Analyzing the Trends in Gaming-Based Tourism for the State of Nevada: Implications for Public Policy and Economic Development

William R. Eadington

Abstract

Gaming revenue trends for Nevada's three major gaming markets—Las Vegas Strip, Reno-Sparks, and South Lake Tahoe—are examined over the past two decades. The Las Vegas Strip had been characterized by cyclical growth from 1990 until 2007, but the Great Recession had dramatic adverse impacts on revenues and employment. Apparent recovery in 2010 was driven largely by baccarat revenues, but they are not likely to be sustainable in the long term. For South Lake Tahoe, deterioration of its core tourism business has been taking place since 1990, but has accelerated since the beginning of the Great Recession and the opening of the Red Hawk Casino near Sacramento in 2008. Both Reno-Sparks and South Lake Tahoe have lost approximately two-thirds of their tourism gaming revenues over the past two decades. Reno-Sparks' overall gaming revenues have held up better than South Lake Tahoe because of a substantial locals' gaming market, which is not replicated at South Lake Tahoe. Finally, fiscal and policy implications of these trends are outlined for the State of Nevada.

Key words: Casinos, gaming revenues, Las Vegas Strip, Reno-Sparks, Lake Tahoe

Introduction

The gaming industry has been good for the state of Nevada. Gaming is the largest employer in the state, the largest taxpayer, and has been the major export industry for Nevada's economy for quite some time. However, gaming has experienced rough times over the last few years, especially since the onset of the Great Recession in late 2007.

This analysis looks at trends in gaming revenue performance that have emerged in Northern and Southern Nevada since 1990. In particular, this analysis examines the dynamics of demand for Nevada casino gaming in Northern Nevada's primary tourist markets of Reno-Sparks and South Lake Tahoe, with the objective of determining how sensitive demand has been to geographic competition from more proximate and convenient casino outlets relative to population centers (i.e. tribal casinos close to California's main metro areas). In the same context, tourist demand for the Las Vegas Strip is examined since 1990, noting that the consumer experience has been expanded with the diversification of the quantity, quality and supply of offerings in that marketplace, including entertainment, conventions, night clubs, and retail shopping opportunities, as well as a substantial shift to more up-market casino-hotel and restaurant facilities. However, since the Great Recession, there has been an unprecedented decline in spending on both gaming and non-gaming activities on the Las Vegas Strip, reflecting far greater sensitivity of such activities to the business cycle than had been previously believed. Furthermore, the rapid and dramatic

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growth in baccarat revenues, the one bright spot on the Strip between 2007 and 2010, is examined in terms of its potential long term sustainability.

The findings in this analysis have dramatic and significant implications for public policy in Nevada. These will require policy makers and researchers to make a sober, careful, and thoughtful analysis of the state's public policy alternatives in the immediate and intermediate future.

The Economic Dynamic

For Southern Nevada, major capital investments undertaken in the first decade of the 21st century created a situation by 2011 of significant over-capacity in gaming-based tourist facilities, especially those on the Las Vegas Strip targeting the high end of the market.[1] With the coming of the Great Recession and continuing through 2009, the Las Vegas gaming industry was challenged by a dawning reality of financially distressed gaming companies that were heavily over-leveraged.[2] Growth had remained relatively robust until November 2007, but then trends in visitation, gaming spending, and spending on non-gaming activities by tourists, all declined dramatically. Initially with the sub-prime mortgage crisis, soon followed by the collapse of Southern Nevada's residential construction market, and then the rapid decline of the commercial construction market, the area's gaming revenues, along with other important industry metrics, experienced consistent negative growth for more than two years through 2009. According to some studies, Las Vegas quickly transformed from one of the most dynamic metropolitan economies in the world to one of the most distressed.[3]

The particular set of events accompanying the Great Recession in Southern Nevada broke the long-held belief that gaming was recession-proof or at least recession-resilient. Indeed, it proved those statements to be dramatically incorrect. As it turned out, much of the successful diversification into non-gaming areas within mega-casino developments along the Las Vegas Strip over the past two decades were far more susceptible to recessionary downturns than anyone had anticipated.

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Over the past two decades, Northern Nevada's gaming industry has followed a fundamentally different path than that of the Las Vegas Strip.[4] Lake Tahoe's casino industry has been in long-term decline since the early 1990s, and for Reno/Sparks, the declines since 2000 have been dramatic. The declines can be seen not only in gaming revenues, but also in tourism visitation and in the size of the casino industry itself, as measured by employment and by gaming positions.[5]

Since 1990, Northern Nevada gaming witnessed the growth of substantial external gaming and casino competition from Las Vegas, Northern California, and the Pacific

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1 Over-capacity in Las Vegas Strip hotel-casinos became increasingly apparent in 2008 and 2009, as major mega-casino projects (i.e. the Echelon, Fontainebleau, Las Vegas Plaza, Crown) were cancelled or went into bankruptcy prior to completion, or which opened but then were substantially reduced in value either through write-downs (i.e. MGM's CityCenter was written down from historic costs of $8.5 billion at opening in December 2009 to $2.65 billion in August 2010) or though sales to third parties (i.e. M Resorts was built for a cost of about $1 billion and opened in March 2009, but was sold to Penn National for $230.5 million in October 2010.) See, for example, Green (2010), Benston (2010-2).

2 Over-leveraged companies included the publicly traded companies MGM and Las Vegas Sands, which experienced declines in share prices between October 2007 and March 2009 between 98% and 99%. Station Casinos and Harrah's (later renamed Caesars Entertainment) went through leveraged buy-outs between late 2007 and early 2008, incurring substantial debt levels, Station at $8.7 billion and Harrah's at about $27 billion. Station subsequently went into bankruptcy in 2009, though Harrah's managed to avoid that alternative. See Green (2009), Benston (2010-1).

3 According to a December 2010 Brookings Institution Study ("Global Metro Monitor: A preliminary overview of 150 global metropolitan economies in the wake of the Great Recession"), Las Vegas fell from a ranking of 14th among 150 major metropolitan areas in the world in terms of employment and income growth for the period 1993-2007 to 146th by 2010. Only Dubai (2nd to 149th) and Dublin (6th to 150th) fared worse than Las Vegas in absolute comparisons by this index.

4 However, the dynamic of casinos in Downtown Las Vegas have been similar to those in Reno/Sparks since 1990.

5 A gaming position is defined as a place where one customer can gamble. Thus, one slot machine is a single gaming position, whereas a table game is assumed to be six gaming positions.

Northwest, in particular in the form of new commercial and Tribal casinos. This, along with limited capital investment in the Northern Nevada gaming industry, resulted in a rapidly diminishing tourism component to the main traditional casino destinations of Reno and South Lake Tahoe. Since the beginning of the Great Recession in 2007 and over the following three years, these declines became even more pronounced.

Northern Nevada gaming also experienced declines in capital investment that not only accompanied and contributed to declining demand from tourists, but were largely driven by lowered expectations on returns on invested capital in the industry. As a result, the region's casinos fell further and further behind their competitors in the quality of facilities and experiences they had to offer.

For a long time, the major threat confronting Northern Nevada, and similarly but less ominously for Southern Nevada, was that California might legalize casino-style gambling. With the passage of Proposition 5 in 1998 and Proposition 1A in 2000, Tribal casino gaming was effectively legalized in the Golden State. California's Tribal gaming industry grew to nearly $8 billion in 2007, at a time when Nevada's statewide gaming revenues were only $12 billion. By 2010, Nevada gaming revenues had contracted to about $10 billion, whereas California's gaming revenues were at about $7 billion (Nevada Gaming Control Board, 2007-2010; National Indian Gaming Commission, 2011).

The Las Vegas Strip

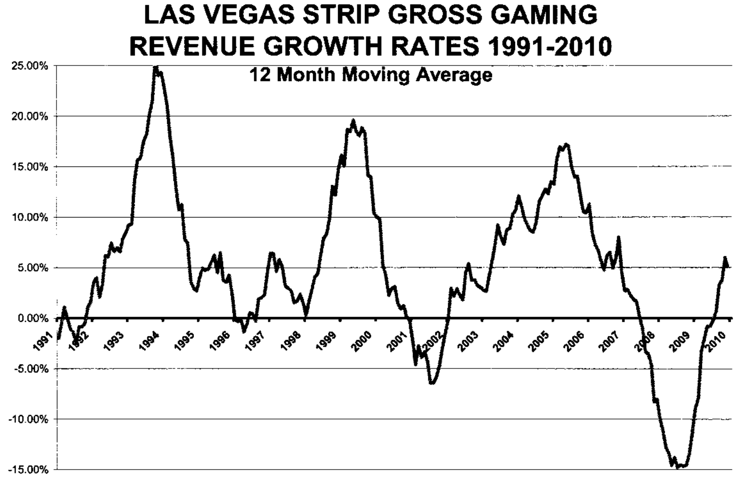
Since 1990, the Las Vegas Strip gaming market has been characterized by robust growth, substantial capital investment and considerable diversification of its tourism offerings, with particular emphasis on convention facilities and high quality hotel, restaurant, entertainment, and retail shopping opportunities. Between 1990 and 2010, Las Vegas arguably became the largest tourist destination in America. (Baedeker, 2008) With nearly 40 million visitors per year at its peak in 2007, modern Las Vegas over the past two decades was characterized by waves of mega-casino openings, beginning in 1989-1990 with the $650 million Mirage and the $275 million Excalibur, and culminating in 2009 with MGM's $8.5 billion CityCenter and 2010 with the $3.9 billion Cosmopolitan.

Another important Las Vegas trend since 2000 has been the consolidation of major gaming companies. Prior to 2005, Harrah's Entertainment had acquired Showboat, the Rio, Harvey's, Horseshoe, Binion's, and other smaller gaming companies. Its competitor Caesars had acquired Bally's and Hilton. In 2005, Harrah's acquired Caesars for $9.7 billion, and in 2010, Harrah's changed its corporate name to Caesars Entertainment. In a similar manner, prior to 2005, MGM had acquired Mirage Resorts and New York New York; in 2005, it acquired Mandalay Resort Group (formerly Circus Circus) for about $8 billion. After the mergers, Caesars and MGM, between them, owned more than half of the major casino-hotels and controlled about two-thirds of the gaming positions on the Las Vegas Strip.[6]

The 1990s could be characterized as a period of unprecedented economic growth and capital investment for the Las Vegas Strip. Waves of new mega-casino development occurred in 1989-90, 1993-94 (Treasure Island, Luxor, MGM Grand), and 1998-2000 (Bellagio, Mandalay Bay, Paris Las Vegas, the Venetian, the Aladdin); new mega-casinos opened with a sense of optimism often mimicking what had worked in the recent past. In aggregate, the new properties continued to increase spending in and visitation to Las Vegas. Larger and more expensive projects were pursued on the belief that Las Vegas-style entertainment was unique, characterized by economies of scale and scope, and still significantly under-supplied. There was also a belief that Las Vegas had created its own business cycle, with peaks around the openings of new mega-casinos, and slowdowns in growth rates in the year or two following the grand openings. These cycles can be seen in Figure 1.

6 As of 2010, MGM Resorts International had full or partial ownership of the following casino-hotels on the Las Vegas Strip: MGM Grand, Bellagio, The Mirage, Circus Circus, Mandalay Bay, Luxor, New York New York, Excalibur, and CityCenter's Aria. Caesars (formerly Harrah's) owned and operated Harrah's Las Vegas, Rio, Caesars, Bally's, Paris Las Vegas, Planet Hollywood, Imperial Palace, Flamingo, O'Shea's, and Bill's. In total, the two companies operate over 31,000 of the approximately 49,000 slot machines on the Strip, and over 2,000 of the 2,800 table games. (Source: www.casinocity.com)

FIGURE 1



Source: Nevada Gaming Control Board, *Gaming Revenue Reports*

From 2000 for the next few years, the Las Vegas Strip experienced a slowdown from over-expansions, the bursting of the dot-com bubble, and the fall-out from the tragic events of September 11, 2001. This created a hiatus in new developments for about three years, but beginning with the development of the $2.5 billion Wynn Las Vegas, the race was on again. By 2006, there were roughly $30 billion in capital investment projects underway on the Las Vegas Strip or elsewhere in the Las Vegas valley, as more and more expensive casino-hotel-entertainment-tourist accommodation unit projects were announced, financed, and undertaken.

One could argue, especially in retrospect, that what was occurring in Las Vegas by mid-decade was clearly "irrational exuberance" on the investment scene.[7] New casino and tourist-oriented projects were being undertaken on a belief that Las Vegas, especially the Strip, would continue doing what it had successfully achieved over the past 30 years. Actions of the major casino companies, supported by the financial community, suggested a widely held belief that Las Vegas would continue to evolve into a high end, hedonistic, tourist accommodation unit-driven entertainment center for America and the world. Virtually every major gaming company in Las Vegas either committed to new massive multi-billion dollar mega-casino projects, or to highly leveraged buy-outs, or both. International gaming and hotel companies that were not yet in Las Vegas wanted in, and some were willing to pay exorbitant prices to enter this booming market. Financial institutions and hedge funds, with plenty of capital to lend, were willing partners. As with Dubai in the Middle East, investment decisions in Las Vegas were being made and major capital projects were being undertaken on the implicit assumption that increasingly affluent classes throughout the world would embrace what Las Vegas had to offer. Growing upper and upper middle classes were all becoming wealthy enough to afford such extravagances. However, as in many other parts of America and the world, the onset of the Great Recession provided a rude awakening.

It is important to appreciate how much the Great Recession crippled the major American gaming companies, many of whom remain heavily debt-ridden and struggling to recover into the second decade of the 21st century. Prior to 2008, commitments were

7 Irrational exuberance was used in a famous speech by Federal Reserve Chairman Alan Greenspan on December 5, 1996. He said: "Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets. We can see that in the inverse relationship exhibited by price/earnings ratios and the rate of inflation in the past. But how do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?" (Emphasis added). "The Challenge of Central Banking in a Democratic Society," Address before the American Enterprise Institute, Washington, D.C.

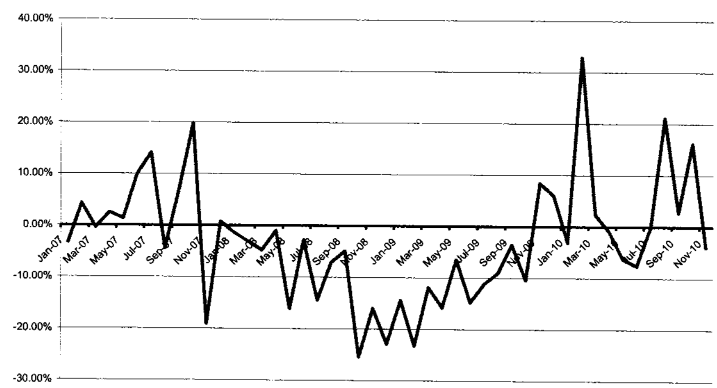
made to enormous projects: MGM had CityCenter with capital costs of $8.5 billion; Wynn had Encore ($2.5 billion); Las Vegas Sands had the Palazzo ($1.7 billion) and the Cotai Strip in Macau (estimated at $12 billion); and Boyd Gaming had Echelon Place (estimated at $4.8 billion). Other Strip developments included the Cosmopolitan at $3.9 billion, Fontainebleau at $3 billion, M Resort at $1 billion, the Plaza on the site of the Frontier Casino at an estimated $6.5 billion[8], and the Crown (near the Riviera) at $3 billion; some of these projects never broke ground, and others were started but not completed, or were later sold at a fraction of their historic costs. (Lerner, 2007)

Other companies incurred substantial debt as a result of leveraged buy-outs: Harrah's with debt of roughly $27 billion after their January 2008 buy-out and Station Casinos with debt of $8.7 billion when their leveraged buy-out closed in November 2007. The combination of substantial debt loads and greatly reduced cash flow pushed nearly all the above companies to the brink. Station and Fontainebleau declared bankruptcy in 2009, though others, including Harrah's, MGM, and Las Vegas Sands, all managed to survive.

Between 2007 and 2010, there had been a major mega-casino that opened each December.[9] However, unlike previous mega-casino openings, there were no discernible increases in gaming revenues and in visitation.[10] Coincident with and probably due to the Great Recession, the paradigm for the Las Vegas Strip appeared to have changed.

As can be seen in Figure 1, Las Vegas year over year growth rates began to trend negative after October 2007. With the exception of the period following 9/11 and those periods a year or two beyond the openings of new waves of mega-casinos, the Las Vegas Strip had rarely experienced negative growth in gaming revenues, and when they occurred, they were never sustained. However, from an examination of monthly data beginning in November 2007, growth rates turned negative and stayed that way consistently for more than two years, through October 2009 (Figure 2). 2010 had a few positive spikes in growth, suggesting a moderate recovery for this most important of Nevada's gaming markets.

FIGURE 2
LAS VEGAS STRIP, YEAR OVER YEAR GROWTH RATES 2007-2010



Source: Nevada Gaming Control Board, *Gaming Revenue Reports*

8 The El-Ad Group, an Israeli based development company, purchased the Frontier Casino on the Strip in 2006 for $1.2 billion, and intended to build a $5 billion Plaza Las Vegas on the 35 acre site. As of 2011, the site remains bare land, purchased at a record (for the Strip) $35 million per acre.

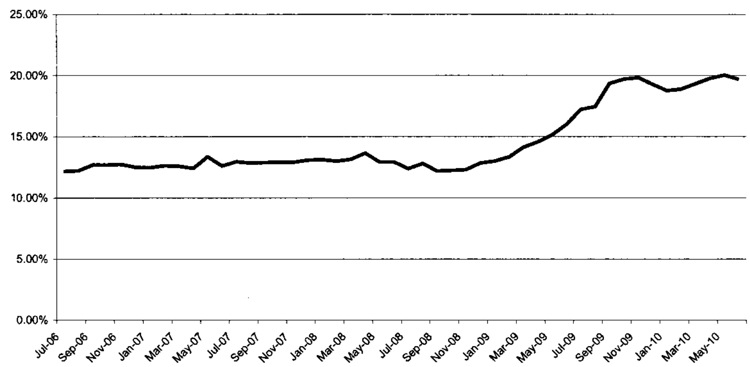
9 Las Vegas Sands' Palazzo opened in December 2007; Wynn's Encore in December 2008; MGM's CityCenter in December 2009; and Deutsche Bank's Cosmopolitan in December 2010.

10 In calendar year 2007, Las Vegas attracted 39.2 million visitors. In 2010, the number of visitors had fallen to 37.3 million. Las Vegas Convention and Visitor's Authority (2007-2010).

However, a closer analysis of trends in one particular game suggests a more pessimistic reality, especially with respect to the domestic American tourist market. The game is baccarat. Between 2006 and 2010, there was clearly an upward trend in baccarat revenues on the Las Vegas Strip, growing from an average of about $65 million per month to an average of about $95 million per month, dramatically opposite the trend of all other game and device categories. In 2006, baccarat revenues had averaged 13.5% of gaming revenues for large Las Vegas Strip casinos[11]; by 2010, this ratio had climbed to 22.6% of gaming revenues. The ratio of baccarat revenues to total gaming revenues for the largest Las Vegas Strip casinos is shown in Figure 3.

Between 2006 and 2010, there was clearly an upward trend in baccarat revenues on the Las Vegas Strip, growing from an average of about $65 million per month to an average of about $95 million per month.

FIGURE 3
RATIO OF BACARAT WIN TO GROSS GAMING REVENUES, 12 MONTH MOVING AVERAGE LAS VEGAS STRIP 2006-2010



Source: Nevada Gaming Control Board, *Gaming Revenue Reports*

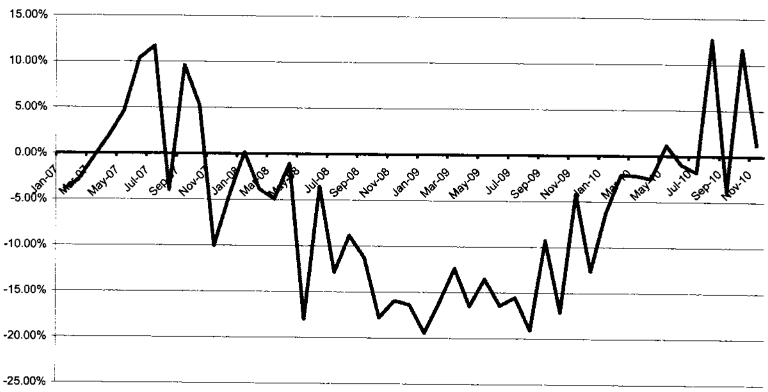
Very few casinos share in high end baccarat play, which comes almost exclusively from a handful of Asian players. Those companies that capture the lion's share of baccarat revenues—Las Vegas Sands, Wynn Resorts, and MGM Resorts International—all have a presence in Macau, giving them far better access to VIP Asian customers than they ever had before 2006. Differential tax structures between Macau and Nevada—39% of gross gaming revenues versus 6.75%—incentivize these companies to encourage their best players to make more visits to their casinos on the Las Vegas Strip. By 2010, baccarat was generating about $1.2 billion per annum to the large Las Vegas Strip casinos' total gaming revenues of $5.2 billion, far exceeding blackjack, the next most important game, with a contribution of $650 million. (Nevada Gaming Control Board, Monthly Revenue Report, December, 2010)

Removing baccarat revenues from total gaming revenues in Las Vegas, a much more pessimistic picture emerges of the domestic gaming market—what Americans spend on gaming in Las Vegas. (See Figure 4.) From November of 2007 to August 2010, the large Las Vegas Strip casino gaming revenues have negative year over year comparisons every month; by the end of 2010, there were only two months that showed positive growth over prior year comparisons. Las Vegas may have been showing signs of recovering in 2010, but very little of that reflects the domestic market. Furthermore, though the continued buoyancy of the baccarat market is good news for Strip casinos and for Nevada gaming in the short term, it cannot be counted on in the longer term. With the rapidly increasing

11 This category includes casinos with annual gross gaming revenues in excess of $72 million. In 2010, there were 23 such locations.

supply of high quality mega-casinos in Macau, Singapore, and perhaps soon in Taiwan, Japan, the Philippines, and elsewhere in Asia, it is unlikely that Las Vegas will be able to retain these select customers as their gaming options in Asia continue to improve over the next decade.

FIGURE 4
LAS VEGAS STRIP GAMING REVENUES LESS BACCARAT, YEAR OVER YEAR GROWTH 2007-2010



Source: Nevada Gaming Control Board, *Gaming Revenue Reports*

Some other long term trends for the Las Vegas Strip are also worth noting. From 1990 to 2008, employment among the largest Las Vegas Strip casinos climbed nearly 200%, from 43,000 to 115,000; between 2008 and 2010, these casino complexes shed over 25,000 jobs. Table games grew in numbers until 2007, but then experienced attrition. There has been a reduction in the number of slot machines in Las Vegas over the last decade, but that is largely due to efficiencies and adjustments within individual properties. (Nevada Gaming Control Board, Monthly Revenue Reports and Gaming Abstracts.)

In summary, it is not difficult to conclude that the Las Vegas Strip is at the end of the mega-casino era. The belief that Las Vegas growth will always occur and that the market will always metamorphosize into the "next new thing" has largely been shattered. There has been a shift in spending patterns by casino visitors in general and Las Vegas visitors in particular. The American public, especially because of what has happened to the equity in their homes between 2007 and 2011—and therefore their implicit savings and retirement accounts—are likely to be far more frugal over the next decade than they were in the last. The "new" Las Vegas from 1990 to 2010 was based on conspicuous consumption and "over the top" spending —the very antithesis of the kind of frugality that might emerge. Whether the free spending that characterized the Las Vegas Strip at its peak comes back or not cannot be known at present, but the prognosis is not encouraging.

In 2011, the Las Vegas economy remains one of the worst economies in the nation. It has experienced reversal in population growth and a collapse of its construction industry, which will be difficult to reverse. With the nation's highest unemployment rate for a metropolitan area (14.9% in January 2011) and an economy based disproportionately on gaming and construction, Las Vegas' immediate future is likely to be characterized more by stagnation or out-migration than population growth.[12] This could change if gaming or other new export industries become job creators in the future, but without such stimulation, it is difficult to see how population growth can once again be robust in the

12 From 2000 to 2010, Clark County (Las Vegas metro area) population grew from 1.38 million to 1.95 million, a 42% increase. However, in 2010, the Nevada State Demographer made "low employment estimates" and "high employment estimates" for Clark County for the period from 2009 to 2030. The "low employment estimates" projected 1.979 million population in 2030, virtually unchanged from the estimated 1.952 million in 2009. Nevada State Demographer at http://nvdemography.org/.

immediate or intermediate future. Without population growth, residential construction will not likely recover to anywhere near its prior levels.

South Lake Tahoe

The casino business at South Lake Tahoe is largely a drive-up business from Northern California, primarily by way of a winding mountain road, Highway 50, which is a difficult highway to drive in winter months. In December 2008, a new tribal casino, Red Hawk, opened in Shingle Springs, near Sacramento, on the California side of the Sierra Nevada Mountains. This tribal casino captured many of the customers who otherwise may have come to South Lake Tahoe.

Lake Tahoe's gaming industry is affected by seasonal tourism that is linked to skiing and to second-homeownership. However, neither of those groups typically provides strong gaming customers, and because of the low permanent resident population in the Tahoe basin, there is no significant locals' market at South Lake Tahoe. The expansion constraints that were placed on the gaming industry at Lake Tahoe by the Tahoe Regional Planning Acts of 1967 and 1980 also affected the growth of the industry by generally prohibiting casino expansions and limited the ability of existing casinos to take advantage of economies of scale. Furthermore, Lake Tahoe has always suffered from lack of easy access from regional airports; Reno-Tahoe International Airport, the closest, is more than an hour and a half away from the South Lake Tahoe casinos.

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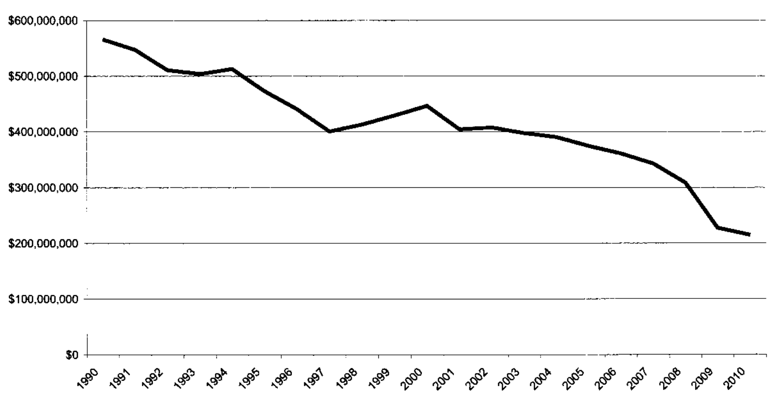
One finding that emerges from trend analysis is that, in real terms, the size of the gaming industry at South Lake Tahoe contracted by about two-thirds since 1990. Real gross gaming revenues for South Lake Tahoe, corrected for inflation, fell from \$566m to \$214m between 1990 to 2010, a nearly two-thirds decline. (See Figure 5). Other industry metrics also declined in a similar fashion. Employment declined from 11,000 employees in 1990 to 3,500 employees in 2010. Gaming positions, as represented by table games and slot machines, declined from 9,470 to 3,773, again a decline of a bit less than two-thirds. (Nevada Gaming Control Board, Monthly Revenue Reports and Gaming Abstracts.) Though declines since 2008 are related to the Great Recession and the opening of the Red Hawk Casino, the long term trends reflect a secular decline that will very unlikely reverse itself.

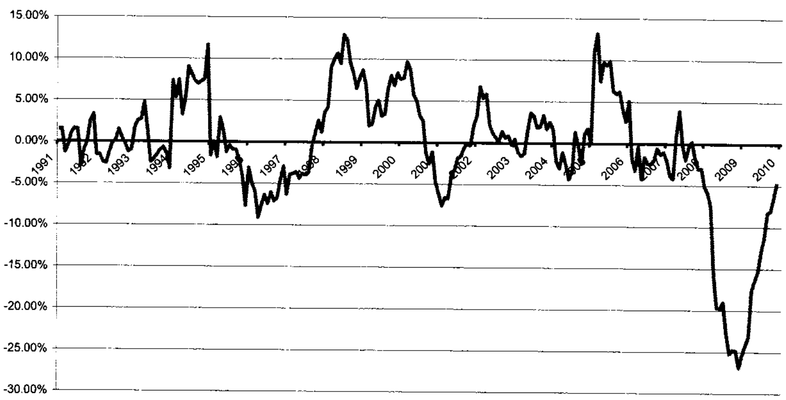
FIGURE 5
SOUTH LAKE TAHOE
REAL GROSS GAMING REVENUES 1990-2010
(2010 DOLLARS)



Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*

Figure 6 shows a 12-month moving average for gaming revenue growth rates at South Lake Tahoe (not corrected for inflation) over the past two decades. The 1990s and the first portion of the 2000s decade were characterized by both positive and negative growth. However, beginning before the Great Recession in early 2007, growth rates became consistently negative; and in 2009, corresponding to the opening of the Red Hawk Casino, the moving average declined into the -25% per annum range, with continuing contraction in 2010 in the negative 10% range.

FIGURE 6
SOUTH LAKE TAHOE GROSS GAMING REVENUE GROWTH RATES 1991-2010
12 Month Moving Average



Source: Nevada Gaming Control Board, *Gaming Revenue Reports*

In summary, corrected for inflation, the casinos at South Lake Tahoe lost about 12% of gaming revenues from 1990 to 2000; another 25% between 2000 to 2007; and an additional 40% from 2007 to 2010. By 2010, slot machine and table game counts were well under half of what they were 20 years before; and casino employment was less than one-third of what it was in 1990.

Most analysts used to believe that casino visitors came to Lake Tahoe because of its aesthetic beauty and recreational opportunities, as well as its various gaming offerings. In retrospect, the evidence suggests that casino customers were coming primarily for the gambling, and their interests in other regional amenities were far less important. The absence of any significant locals' market that might otherwise sustain the Lake Tahoe casinos made the long term contraction in gaming revenues quite dramatic.[13]

An alternative business strategy that many of Lake Tahoe's gaming and tourism interests tried to pursue in the mid-2000s was to develop tourism accommodation units as an alternative to hotel rooms; the concept was to build and sell condominiums or time share units to vacationers and others willing to buy second homes in a pristine resort area. Regrettably, when the sub-prime mortgage crisis emerged in 2007 and the Great Recession followed, housing markets collapsed nationally, along with this particular strategy.

Reno-Sparks

The Reno-Sparks gaming market has historically been a tourism market serving the populations of Northern California and the Pacific Northwest. Reno had been the primary tourism center in the state of Nevada from legalization of gaming in 1931 until the 1960s when Las Vegas and the development of the Strip overshadowed it. (Barber, 2008)

13 There are a small number of casinos at the north end of Lake Tahoe. These casinos have seen similar contraction in their gaming revenues over the past two decades, for similar reasons. However, this market generated only $28 m in gaming revenues in 2010, in comparison to $212 m in gaming revenues at South Lake Tahoe.

The downtown gaming markets in Reno and Sparks have struggled since the 1970s, but there were a number of satellite casinos developed outside the downtown areas that are now among the region's most successful casino-hotels.

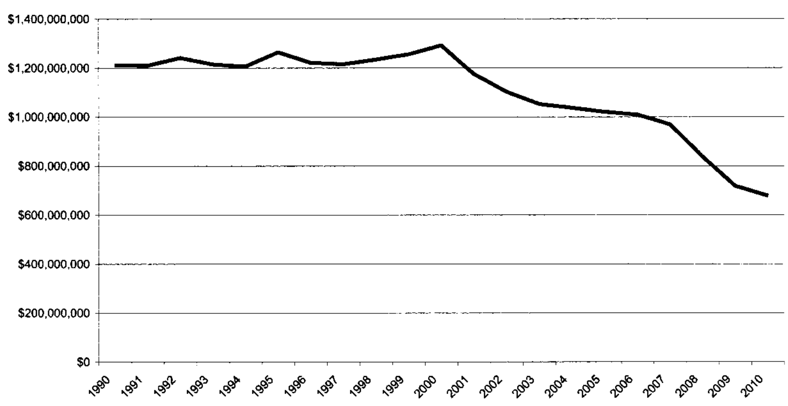
Over the years, Northern Nevada tourism has experienced a high degree of seasonality, driven largely by climate, but neutralized to some extent by a variety of well-marketed special events.

Over the years, Northern Nevada tourism has experienced a high degree of seasonality, driven largely by climate, but neutralized to some extent by a variety of well-marketed special events, many of them concentrated in the summer and fall. The Reno-Sparks area has adequate convention facilities and good air transportation, but it has remained primarily a "drive-to" regional market. The locals' market has grown in importance over the past two decades for the Reno-Sparks area, as the metropolitan area grew in population from 255,000 in 1990 to about 421,000 in 2010.

Reno and Sparks tourism from Sacramento and the San Francisco Bay Area has suffered by having a reputation of being a budget market and comparatively low average daily room rates for hotels and motels. This reputation has been very hard to change over the years, in spite of efforts by tourism officials. The weak tourism economy of the past decade has made this even more challenging.

Figure 7 (below) shows that real gross gaming revenues for Reno-Sparks had low but positive growth from 1990 to 2000, increasing from about $1.2 billion to $1.3 billion (in 2010 dollars). But beginning in 2000—the year that California tribal gaming became effectively legal—the gaming market began to experience declines. In real terms, gaming revenues fell nearly in half between 2000 and 2010. The most important factors affecting Reno-Sparks tourism since 2000 were the opening of Thunder Valley Casino—a substantial casino near Sacramento—in June 2003, the Great Recession beginning in late 2007, and the opening of the Red Hawk in Shingle Springs, near Sacramento in 2008. Not adjusted for inflation, the 1990s gaming revenue growth rates hovered in the 5% range. However, beginning in the year 2000, gaming revenue growth was negative until 2004, turned mildly positive for a couple of years, but then in 2006, began consistently contracting again. With the emergence of the Great Recession, Reno-Sparks casinos experience dramatic contraction through 2010, with few signs of improvement for the future.

FIGURE 7
REAL GROSS GAMING REVENUE
RENO-SPARKS 1990-2010
(2010 DOLLARS)



Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*

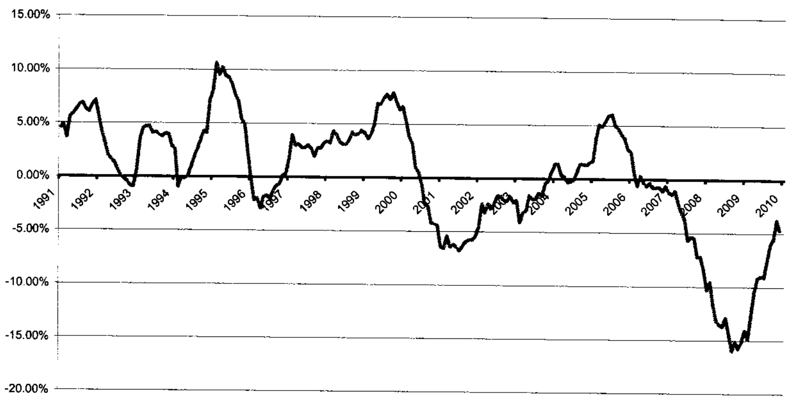
Casino employment in the Reno-Sparks area has also seen dramatic changes. Employment peaked in 1996 at nearly 30,000; by 2010, it was under 15,000. Historically, gaming-based tourism had been Reno-Sparks' dominant export industry. That designation has now changed permanently, being replaced by a number of service oriented or manufacturing industries, such as financial services, warehousing, and slot machine manufacturing.

Changes in economic performance of the Reno-Sparks gaming market since the beginning of the Great Recession are also worth noting. Year-over-year monthly gaming revenue growth from 2007 through 2010 was almost always negative, with only seven of the 48 months showing positive growth, with some of the year-over-year monthly growth rate comparisons in the negative 15% to 20% range.

FIGURE 8

RENO SPARKS GROSS GAMING REVENUE GROWTH RATES 1991-2010

12 Month Moving Average

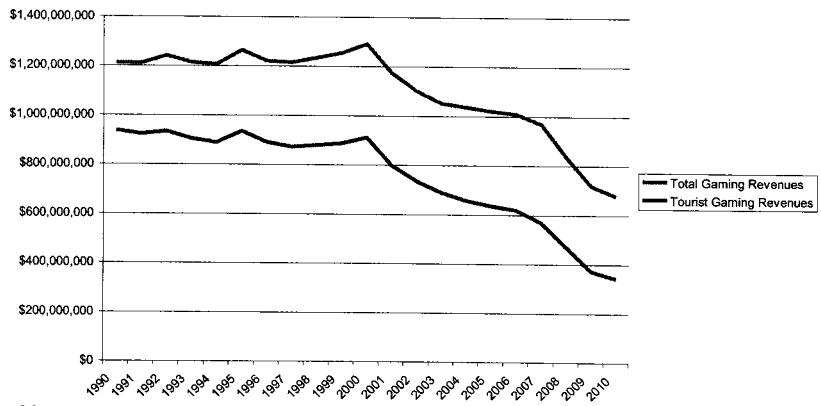


Source: Nevada Gaming Control Board, *Gaming Revenue Reports*

One can also try to isolate tourism spending on gaming by estimating and subtracting locals' spending. Given reasonable estimates about how much gaming spending in the Reno-Sparks market comes from the local market, the residual reflects gaming spending by tourists.[14]

FIGURE 9

TOTAL V. TOURIST REAL GAMING REVENUES, RENO-SPARKS 1990-2010



Source: Nevada Gaming Control Board, *Nevada Gaming Abstract*

14 In order to estimate gaming spending by locals in the Reno-Sparks market, aggregate personal income for the metropolitan area was noted, and a conservative assumption of local gaming spending at 1.0% of aggregate personal income was computed. Based on the experience of other predominantly locals' markets in Nevada, such as the Carson City/Carson Valley area, the actual ratio of locals' gaming spending to aggregate personal income could very well be in the 1.5% to 2.5% range. If this is the case, the decline in tourism gaming spending in Reno-Sparks is even greater than indicated here.

By this analysis, total real gaming revenues in Reno-Sparks (corrected for inflation) have declined by about half between 1990 and 2010. However, because of a growth in population and aggregate personal incomes in the Reno-Sparks area, gaming spending by locals increased over this period. One can deduce from Figure 9 that tourism gaming spending fell by about two-thirds over that same period of time, with almost all the tourism decline occurring within the last decade. The underlying reality for the Reno-Sparks tourism market is that their primary customers, from California and the Pacific Northwest, now have much more convenient—and often higher quality—gaming alternatives that did not exist before, and those customers would seem to be pursuing those alternative choices.

Thus, strikingly, both Reno-Sparks and South Lake Tahoe have experienced similar declines in their tourism gaming markets. For both areas, inflation-adjusted tourism gaming spending contracted about two-thirds from their respective peaks. Based on the computational assumptions used here, the percentage of gaming revenues generated by local residents of the Reno/Sparks market climbed from about 10% of the market's total gaming spend in 1990 to about 40% in 2010.[15] Thus, the difference between the two Northern Nevada regions is in their locals' markets: Lake Tahoe, with a permanent population of about 50,000, does not have much of a locals' market, whereas Reno-Sparks (Washoe County), with a population of 421,000, does. The locals' market is becoming the foundation for the Reno-Sparks gaming industry, contributing about 40% (or more) of the total gaming spending in the region. Therefore, gaming is not nearly as significant an export industry for Northern Nevada as it was before.

Finally, as with Lake Tahoe, the strategy of converting hotels to tourism accommodation units for Reno-Sparks has proved unsuccessful, especially since the beginning of the Great Recession. Two major casino hotels, the Montage (formerly the Flamingo Reno and later the Golden Phoenix) and the Grand Sierra (formerly MGM Reno, Bally's and the Reno Hilton), both struggled with sales after pursuing a tourism accommodation unit or condominium development strategy.

Policy Implications for the State of Nevada

Revisiting the implications of baccarat for the Las Vegas Strip is now in order. In the same manner that Northern Nevada gaming-based tourism has been marginalized primarily by competition from Tribal gaming in California, Las Vegas baccarat will likely see a parallel fate in the next decade. Macau, which liberalized its gaming laws in 2001, generated over $23 billion in gaming revenues in 2010, and is expected to increase to over $30 billion in 2011. Singapore, which opened its two Integrated Resort casinos in 2010, will probably generate in excess of $5 billion in gaming revenues in 2011, and will likely surpass Las Vegas in gaming revenues by 2012 or 2013. Taiwan has already legalized casinos and is in the planning process to implement its new law. Japan and the Philippines are also signaling that they are interested in going after the new mega-casino market. Asian gamblers who now come to play baccarat in Las Vegas will have a variety of choices in the very near future among very good alternatives within their particular region, and can avoid the inconvenience of 24 hours in transit to get to a comparable casino facility on the Las Vegas Strip. What the Red Hawk Casino in Shingle Springs has been to South Lake Tahoe, new Asian mega-casinos may very well be to baccarat play in Las Vegas.

The policy implications of the overall situation for the casino industry in Nevada are both challenging and sobering. As a state, Nevada has no choice but to pursue new export industries, especially in Northern Nevada. Nevada wants to be able to attract high value-added industries as its focus, but to do so, it will need to have an educational and public sector infrastructure—and therefore a tax structure—that can support desirable economic

15 Such estimates are based on a "rule of thumb" that casinos will capture about 1.0% of Aggregate Personal Income from its catchment area. This estimate might be conservative for such gaming-centric metropolitan areas such as Reno/Sparks and Las Vegas.

growth. Nevada's current tax structure, which is heavily based on the percentage tax on gaming revenues and sales tax revenues from tourist spending, is inconsistent with the economic realities that the State is confronting. Thus, as of this writing, meaningful and substantial fiscal and tax reform is fundamental.

What policy makers in Nevada need to do is consider those alternatives for spending and tax reform that can strategically focus public sector outlays and broaden the tax base, creating a fiscal and tax base consistent with the kind of industry that the State's leadership wants to see in its future. This structural change is more critical for Northern Nevada than Southern Nevada because its gaming-based tourism is disappearing.

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For Southern Nevada, the gaming and tourism industry will likely recover, but to what extent and with what kinds of emerging spending patterns by its visitors, remains uncertain. The pursuit of economic diversification in Southern Nevada has taken on a new urgency since the beginning of the Great Recession, and it seems much less likely that gaming-based tourism will ever be the engine of economic growth that it had been for the region over the previous three decades. Without alternative export industries, Southern Nevada population growth could remain stagnant for the foreseeable future.

For Northern Nevada to remain prosperous, it needs to find replacement export industries even more so than southern Nevada, and therefore must be able to attract them. Given the demographic realities of the State, with 72% of Nevada's population in Clark County (Las Vegas), Northern Nevada runs the risk of being politically marginalized as well. Without an export-based casino industry, and the population concentration in Southern Nevada, the Reno-Sparks area will find it increasingly difficult to provide the kind of private and public sector infrastructure that will be attractive to "high value added" industries in the future.

In summary, Nevada cannot be as dependent on a single industry for tax revenues in the future as it has been in the past. Economists in the State have been warning about this for the past 50 years. (Zubrow, 1960). With the Great Recession, Nevada has finally gotten burned. It is imperative for policymakers and citizens to realistically assess the needs of the State and the implications of alternative public policy choices. Fundamental reform of fiscal outlays and the tax structure may be critical as a foundation to create a new and evolving economic base in Nevada, and such structures must reflect the demands of the kinds of industry Nevada is hoping to attract.

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