

The Concerned Citizen's Guide to Slot Machine Gambling and Horse Racing in Maryland

by Robert E. Carpenter

About the Author

Robert E. Carpenter is an Associate Professor of Economics at UMBC. In 2003, Dr. Carpenter prepared a research paper, *Slot Machine Gambling in Maryland, an Economic Analysis*, on the economic issues and implications of introducing slot machine gambling to Maryland.¹ At the time, the Maryland legislature was considering legalization of slot machines as a way to raise revenues and close the projected gaps in the state's budget. In August 2003, he briefed the Maryland House of Delegates Committee on Ways and Means on the results of his research on this divisive and controversial topic. The bill to legalize slot machine gambling in Maryland did not pass.

Four years later, the debate on slot machines continues. The Maryland legislature is now considering legislation to place slot machines in horse racing tracks around the state to raise revenues and subsidize the horse racing industry. Dr. Carpenter prepared this Policy Brief to provide an independent analysis of the public policy implications of legalizing slot machine gambling and using slot machine revenues to support horse racing.

This paper was prepared for the UMBC Maryland Institute for Policy Analysis and Research. Evan Perlman, a doctoral student in UMBC's Public Policy Program, assisted with the preparation of this analysis.

Issue

Four years after it started, the debate about legalizing slot machine gambling in Maryland remains emotionally charged with expansive claims, but lacks solid information and research about the quality of those claims. Advocates for legalization frequently make arguments about strong economic and financial benefits of slot machine gambling to the state. Many claim that legalizing slot machine gambling is important for the future of the Maryland horse racing industry.

In this paper, I list ten of the more common questions that citizens, advocates, and policy makers are asking about this issue, and provide readers with answers based on the available data and the principles of economics.

It is my belief that advocates for the legalization of slot machine gambling in Maryland tend to overstate its economic benefits. Many interested parties in this debate are more forthcoming with estimates of the dollars and people involved with slot machine gambling than they are with the way those estimates were constructed. It is very important that state legislators and analysts press advocates on both sides of the issue for their evidence, not just their estimates.

1. Isn't it true that every year many Maryland residents travel to Delaware and West Virginia (and soon Pennsylvania) to spend over \$400 million in their slot machines?

It is certainly true that Marylanders travel to Dover Downs and Charlestown, among other places, to play the slots. The exact number of people who do is probably substantial. No one really knows, however, how many people travel to out of state racinos (racetrack casinos) or how much they spend.

The estimates we do have probably aren't very good. For example, one way that people try to measure Maryland gambling out of state is to count the number of Maryland license plates in racino parking lots. That won't tell you very much for a number of reasons. First, it is impossible to know whether that car carried one player or several players. Second, you don't have any way of telling whether the car carried heavy slot machine bettors or people who play slots lightly because they are interested in the other amenities offered by the racinos (for example, the food or the shows), or are there only for the races. Third, those estimates are easily manipulated. If I wanted to make a case that lots of Maryland residents played Delaware slots, I'd count during a weekend in the summer where people might want to also spend a day at one of the nearby beaches. If I wanted to make a case that few Maryland residents play Delaware slots, I'd pick a day the Baltimore Ravens were in town.

The most recent estimate of the Maryland gambling dollars leaving the state comes from a study conducted by the Innovation Group for the Magna Corporation. It should be noted that Magna is an interested party in the debate and favors the legalization of slot machine gambling. The Innovation Group's 2003 estimate, adjusted for inflation, suggests that approximately \$484 million gambling dollars leave the state each year.²

It is important to put that number into perspective by comparing it to the size of the Maryland economy. Maryland produces approximately \$246 billion dollars in goods and services each year.³ If the \$484 million figure is correct, for each 10 dollars of output produced in Maryland each year, we take 2 cents out of state to gamble. That's 0.2 percent of state output, which is very small.

2. Don't we need slots so those people who are gambling out of state will stay home and spend their money here? That way, Maryland residents won't be supporting other states, to our detriment.

The "keep our dollars at home" argument is among the most-often cited reasons for legalizing slot machine gambling. However, legalizing slots here would not guarantee that we would recapture all the dollars that currently leave the state. People may decide to travel out of state to gamble even if Maryland has slot machines.

Dollars leave Maryland every day for many reasons. If you ride the Washington Metro, trade a share of stock, buy a car, a book from Amazon, a banana, or a cup of coffee, dollars leave the state. The dollars that leave Maryland for slots elsewhere are no more, or no less, important than the far greater number of dollars that leave Maryland when someone buys a new car, and we're not worried about that.

Dollars also enter this state for many reasons. For example, people who work in Washington D.C. and Northern Virginia make very high weekly wages. However, many of those workers return to suburban Maryland every night and spend those wages here.

The bottom line is that states trade hundreds of thousands of different goods and services. Billions of dollars flow across state borders in all directions. One particular and relatively small dollar flow, in this case gambling dollars, is something that concerns only advocates in this debate. Slot machines are not draining the state's resources in any meaningful way. The health of the state's economy in no way hinges on dollar flows of this magnitude. The idea that when entertainment dollars leave Maryland it drains the state's economic vitality is just plain wrong.

3. The Maryland state budget is facing large deficits. Won't slot machine revenues help solve that problem so that the state won't have to increase taxes or reduce the amount of services it provides to its residents?

Maryland's state budget situation is forecast to worsen in the near term, with an estimated budget deficit of \$489 million in FY 2007 and \$1.28 billion in FY 2008.⁴ Since the state is constitutionally required to balance its books each year, lawmakers must cut spending or find additional revenues. Many state policymakers have argued that legalizing slot machine gambling would provide a revenue stream that would help solve the state's budget problem. Some of the state government's revenue estimates from this year's legislative debate about slots are quite large. For example, one

estimate has projected revenues of \$800 million.⁵ The method used to calculate those estimates has never been fully explained, so it is impossible to comment upon their accuracy.

The revenue generated by the slot machines, however, would not all be "fresh" or new dollars. Much of the revenue would be spending that has been reallocated from other goods. Legalizing slot machine gambling would take dollars that people are already spending here on other goods like food, clothing, entertainment, the state lottery, etc., and reallocate them toward slot machine gambling.

This point is important because it means that you cannot count all of the slot machine revenue as new spending. Only new spending will help close the budget gap. The Innovation Group report estimated that new spending would make up only half of total revenue.⁶ The rest of the spending is already occurring, and being taxed, within and by the state. Therefore, the overall revenue figures, which do not take the reallocation into account, are overstated.

4. Is the Maryland horse racing industry in decline? If it is, should we use slot revenues to subsidize it?

Many have claimed that the horse racing industry is in decline, with declining attendance at tracks, fewer races, and smaller purses. The Magna Corporation recently announced plans to cancel the 2007 Pimlico Special because of the financial pressures it faces.⁷

It is likely to be true that horse racing in the United States faces a long term decline. Horse racing contends with stiff competition from a growing number of attractive entertainment substitutes that were unavailable in racing's heyday. Ironically, one strong competitor to gambling on horse races appears to be gambling on slot machines.

Earmarking a portion of the revenue stream from slot machine gambling and using it to supplement purses and payments to breeders and trainers is a subsidy to racing. This subsidy will help prop up a declining industry that its participants argue can no longer make it on its own.

From an economic standpoint, the question is whether or not the horse racing industry has any special characteristics that make it worthy of subsidies, whether from diverting a portion of the proceeds of slot machines or from any other public source.

Although the size of an industry and the number of people employed make the personal costs of a declining industry more visible and more heartbreaking, these factors are not economic justifications for a subsidy.

Economists rarely like subsidies. Subsidies keep people employed in industries with poor future prospects. They keep land tied up when there are potentially more profitable and more beneficial uses for that land. When they are used to prop up declining industries, subsidies distort incentives and keep people from making good long-term decisions. Most importantly, the dollars used to subsidize an industry have better, higher valued uses somewhere else in the economy. Subsidizing declining industries ultimately amounts to "chasing losses."

(continued on reverse)

5. How important is the horse industry, including the racing industry, to the state's economy? Is it really one of the state's largest industries?

Estimates of the size and economic importance of the Maryland horse and horse racing industries vary widely from study to study. For the horse industry, the Maryland Horse Breeders cite a 2005 economic impact study by Deloitte and the American Horse Council that claims "the racing and breeding industry [in Maryland] provides in excess of 10,000 jobs... [and] produces spending of more than \$1 billion on goods and services each year."⁸

The Optimal Solutions Group conducted a study commissioned by the Maryland Jockey Association in 2003 that estimated the racing industry employed 7,500 people.⁹ The College of Agricultural and Natural Resources at the University of Maryland, College Park prepared a study for the Maryland General Assembly where it estimated that the combined total of race horse and race track employment was approximately 8,900 jobs, with a total economic impact of approximately \$598 million.¹⁰ More recently, the Deloitte/American Horse Council study attributed 5,800 jobs directly to racing (15,400 jobs both directly and indirectly related), and claims economic activity of \$551 million directly related to racing and breeding together, with a total direct and indirect impact of \$856 million, in 2007 dollars.¹¹

The reported employment figures are difficult to judge because studies do not always make clear whether the jobs are expressed on a full time equivalent (FTE) basis, or whether the jobs are the combination of full and part-time.¹² Counting a part-time worker as a full time worker overstates employment.

It is also important to distinguish between direct and indirect employment. Direct employment is when someone is specifically working in the racing industry, like a jockey. Indirect employment is when someone is working for an industry supplier (or a supplier's supplier) to support the racing industry. Counting indirect employment on an equivalent basis to direct employment also overstates an industry's employment. An employee of an animal feed supplier would be an example of indirect employment. The feed store employee might still be employed even if he does not sell products to the racing industry.

Assuming that advocates for the racing industry would be least conservative with estimates of the industry's size and employment, I used the largest industry numbers to put the size of the horse and horse racing industry into perspective relative to the Maryland economy.

If all \$1 billion dollars in spending claimed by the American Horse Council constitute spending on final goods and services, then Maryland's entire horse industry accounts for roughly 0.4 percent of the \$250 billion in overall state economic activity.

The racing segment of the horse industry is also small. Maryland's businesses employ about 2.6 million people overall,¹³ which means that if the racing and race related industry employs 15,400 people it accounts for about 0.5 percent of the labor force.

While at least one advocate claims that racing is the third largest industry in Maryland, employment data do not support this claim.¹⁴ More than thirty other industries employ more workers than racing does. As one might expect, federal, state, and local governments are much larger industries, and so are residential construction firms (23,510 employees), new car dealers (26,268), realtors (31,826), hospitals (90,002), and printing

(17,920). Further, horse racing is classified as part leisure and hospitality sector. The racing industry is not even the largest leisure and hospitality industry in the state, even if we include all 15,400 workers claimed by the American Horse Council. The accommodation sector, such as hotels (21,736), and food service and drinking places (154,759), has more employees.¹⁵

6. If we don't legalize slot machine gambling will the horse and racing industries disappear? What effect will that have on the people who work in the industries?

Horses appear to be intertwined into the culture of some of the state's residents. Many people in this state have chosen the horse industry as a vocation, a pastime, and a passion. Certainly, the horse industry as a whole will survive the decline of racing. If jobs are unavailable in racing, some people employed in the racing industry are likely to seek employment in other aspects of the horse industry that do not involve racing. It is important to remember that a substantial amount of the resources used in the Maryland horse industry are not involved in racing, as racing horses make up less than one-third of all the state's horses.¹⁶

It seems very unlikely that owners of large, attractive, and historic horse breeding farms will take the very costly step of pulling up their stakes here to move across the Pennsylvania, Delaware, or West Virginia borders to take advantage of the subsidies that those states may provide to their horse racing industry. The people who tend to move to other states will be those that do not have significant economic ties to Maryland.

Horse racing is in a long-term decline nationally and in Maryland. It is hard to know whether racing will ever completely disappear from Maryland, but it is unlikely to do so in the near future. Industries in a state of long term decline gradually contract as new workers choose other occupations, existing workers move on, and firms shrink or move into other lines of business.

Some firms engaged in the racing industry are likely to redirect their efforts toward racing activities in other states. The horse racing industry is already very heavily engaged in interstate commerce. Advocates have often claimed that the financial support Maryland provides to domestic breeders is extremely important to their decision about where to locate their farms. However, it also appears as though many of the people engaged in the racing industry in Maryland are not residents of the state. In 1998 the Maryland General Assembly commissioned the University of Maryland to conduct an economic impact study of the racing industry. The authors of the study surveyed owners, breeders, trainers, and jockeys who were registered in Maryland. Only about 28 percent of the survey respondents registered in the state actually lived here.¹⁷

Some people engaged in the horse racing industry that have specific skills that are not transferable to other segments of the horse racing industry, or who are unable to move to new jobs because that industry contracts, are likely to be harmed if their jobs are eliminated. Economic research shows that experienced workers who are displaced when their firm closes suffer long-term wage losses.¹⁸ Fortunately, the Maryland labor market is particularly vibrant, with an unemployment rate that has been below the national average for the past 30 years.

7. Do we have to put the slot machines at the state's racetracks? Are slots and horse racing necessarily intertwined?

Slot machine gambling will only have financial benefits to the state if it generates new spending. New spending will occur when people who are currently spending dollars outside the state (on gambling and other goods and services) spend those dollars in Maryland slot machines.

The costs to other businesses from the reallocation of spending will be spread throughout the state, and even regional economy. This reallocated spending will be concentrated at slot machine casinos whether or not they are located at tracks. The casinos themselves are likely to do very well.

The Innovation Group study estimated the economic impact of slot machine casinos in Maryland, using something called a "gravity model" to estimate the revenue that would be generated by locating casinos at the states existing tracks. The gravity model assumes that most of the revenue would come from residents who live close to the casino (within 25 miles) and that the primary market area for track-based casinos is primarily comprised of central Maryland.¹⁹ The results of the consultant's report indicate that most of the spending at tracks would probably come from residents of the state and much of the spending would be reallocated, not new.

Advocates for racing will, of course, argue that the best location for slots is at the tracks. Slot machine casinos would generate large revenues for the tracks that housed them. These revenues would generate high profits that the owners of the casinos could use to support racing activities and to benefit their owners. It is worth mentioning that when slot machine casinos are located at racetracks, racing quickly becomes a very small proportion of the business activity at the track. For example, in Dover Downs' financial report to the Securities and Exchange Commission (SEC) they state that racing and race related activities constitute approximately 15 percent of their revenues.²⁰

If the state's goal is to maximize the revenues that it generates from casinos, then the best solution is to locate these casinos in places that would maximize the amount of new spending, not simply in locations where people are used to gambling. This means that the locations should be chosen to make them accessible and attractive to out-of-state players, perhaps, for example, on Maryland's borders with Virginia, West Virginia, Delaware, and Pennsylvania. It is by no means certain that the revenue maximizing locations are at the state's existing racetracks.

The argument that the optimum location for slot machine casinos is at tracks is best viewed as a negotiating strategy by the state's track owners and racing interests seeking to be first in line for the very profitable licenses to run slot machine racinos.

8. By not allowing slot machine gambling at the tracks, aren't we putting the Maryland racing industry at a competitive disadvantage relative to other states? Isn't it unfair that current gambling laws prevent track owners and other industry participants from diversifying the products that they offer?

Choosing not to subsidize our racing industry when other states do is a source of stress for Maryland racing. To the extent that purse sizes and

other forms of financial support in surrounding states benefit their domestic horse racing industries, the Maryland racing industry faces a competitive disadvantage.²¹

But it is not unfair to investors and industry participants for the state to refuse to allow different forms of gambling. Gambling is a heavily regulated activity everywhere in the United States. Investors in horse racing and horse tracks knew that before investing, and they continue to participate in this regulated industry. The state is under no obligation to change its regulatory structure to ensure a specific return to investors. The argument that state regulations need to be changed because past investments made in the racing industry no longer perform up to investor expectations is weak.

Moreover, the argument that industry participants are being prevented from diversifying needs to be clarified. Industry participants and investors can diversify into different product areas outside the racing industry, and can diversify their investments to include gambling and racing in other states. For example, many casinos, gambling equipment manufacturers, and at least one horse racing track are publicly traded companies. Current state regulations and laws prevent them only from offering additional forms of gambling in Maryland and so restrict their diversification in a very narrow sense.

9. Won't horse farms disappear if the racing industry continues to decline? Isn't it important to save the racing industry to preserve open space?

Advocates for using slot machine gambling revenues to support Maryland horse racing often make the argument that it is important to preserve open space within the state's horse farms. However, it is important to note that the space is not open and it is misleading to refer to it as such. The farms would remain private property, open only to the sky, but certainly not to the public. If "open space" is a priority, the state might do better to invest in additional parkland.

It is also not accurate to say that the closing of horse farms would lead to the rapid development of dense subdivisions. For example, Baltimore County regulations may present formidable obstacles to the development of zoned agricultural areas.

10. What are the social issues related to slots?

There are social benefits and costs associated with the legalization of slots. There are likely to be financial benefits from slot machine gambling that depend on the extent to which Maryland residents stay home to gamble instead of traveling out of state, and the extent to which out of state residents come here to play the slots. These financial benefits will accrue chiefly to track owners, slot emporium owners, race horse owners and breeders, and other racing interests. The size of these benefits is likely to be smaller than advocates claim, however, because they almost always fail to distinguish between new and reallocated spending.

It is also true that some, perhaps many, people in the state want to gamble. If the state changed its regulations to allow businesses to offer gambling as a form of entertainment, these people would be able to buy something they want, making them happier, if not wealthier. It is impossible to quantify the size of these benefits.

But there are social costs associated with gambling. Some believe gambling to be morally suspect, e.g., a “vice.” Others emphasize the socially undesirable behavior that may accompany gambling: crime, bankruptcy, lost worker productivity, broken families, and more broadly, the costs associated with problem and pathological gambling.

The prevalence of problem and pathological gamblers, and the social costs associated with their behavior, are a matter of some debate. The number of people involved is potentially quite large. Estimates range from approximately 1.0 to 1.5 percent of the population on the low end, to 6.5 to 9 percent or more on the high side and appear to depend on whether or not pathological gambling (more serious) is separated from problem gambling.^{22 23} These individuals have a medical condition and they will not be made better off from slots.

The social costs associated with each problem gambler are also a matter of debate. Estimates range from approximately \$1,000 per problem gambler per year on the low side, to \$13,000 per problem gambler per year or more.²⁴

The social costs of problem gambling are potentially very large. One percent of the Maryland over-21 population equals over 37,000 people.²⁵ The Department of Legislative Studies has suggested that nearly twice as many (70,000) Marylanders may be problem gamblers.²⁶ The total social costs of gambling may be a large proportion of, or even exceed, some of the revenue estimates from slot machines. To be sure, some of those costs are already being incurred by current problem gamblers, and opponents of slots should be prepared to provide evidence about how much worse the problem would be by legalizing slots.

What’s the bottom line about using slots to subsidize racing?

It seems fairly clear that the attractiveness of horse racing as a spectator sport has declined over time in the United States. Many people, however, have argued that the state’s horse racing industry is important to keep and maintain because of the psychological benefits it offers to residents and because of its strong historical ties to the state. In all the plans discussed so far in the legislature, a portion of the revenue stream from slots would be reserved for the support of the racing industry, creating a subsidy that, based on prior legislative proposals, would grow over time.

The Maryland horse racing industry strongly favors the legalization of slot machine gambling. The fact that the number and location of the machines would be tightly limited would be likely to generate large profits for the

owners of casinos (or racinos) that housed them. Legalizing slots provides them with a lucrative new business and can help slow the decline of the racing industry. As a consequence, track owners argue that the state’s existing tracks should be the preferred location for slot machines.

Some activities warrant subsidies, and they are not always bad. There are classic arguments for subsidizing an industry. Those arguments include subsidizing industries because they are necessary for national defense or subsidizing industries because of widely agreed-upon principles of equity (for example, rural electrification, and the rural delivery of mail). Other arguments include subsidizing industries where there is a substantial spillover effect (for example, primary and secondary education, medical research, and vaccinations). These arguments do not apply to the racing industry.

Because all industries employ workers and have suppliers, generating direct and indirect employment is not a good justification for a subsidy. If it were, all industries would deserve one; they don’t.

Subsidizing the horse racing industry in Maryland would allow some workers in this industry to keep their jobs, and it would allow owners of racing horses and farms to continue to operate those farms even though their costs are too high and revenues are too low for the market to support them. But, subsidies are well known to impose efficiency costs on an economy. Generations of students have learned this in Economics 101.

Allowing declining industries to shrink is good public policy, even though that decision may be painful. It is best to let them shrink and let workers and investors employ their skills and talents in other directions.

Once the decision is made to prevent historic or declining industries from shrinking, where do we stop? Should the state government have intervened to preserve the jobs of Marylanders employed as chandlers, shipwrights, and coopers?²⁷ It certainly did not intervene to save the jobs of miners, autoworkers, or steelworkers, which were all significant industries in Maryland. Keeping entrepreneurs, employees, and financial resources locked up in declining industries prevents them from moving to new, vibrant industries where Maryland’s prominence is growing, such as technology and life sciences.

The financial benefits to Maryland residents from putting slot machines at race tracks would be significantly smaller than claimed and they are not a cure-all for the state’s long-term budget problems. Further, there is no economic justification for legalizing slot machines to use their revenues to subsidize the horse racing industry.

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Editor: Anne V. Roland, UMBC Department of Public Policy
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Footnotes

- 1 The economic analysis and testimony are available at <http://www.umbc.edu/mipar/pubs.htm>.
- 2 Rittvo, Steve and S. Paul Girvan (2003). Central Maryland racetrack VLT venues: revenue projections. Innovation Group, p. iv.
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- 11 Deloitte, p. 2.
- 12 Two people working half time or four people working quarter time would be counted as one FTE worker. If total jobs are not reported on an FTE basis, it overstates employment in an industry.
- 13 Bureau of Labor Statistics (2006). Regional and state employment and unemployment.
- 14 Alan Foreman, of the Maryland Thoroughbred Horsemen's Association, as claimed on the Marc Steiner Show, January 17, 2007.
- 15 U.S. Economic Census (2002). Geographic Area Series: Maryland.
- 16 Deloitte, p. 2.
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- 18 Louis S. Jacobson; Robert J. LaLonde; Daniel G. Sullivan. Earnings Losses of Displaced Workers. The American Economic Review, Vol. 83, No. 4. (Sep., 1993), pp. 685-709.
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- 21 This question raises a broader issue: when states compete for business, how far should they go toward pursuing specific strategies tailored to support individual industries (and how should they choose which industries to support) rather than a strategy to provide a supportive general business climate.
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