

Internet Gambling: Problems and Options

By

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Introduction

Internet gambling is growing at an increased pace in terms of revenues, websites, and participants. “In 2000, Internet gambling brought forth an estimated \$2.2 billion in worldwide revenues... [and] could reach \$100 billion a year by 2006” (Hammer, 2001). Americans wagered the majority of the \$2.2 billion (Sinclair, 2001). Recent market research estimates that consumers spent from \$6.5 billion to \$8 billion on Internet gambling in 2002 (M2: Presswire, 2003). This represents significant revenue growth from just \$300 million in 1997 and \$651 million in 1998 (NGISC, 1999).

The first Internet gambling website began in 1995 (Clark & Dempsey, 2001). The number of websites grew to 800 by 1998 (NGISC, 1999). Today there are an estimated 1,800 Internet gambling websites. The number of users has steadily increased from 6.9 million people in 1997 (APA Advisory, 2001) to 14.5 million people in 1998 (Mitka, 2001) to 52 million in 2001 (M2: Presswire, 2003). According to one industry website, 71 jurisdictions now offer some form of online gaming license (www.gamblinglicenses.com).

Internet gambling attracts the attention of policy makers because of its size and rapid rate of growth, the problems associated with it, and the fact that traditional gambling is already heavily regulated. In this paper I will list and explain the main problems claimed to be associated with Internet gambling. Then I will discuss available policy options and how they address the problems. Lastly I will provide my conclusions in which I argue for the regulation of Internet gambling because it is a solution that can be implemented providing consumer protection, tax revenues, and most of the benefits prohibition would provide.

The Basics of Internet Gambling

The estimated 1800 websites offer broad opportunities to gamble. The games offered fall into three main categories: lotteries, sports betting, and casino games (Clark and Dempsey, 2001). Websites typically require the same simple steps to start gambling: “(1) Download the free casino software; (2) Install it on your computer; (3) Register and make an initial deposit; (4) Begin gambling” (“Online Casinos,” 1999). The initial deposit is typically made by credit card, wire money, or electronic check.

Starting an online casino can be relatively simple. Estimates to start a website are as low \$135,000 (Clark and Dempsey, 2001). The number of countries allowing Internet gambling websites to operate from their borders is growing and now numbers 71. In the infant stages of Internet gambling, most countries allowing it were based in the Caribbean. Today, major countries such as the United Kingdom and Australia allow Internet gambling.

Given the ease to provide and access Internet gambling, the rapid growth of the industry is not surprising. However, the growth is drawing considerable attention and presents difficult choices. Regulation of gambling in the United States varies among states. The introduction of Internet gambling complicates existing regulations by allowing a person in a state that prohibits gambling to easily access gambling via the Internet. Increasing the facility of any Internet user to gamble potentially increases social costs. Policy makers are faced with no dominant solutions.

Problems of Internet Gambling

The problems of Internet gambling can be divided into two categories: social and economic. The social problems are economic problems indirectly. The main social

problems are youth gambling and problem gambling. The main economic problems are money laundering, unfair gaming, and substitution.

Youth Gambling

A major problem of Internet gambling is increased availability of gambling to youth. Traditional casinos have controls in place to prohibit youth from gambling. However, Internet gambling has only weak controls to prevent youth from gambling. Internet gambling websites claim that requiring an account to be initiated by credit card allows only adults, since youth will not have credit cards.

The Interactive Gaming Council, an Internet gambling industry group, states that gambling websites are motivated to prevent youth gambling because “gambling debts incurred by minors are uncollectible” (Mitka, 2001). The Council states that gambling websites prevent youth gambling by requiring large amounts of money (\$1,000) to open an account. However, little evidence supports this claim. As I browsed various gambling websites, I found most advertising low requirements for opening accounts.

The problem of youth gambling is significant. In fact, the American Psychological Society [APA] issued an advisory in January 2001 regarding the danger of Internet gambling towards youth. The advisory states:

One significant hazard is that many online games sites—which target children and teens—have direct links to gambling sites. Many of these sites offer “freebies” and other supposed discounts to get young people started. Young people are at special risk for problem gambling and should be aware of the hazards of this activity, especially the danger of Internet gambling, which may pose an increased risk to high school and college-aged populations (APA Advisory, 2001).

Another author reports that “10-15% of young people surveyed in the United States and Canada report having experienced one or more significant problems related to gambling” (Mitka, 2001).

Therefore, due to advertising towards youth and poor control of access, the problem of youth gambling is worsened by Internet gambling.

Problem gambling

Another problem of Internet gambling is pathological gambling. “Pathological gambling is a disorder characterized by maladaptive gambling behavior leading to negative personal, family and/or social consequences,” and an individual must demonstrate five of ten specific symptoms of pathological gamblers to be diagnosed (APA Advisory, 2001). Individuals demonstrating any, but less than five, of the symptoms are considered problem gamblers.

A study released in 2002 surveyed 389 individuals and asked about their gambling habits, including those on the Internet. The results demonstrated that “individuals who gambled on the Internet were more likely to be pathological gamblers than individuals who did not gamble on the Internet” (Netizens @ Risk, 2002). The authors of the study did acknowledge that the survey results may have been skewed by self-selection bias. Even taking into consideration the possibly skewed results, one might wrongly infer causation from the correlation. However, even if Internet gambling does not cause an increase in the percentage of pathological gamblers, this survey indicates that Internet gambling does facilitate gambling for pathological gamblers as revealed by a higher percentage of Internet gamblers being pathological gamblers.

A study by the Gambling Treatment Research Center at the University of Connecticut provides similar evidence. The study “found that 75 percent of those who gamble online have a gambling problem. That compares with about 5 percent of the overall gambling population” (Lamb, 2003). Based on estimates of 52 million Internet gamblers in 2001, a

significant 39 million people with gambling problems use the Internet. Again, the correlation does not prove causation; however, it lends support to the idea that Internet gambling facilitates gambling for those with gambling problems. Someone with a gambling problem might be attracted to Internet gambling for its convenience or anonymity. Thus it appears that Internet gambling appears to worsen problem gambling.

The APA Advisory provided further evidence regarding the detrimental associations of readily available gambling: “Research has shown a correlation between the availability of legal gambling in an individual state and the proportion of that state’s population reporting gambling problems (2001).

Therefore, research suggests that readily available Internet gambling might both attract pathological gamblers, and increase the number of gambling problems.

Money Laundering

Money laundering is another problem associated with Internet gambling. One expert has testified in Congress concerning the ease of money laundering via Internet gambling:

Internet gambling and online capabilities have become a haven for money laundering activities We believe there is a huge potential for off-shore sites being utilized to launder money, and there are examples of pending cases, particularly in our organized crime program involving enterprises using these types of services as conduits for money laundering gambling (Hugel and Kelly, 2002).

Also, a Government Accounting Office report states, “[law enforcement] officials said that the volume, speed, and international reach of Internet transactions and the fact that many Internet gambling sites are located offshore increased the potential for misuse” (GAO, 2002).

Although strong evidence has not been brought forth that money laundering actually is performed through Internet gambling, it is reasonable to infer that the lack of regulation and oversight makes it an attractive facility for laundering.

Unfair Gaming

Another economic problem associated with gambling is the ease of dishonesty for the providers. The dishonesty can occur by winnings not being paid out in their entirety, or not at all. Or it may take place in the form of payout percentages not being as high as claimed. This problem can be worth a significant amount: if all Internet gambling providers cheated by taking an additional one-half percent of the more conservative figure of \$6.5 billion in 2002 revenues, it would have resulted in \$32.5 million stolen from gamblers. A lack of regulation and oversight coupled with large amounts of money makes Internet gambling attractive for those seeking to cheat.

Substitution

For those states with traditional gambling already functioning, Internet gambling presents a problem as a substitute. Rather than travel to the traditional gambling sites, individual can simply gamble from the convenience of their work or home. Likely for this reason, Nevada was among the first states to prohibit Internet gambling. Although Internet gambling is not a perfect substitute for the traditional gambling experience, it offers significant competition because of its ease.

Summary

Internet gambling has significant drawbacks. It worsens the social problems of youth and at-risk gamblers through its easy access. Its lack of regulation and oversight provides a haven for money laundering and unfair gaming.

Options

Policy makers have a continuum of options to deal with Internet gambling. The options range from leaving their hands off it to prohibiting it. In between these two options are forms of regulation. The following table shows the effectiveness of each option for each problem and its ease of implementation.

	Hands Off	Regulation: Licensure	Regulation: Advertising	Effective Prohibition
Youth Gambling	No effect	Reduces	Reduces rapid growth	Doesn't increase
Problem Gambling	No effect	Reduces	Reduce rapid growth	Doesn't increase
Money Laundering	No effect	Deters through oversight	Little effect	Deters
Unfair Gaming	Some initiated	Deters through oversight	Little effect	No gaming
Substitution	No effect	Actually increases	Slows	Prevents
Ease of Implementation	Easiest	Harder than advertising	Easier than licensure	Hardest

Hands Off

One option is to simply leave Internet gambling untouched. Such a policy might assume that any regulation or prohibition will be easily avoided, so such attempts would be in vain. Proponents of leaving it alone can argue that market forces will take care of the demand for Internet gambling.

Reasons for Hands Off

One of the advantages of this option is that the government does not enter into the regulation of people's lifestyles. Also, proponents can argue that "hands off" is better than regulation. If the point of regulation is to get gains from taxation and if Internet gambling is regulated, then providers will stay away from the regulated United States and

locate themselves in unregulated jurisdictions. Thus, the anticipated tax revenues would be lost, but the costs of trying to regulate would still be a burden.

Hands Off Difficulties

The main disadvantage of the “hands off” option is that it provides no guarantee of an effort towards the reduction of Internet gambling’s problems. One can argue that the government has an obligation to prevent such problems. Also, a hands off policy is inconsistent with current traditional gambling policy.

Summary

The “hands off” policy does nothing to prevent or reduce any of the problems unless market forces signal to providers the need to reduce the problems. At the present time, the only problem being addressed through market forces is unfair gaming. Currently, some private companies are attempting to act as regulators to instill confidence in users. For example, various Internet gambling websites display a PriceWaterhouseCoopers (a public accounting firm) symbol that states that the website’s payouts have been certified. This is an attempt to instill in players confidence against the problem of unfair gaming. Other evidence for the attempt of market forces determining what users want is the existence of various websites that rate the payouts of gambling websites.

Both PWC and payout rating websites attempt to self-regulate as determined by market forces. Again, nothing is done for the main social problems, and nothing likely will be done because private firms gain nothing from helping youth and problem gamblers. In fact, youth and problem gamblers increase gambling websites’ revenues.

Prohibition

The 1996 Congress created the National Gambling Impact Study Commission (NGISC) to conduct a study of all aspects of gambling. The study included Internet gambling. The NGISC recommended that Internet gambling be prohibited for the following reasons:

Because it crosses state lines, it is difficult for states to adequately monitor and regulate such gambling. Because of the lack of sound research on the effects of these forms of gambling on the population and the difficulty of policing and regulating (NGISC, 1999).

Their recommendation is based on the assumptions that regulation would be more difficult and the effects of gambling are not well known. Although I agree that regulation would be difficult, I don't find it conclusive that regulation would require more resources than prohibition. And although I agree with the aims of prohibiting gambling, I doubt the ability to effectively prohibit.

Reasons to Prohibit

If prohibition were effective, it would eliminate the risk of increased youth gamblers due to Internet gambling by closing the opening to gamble on the Internet. Effective prohibition of Internet gambling would also prevent gambling from making itself more available to those who may be at risk of problem or pathological gambling. Prohibiting Internet gambling would clearly combat these problems by eliminating access. However, effective implementation of prohibition is difficult.

Prohibition Difficulties

Prohibition entails deterring potential providers and participants by making Internet gambling illegal and prosecuting violators of the prohibition. A main difficulty of prohibition is having the necessary resources needed to prosecute violators and

prosecuting often enough to signal to providers and participants that the prohibition will be strictly enforced (Clark and Dempsey, 2001).

Three additional aspects of Internet gambling make it particularly difficult to prohibit outright. First, Internet technology is so advanced that it easily circumvents its prohibition. Internet gambling websites whose addresses are blocked can easily reemerge with new addresses. Second, the international nature of the Internet makes it impossible for law enforcement to enforce prohibition in only the United States when foreign websites are both easy to access and difficult to precisely censor. Lastly, government needs for Internet gambling's potential tax revenue coupled with consumer demand would likely create a call for the rescission of its prohibition. (Bell, 1998)

Another difficulty for prohibition is the bad experience of alcohol's prohibition in the early part of the 20th century. Mentioning prohibition recalls the memories of the previous failed attempts to prohibit a good considered a vice by the government. Some argue that "it is doubtful if prohibition can be enforced. They argue that if a country does introduce a ban, citizens will turn to offshore sites, with a consequential loss of valuable revenues" (McMillen, 2000).

Prohibiting Internet gambling would not be consistent with the current policy for traditional gambling establishments. Rather than being prohibited, traditional establishments are regulated.

Methods

Various methods have been proposed to prohibit gambling. The Kyl bill in Congress explicitly prohibits Internet gambling (McMillen, 2000). Others have prohibited it through indirect means. For example, some people have proposed banning the use of

credit cards for Internet gambling (Batt, 2003). Others have proposed that Internet Service Providers (ISPs) be held responsible to block Internet gambling websites. A difficulty of most prohibition options is that they place the responsibility of prohibition upon private companies. The private companies would not have the resources to deal without significant help from the government.

Summary

Outright prohibition would reduce increases in gambling problems. However, implementing prohibition is nearly impossible due to the resources required and the elusive nature of Internet gambling. Although in theory prohibition prevents an increase in problems due to Internet gambling, regulation is more practical.

Regulation

Regulation is the best solution not because it treats each problem best, but because it maximizes the financial benefits while minimizing the social problems. As one researcher noted, "Regulation allows governments to establish consumer protectionism and gain revenue and social benefits" (McMillen, 2000).

Reasons to Regulate

The social reasons to regulate are identical to those to prohibit: prevent the abuse of Internet gambling by youth and problem gamblers, and reduce the risk of money being laundered through Internet gambling websites. In addition, regulation enables fair gaming.

In comparing regulation to prohibition, regulation is more practical. Regulation provides benefits that prohibition does not. Regulation better protects consumers from unfair gaming. A regulated gambling website is more likely to honor payouts than an

unregulated website. Whereas, under prohibition, individuals would be gambling on illicit websites and have no recourse against unfair gaming—although that would be an advantage under prohibition.

Researchers suggest that gamblers would be “confident of operator fairness and solvency, and the availability of legal redress, if a government authority has screened the licensee, improving transparency” (Clark and Dempsey, 2001). Similar support has been given that “a strict regulatory regime that ensures probity and protects consumers will have strong appeal” (McMillen, 2000). Under regulation, Internet gambling consumers will shift towards using regulated websites because they will have greater trust in the integrity of approved websites.

Regulation can also deter money laundering through its oversight of licensed websites. Regulation is also consistent with current policies for traditional gambling establishments.

Regulated Internet gambling can produce tax revenues by allowing licensed websites to be located in the United States that currently are in other jurisdictions. To demonstrate the costs versus the benefits of regulation in strictly monetary terms, we look at the Nevada Gaming Commission budget. In 2001, the budget for the Gaming Commission was \$27.4 million. State gaming taxes and fees totaled \$727.1 million. The total gaming win was \$9.66 billion (<http://gaming.state.nv.us/gamefact01.htm#1a>). The taxes and fees gained are over twenty-five times the budget needed to regulate gaming in Nevada. Although Internet gambling numbers are smaller, the ratio of benefits to costs has significant room to shrink and still be profitable. If the savings from fair gaming,

controlled youth and problem gambling, and reduced money laundering are included, it appears even more so that the benefits outweigh the costs.

Regulation Difficulties

Regulation has difficulties. Regulation requires significant resources, and is difficult to fully enforce due to the nature of the Internet.

As one of the benefits of regulation is tax revenue, it should be noted that finding the optimal tax rate is very difficult. For example, Australia's tax-sharing model among states failed due to a lack of cooperation among states. The states' tax rates varied from four percent to fifty percent (McMillen, 2000). A poor tax rate might not just cause tax revenues to go to the next state, but might cause the revenues to leave to unregulated countries. In such cases, the regulated country would still be burdened by the enforcement of regulations, but without the benefit of tax revenues.

Methods

Internet gambling could be regulated in many ways. Currently, most governments that allow Internet gambling regulate by requiring Internet gambling websites to be registered, or licensed, and regularly reviewed. These "licensing schemes range from merely selling licenses to requiring complete background checks and continuing oversight of operators" (Rose, 2000). Payouts can be verified. Also, control systems to prevent youth gamblers and problem gamblers can be checked. In addition, to receive a license in some jurisdictions, a fund must be set up to support problem gamblers (Kahnawake, 2003).

Another method of regulation recently introduced is similar to one for traditional gambling: regulation of advertising. An Indiana state Senate committee approved a bill

that would make it a felony to promote *illegal* Internet gambling. The Indiana bill targets radio advertisements and pop-up ads on the Internet (Buchthal, 2003). With regulation, instead of illegal Internet gambling, *any* (not just illegal) Internet gambling advertising could be regulated. Such regulation would help slow the rapid growth and spread of Internet gambling to youth and problem gamblers and substitution; although alone it would not affect money laundering or unfair gaming.

Jurisdiction

If legislation is introduced to regulate Internet gambling, arguments may arise as to who has jurisdiction between states and the federal government. (Prohibition would encounter the same arguments.) Proponents of the federal government state that commerce on the Internet is interstate and falls under federal jurisdiction. In addition, since states have mixed laws and Internet gambling is conducted across state and national borders, the federal government would be most able to create standardized regulations for the whole nation. As the example of Australia states and varying tax rates demonstrates, states do not cooperate well when competing for tax revenues. The federal government would best coordinate regulation among states.

Proponents of states taking the lead argue, “States have almost always been the chief guardians of morality, including the control of gambling” (Rose, 2000). In fact, since states currently regulate traditional gambling, allowing states to regulate Internet gambling would be consistent with current policy.

I propose that the federal government take the lead. The nature of Internet gambling is distinct from traditional gambling and has a strong interstate element. The federal

government can best enact clear and uniform regulations that will enable easier compliance.

Conclusion

Internet gambling is a rapidly growing industry. The many problems associated with Internet gambling justify its restriction. Outright and effective prohibition of Internet gambling reduces the problems of Internet gambling. However, Internet gambling evades prohibition due to its international and circuitous nature. Also, prohibition's high cost and difficulty of effective implementation make it a poor choice.

Since prohibition cannot be practically implemented, its benefits are unlikely to be realized: Internet gambling will continue to be available. Given that Internet gambling exists regardless of prohibition or regulation, regulation provides a better solution. The NGISC's recommendation for prohibition makes prohibition appear easier than regulation. However, this is unfounded. Both require significant resources and encounter similar difficulties. But regulation has greater benefits. Regulation emerges as the best practical strategy because most benefits of prohibition are obtained, it provides additional benefits of tax revenues and consumer protection, and it can be implemented.

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