have to undergo background checks and prove they've paid state taxes before they get a green light. They'll even keep special bank accounts for lottery proceeds, which will be cleared out by lottery officials each week.

Ah, and there’s one other difference: retailers only receive 7 percent of ticket sales and 2 percent of prize money. That’s nothing to sneer at, but also nothing near the amount they were raking in with video lottery terminals.

On to West Virginia, where in May of 2001 the governor signed a bill to bring the state’s video poker industry under state control. While an estimated 13,000 machines have been in operation at mom-and-pop shops for years, the new policy limits them to 9,000 machines, charges a $2,000 annual licensing fee and restricts them to bars and fraternal organizations. The change is expected to yield around $72 million for education-related programs.

Finally, Georgia, where Governor Roy Barnes signed legislation on Sept. 15, 2001 to eliminate video poker starting Jan. 1, 2002. Before the ban, the state was estimated to have as many as 20,000 video poker machines that took in around $1 billion annually. When the video gaming machines are sent packing, the state’s famous lottery will remain as Georgia’s only option for so-called "convenience betting."

In each of these examples, privately owned video gaming is booted while state-sponsored video gaming or traditional lotteries are supported. But is one inherently worse than the other? Conventional wisdom says no. Lotteries and video gaming fall into the same bucket no matter who owns them.

When the National Gaming Impact Study Commission released its report two years ago, it targeted state lotteries and video poker machines with the same criticisms. The report specifically stated that lotteries are the most widespread types of gambling, the least likely to generate significant economic development, and the most likely to target the poor and the under-aged.

If there’s any distinction to be made about the social issues of video gaming, it’s between states that make VLTs available at thousands of saloons and convenience stores, and those like Delaware that sequester them in racetracks and other gambling-oriented locations.

Lawmakers who favor keeping VLTs, but folding them into state lotteries, argue that state regulation makes the difference between a clean and dirty business. Well, of course a regulated business is better than an unregulated one. Addiction programs, underage gambling prevention and financial oversight always benefit the participants, the governments and the reputation of the industry.

But here’s the question: why couldn’t this oversight have existed while the machines were in the private sphere? Because money -- the states’ percentage of the take -- is the real issue here.

When states realize how much their "gray machines" are bringing in, the instinct is not to help small businesses manage them but to take them over. That strategy is illustrated perfectly on the official website of the Oregon Lottery:

"In 1991, it was estimated that up to 10,000 video slot and video poker machines ... were being used for illegal gambling in Oregon. That year, the Oregon Legislative Assembly outlawed the ‘grey machines’ but, recognizing their well-established

presence in the marketplace, placed the operation of similar devices under the authority of the Oregon State Lottery Commission."

The battle to control video gaming is not about technology or corruption or social good. It's about states recognizing a money-maker when they see it, and wanting to own it.

What does this mean for the business? The number of states that offer video gaming as part of a lottery -- currently South Dakota, Delaware, Rhode Island, Virginia, Oregon -- will probably grow. New York is set to join that group, and similar movements are afoot in Ohio and Pennsylvania.

Meanwhile, it's a safe bet that other states like Louisiana or North Carolina may find their VLT industries subject to increased criticism, culminating in a ban or a takeover.

What you've read so far is not a defense of the convenience gaming business. Frankly, there are few nice things to say about it. In the past decade small-time truck-stop casinos have been involved in more scandals and subject to more corruption than any other type of gambling. They are disorganized and under-regulated, scraping along on the fringe of social acceptability. It's worth considering whether we as a nation and an industry want this business to be part of our identity.

However, state governments bear some responsibility for this condition. They could have instituted higher taxes and better regulation on VLTs, instead of letting the corruption fester. They could have banned gas station gambling completely. Or, they could have been forthright about their budgetary motives and claimed ownership of VLTs from the get-go.

In states like West Virginia and Oregon, lawmakers have tried to play the role of hero -- saving the day by turning a dishonest and legally murky business into money for schools and roads. But not all of the small business owners who've lost their machines to state lottery commissions are villains. They didn't create the gray area they inhabited; lack of official oversight did.

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