

## **A RESEARCH NOTE ON INDIAN GAMING IN CALIFORNIA: SHIFTING STRATEGIES IN A BAD ECONOMY**

Thaddieus W. Conner, University of Oklahoma and William A. Taggart  
New Mexico State University

### **Abstract**

The following research note investigates the Indian gaming industry in the Golden State of California, where the recession has arguably had the greatest impact. Using annual revenue reports from the National Indian Gaming Commission and payments to California's Revenue Sharing Trust Fund, we look at not only how the recession has effected one of the largest gaming markets in Indian Country, but the apparent strategic response of gaming tribes to this volatile economic situation.

### **Introduction**

Almost three years have passed since the economic recession first swept across the American states and Indian Country. As our past investigations have revealed, Indian nations with Class III "casino style" gaming have felt the negative impacts of the financial downturn, but with noticeable differences evident across states and tribes (Conner and Taggart 2009a, 2009b, 2010). For instance, virtually all of the gaming tribes in New Mexico and the two situated in Connecticut have experienced substantial declines in either "net win" or their revenue sharing payments to the state, while the rather young and budding Indian gaming industry in Oklahoma has actually displayed signs of growth and appears to be weathering the storm better than most. More generally, the recession has shown few signs of loosening its grip on state and tribal economies, which continue to adapt to these volatile market conditions (Palermo 2009; Salgado 2009).

One state in particular that has received considerable attention as of late is California, where budget shortfalls are reported to be as high as \$19.5 billion in the most recent fiscal year and unemployment hovers around 12.5%, the third highest in the U.S. (Buchanan 2010; U.S. Chamber of Commerce 2010). In this research note, we explore the contours of the Indian gaming industry in California, where little is known about how the approximately 60 gaming nations have been affected by this spiraling economic crisis in the country's largest state. In the next section, we provide a brief background on Indian gaming in the state of California, which includes a discussion of two different revenue streams operated under the terms of the governing compacts. We follow this with an assessment of what appears to be unfolding with respect to Indian gaming in the state, drawing upon data reported by the National Indian Gaming Commission ([NIGC] 2010) and the California Gambling Control Commission ([CGCC] 2010b). We conclude by examining how the experiences of the Golden State align with the case studies explored in our previous research notes.

### **Indian Gaming in California**

Indian gaming in California is unique for a number of reasons. First, in terms of sheer size, the Indian gaming industry in California is one of the largest in the country, with approximately 58 casinos operated by 57 tribes throughout the state (CGCC 2010a). California is home to more Class III gaming

nations than any other state and boasts the second largest number of casinos behind only Oklahoma (Smith and Taggart 2010). Moreover, the NIGC (2010) reports that the “Sacramento Region,” which includes all of California and no more than a couple of nations in Nevada, accounts for approximately one-quarter of all Indian gaming revenues in the country.

A second reason for California’s uniqueness is that it is arguably the birthplace of “legalized” Indian gaming in the country. The Cabazon Band of Mission Indians in California were party to one of the most landmark Supreme Court cases in gaming history, *Cabazon vs. the State of California* in 1987, which established the sovereign right of tribes to operate gaming facilities in the United States (Light and Rand 2005). This ruling, as students of gaming are well aware, prompted passage of the Indian Gaming Regulatory Act (IGRA) in 1988, which delineates the legal framework for Indian gaming across the country today. Despite these policy developments nationally, gaming was still slow to emerge in California due to intense political pressure from groups both within and outside the state (California Nations Indian Gaming Association (CNIGA) 2010).<sup>1</sup> After an impressive tribal campaign, with millions of dollars spent on both sides of a popular referendum, California voters legalized high stakes casino style gaming and the first tribal-state compact was signed on September 9, 1999.<sup>2</sup> Over the past decade, the state of California, has signed identical compacts with over 60 nations that define the current legal, financial and regulatory dimensions of the industry (CGCC 2010a).

Finally, the gaming tribes in California also have a couple of rather unique compacting provisions with the state, including the payment of revenues to two different designated funds. The first of these requires gaming tribes to pay into the state’s Special Distribution Fund (SDF), used to cover the cost of regulating gaming according to tribal-state compacts, and “any other purposes specified by the Legislature” (CGCC 2010a). Payments to this fund are based on the “average device net win,” which is a combination of percent net win from gaming devices and the number of machines on the floor. Tribes with less than 200 devices pay nothing, while the scale rises to as high as 13%, where the number of active gaming devices exceeds 2,000. The gaming tribes in California make quarterly contributions to this fund, and access to this information is prohibited to third party users per the terms of the compacts.<sup>3</sup> The second fund that gaming tribes in California pay into is the Revenue Sharing Trust Fund (RSTF), designed to distribute or share revenues with non-gaming tribes in the state (CGCC 2010a). As a condition of their gaming licenses, most gaming tribes must pay a quarterly fee per gaming device based on a sliding scale shown in Table 1.<sup>4</sup> Nations with fewer than 350 gaming devices, including slot machines and other electronic games of chance, pay nothing into the fund, while those exceeding 350 machines each quarter pay on a graduated scale depending on the number of gaming devices on the floor. Thus, the more licensed machines a tribe operates each quarter, the higher the contribution to the RSTF. The money paid into this fund is distributed evenly to all non-gaming tribes *and* gaming tribes operating fewer than 350 gaming devices. According to the compacts, “non-compact” tribes, defined as Indian nations without a tribal-state compact or with less than 350 gaming devices, are entitled to quarterly payments of approximately \$275,000 from the RSTF. In the event of a shortfall in the RSTF, which has been rather substantial over the past decade, the compacts mandate that the CGCC use SDF revenues to cover the difference owed to non-compact tribes. Per the compacts, they cannot use state general funds to honor these obligations to the non-compact tribes. Thus, while non-compact tribes will

generally receive quarterly payments with or without a shortfall, it is in their best interests that the RSTF remains well funded and stable to ensure continued payments in the future.

*Table 1*

*Formula for Determining RSTF Quarterly Contributions\**

<b>Number of Licensed Devices</b>	<b>Fee Per Device</b>
1 – 350	\$0
351 – 750	\$900
751 – 1250	\$1950
1251 – 2000	\$4350

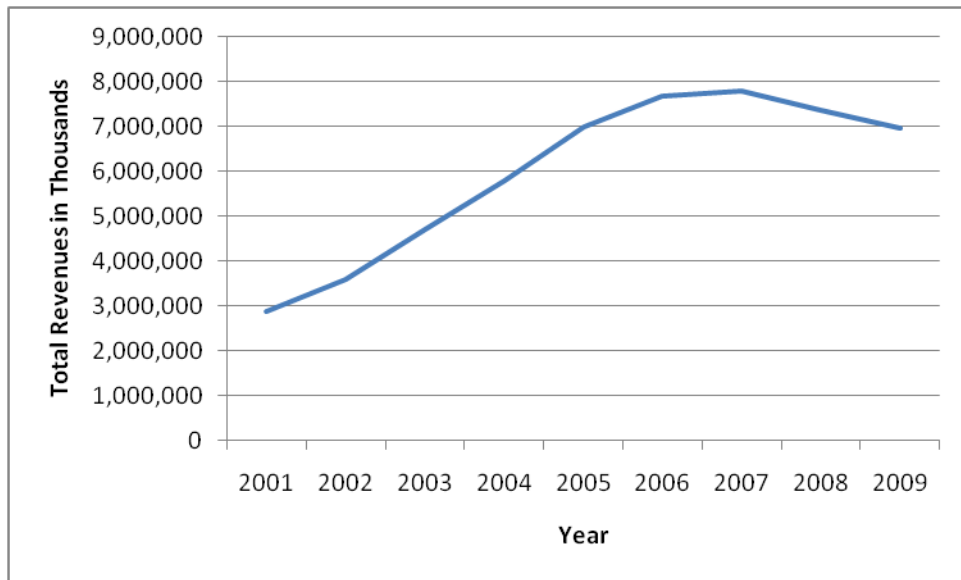
*\*Source: California Gambling Control Commission (2010) 1999 Compacts*

### **Current Trends in California**

Given the nondisclosure of payments to the SDF, which would be a telling indicator of changes in gaming activity in the state, the first step was to consider information released by the NIGC. The NIGC (2010) makes annual revenue reports available on their website with regional breakdowns, including one for the “Sacramento Region.” This region, which has had different labels in the past, has consistently covered all of California and, at most, less than a handful of gaming nations in “northern Nevada.” With this noted, these reports would appear to offer the most direct and accurate image of regional trends affecting the gaming industry in the Golden State.

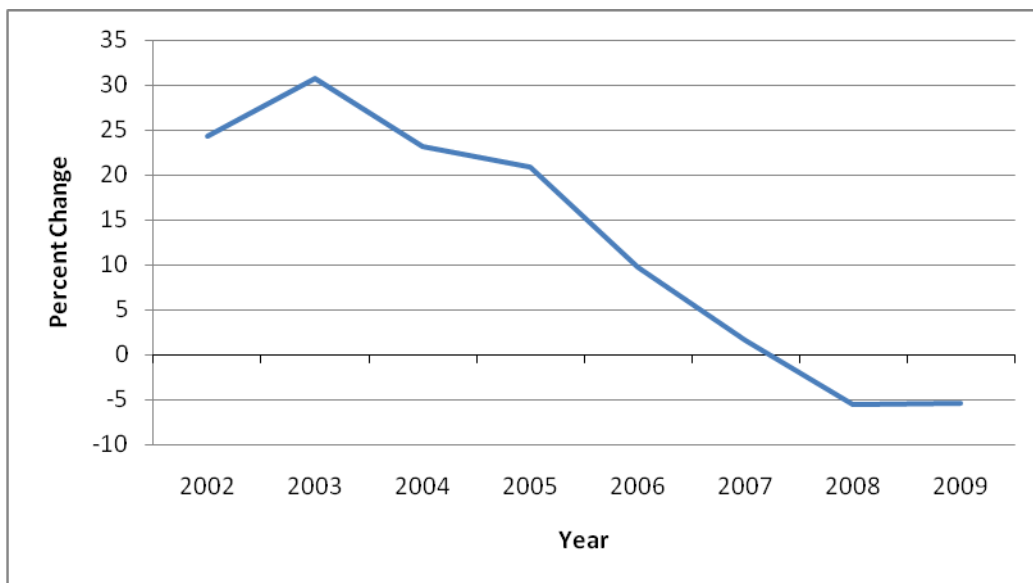
Figure 1 summarizes total Indian gaming revenues in the region from 2001 to 2009, information reported on an annual basis only. It is clear that there was a rather impressive positive trend in Indian casino revenues up until 2006, with these gains stalling and then eventually declining after 2007. In fact, according to the NIGC (2010) reports, total revenues from Indian gaming in 2009 were the lowest they have been since 2005. Even more illustrative of the decline in revenues since the economic crisis is shown in Figure 2, which presents the annual percent change over the past nine years. According to Figure 2, while the percent change in revenues has generally been positive from year to year for the region, though on the decline, the gaming industry experienced negative growth for the first time in 2008, slightly over 5% relative to 2007. An additional 5% loss was registered in 2009, compounding an already difficult situation. These trends would suggest the Indian gaming industry in California has experienced adverse impacts in ways similar to nations in other states.

Figure 1. Total Indian Gaming Revenues (in thousands) for the NIGC Sacramento, California Region between 2001 and 2009\*



\*Source: National Indian Gaming Commission (2010)

Figure 2. Percent Change in Annual Indian Gaming Revenues for the Sacramento, California Region between 2001 and 2009\*



\*Source: National Indian Gaming Commission (2010)

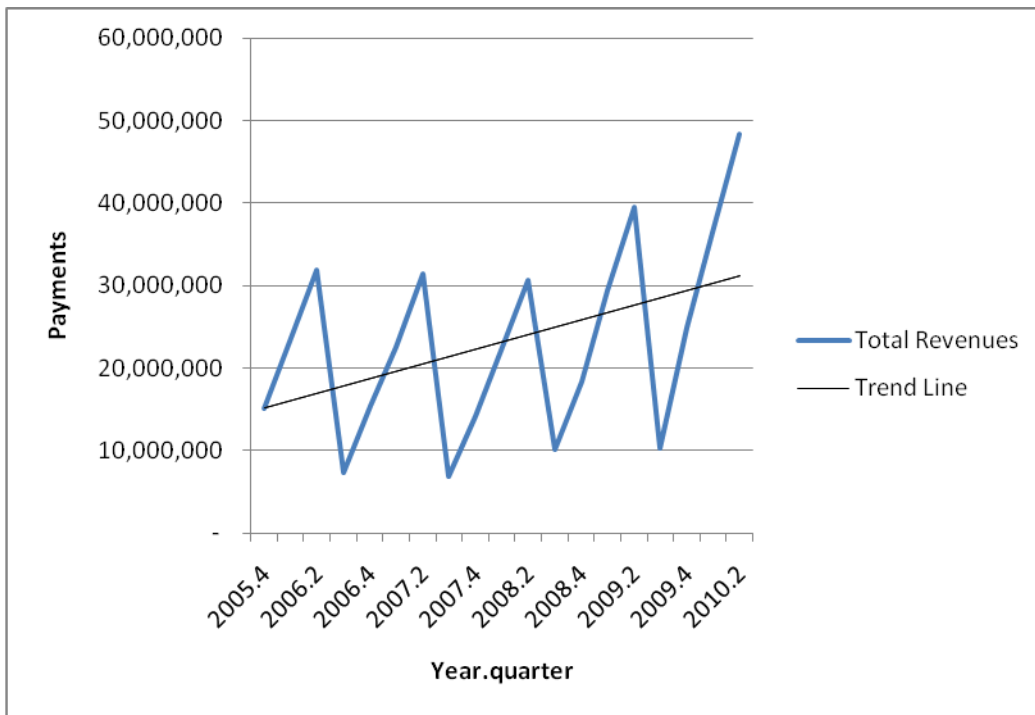
Because the NIGC data are not limited to California and reported annually, which may conceal important within year fluctuations that have been detected in other states, the next step was to take a closer look at available tribal payment information. Although the state does not release information

regarding payments to the SDF, we were able to access quarterly contributions by gaming nations to the RSTF and quarterly shortfalls in the RSTF from the fourth quarter of 2005 to the second quarter of 2010 (19 observations). Changes in the RSTF can offer insights into the dynamics surrounding the status of Indian gaming in California given that payments to the RSTF are a function of a sliding scale of licensed machines in operation every quarter. In Connecticut, the two gaming nations there have responded to the economic crisis by increasing the number of electronic devices on the floor, which are more profitable than traditional table games that carry higher labor demands (Conner and Taggart 2009b). While not a direct measure of licensed machines, an increase in payments to the California RSTF would capture general tendencies in this regard since it is based on the average number of devices in operation. At the same time, we would expect the fund to stabilize in light of increased contributions from gaming nations that would result in a subsequent decline in shortfalls in the fund. As noted, the non-compact tribes receive their quarterly payments as promised by the state regardless of shortfalls, but the stability of this fund is important in relaxing the demand placed on the SDF to honor the agreement.

Payment information is available for each tribe operating 350 or more machines, which we aggregated into quarterly totals according to the California fiscal year (July 1 to June 30). Figure 3 summarizes this information and includes a fitted trend line to reveal the general pattern reflected in the 19 time points between 2005 and 2010. As the graph reveals, there has been a steady increase in quarterly payments to the RSTF, particularly in the last two years, suggesting an increase in the number of licensed machines within the state.<sup>5</sup> In fact, payments to the RSTF went from \$32 million in the second quarter of 2006 to a record high of almost \$50 million by the second quarter of 2010 just four years later. Indeed, it is worth mentioning that the contributions made in the second quarters of 2009 and 2010 were the highest recorded total revenues in the ten-year history of the RSTF (CGCC 2010b).

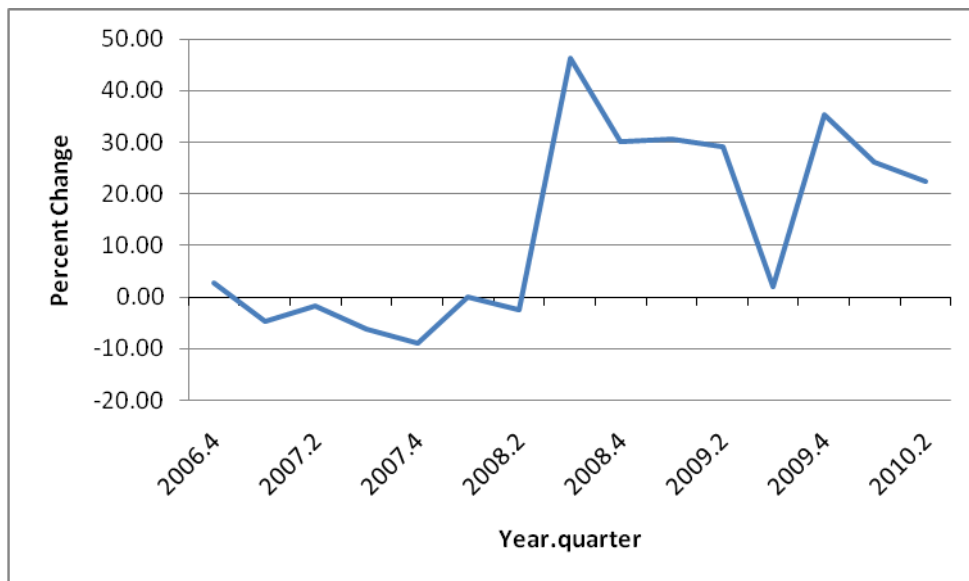
To demonstrate this change a little more clearly, we calculated the percent change in contributions between every four quarters - the annual quarterly change - in light of the cyclical patterns discovered in the previous figure. Figure 4 provides the annual quarterly change in payments to the RSTF from 2006 to 2010 and reflects the loss of four observations at the beginning of the series. As Figure 4 demonstrates, there was little fluctuation in the cyclical pattern of payments to the fund up until the dramatic increase in payments recorded in 2008. Generally, this increase has been sustained in the subsequent quarters, though not quite of the same magnitude as the initial “shock” recorded in 2008. This suggests that the gaming tribes in California have been drastically increasing the number of licensed machines on the floor. As a result, it would appear that the gaming nations are paying a higher price to operate in the hopes of making up the lost revenues through the provision of more electronic machines. These are no small percentage increases from previous quarters, with the second quarter spike in 2008 registering at more than 40% higher than the second quarter in 2007. With but one exception, all of the increases during this period are in the double-digits.

Figure 3. Quarterly Payments to the California RSTF From the Fourth of Quarter of 2005 to the Second Quarter of 2010\*



\* Source: California Gambling Control Commission (2010b)

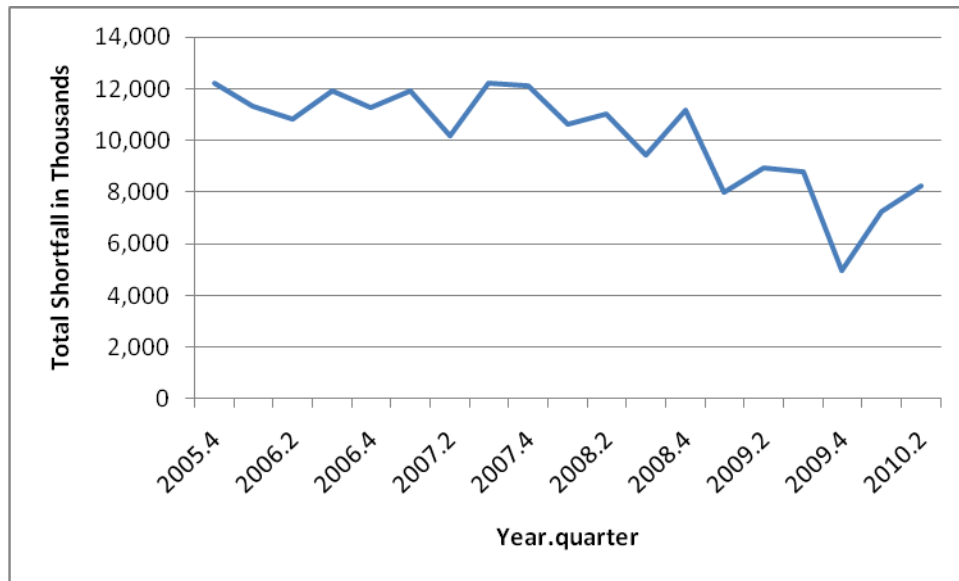
Figure 4. Percent Change Every Four Quarters in Payments to the RSTF from the Fourth of Quarter of 2006 to the Second Quarter of 2010\*



\* Source: California Gambling Control Commission (2010b)

Equally telling is that this change in business strategy has had a positive impact on shortfalls in the RSTF. Figure 5 shows the total amount of shortfalls that have persisted in the RSTF since the fourth quarter of 2005. It is clear that there have been rather severe shortfalls in the RSTF since this date, covered by revenues from the SDF. However, there appears to be a steady decline in this shortfall beginning in 2008 and continuing to the most recent quarter of 2010, suggesting a stabilizing effect from the increased contributions made by gaming tribes on licensed machines. In the process, the RSTF has seen quarterly drops in the shortfall by several million dollars, though it continues to still fall short of “breaking even” by a much larger amount.

Figure 5. Total Shortfalls (in thousands) in the California RSTF from the Fourth of Quarter of 2005 to the Second Quarter of 2010\*

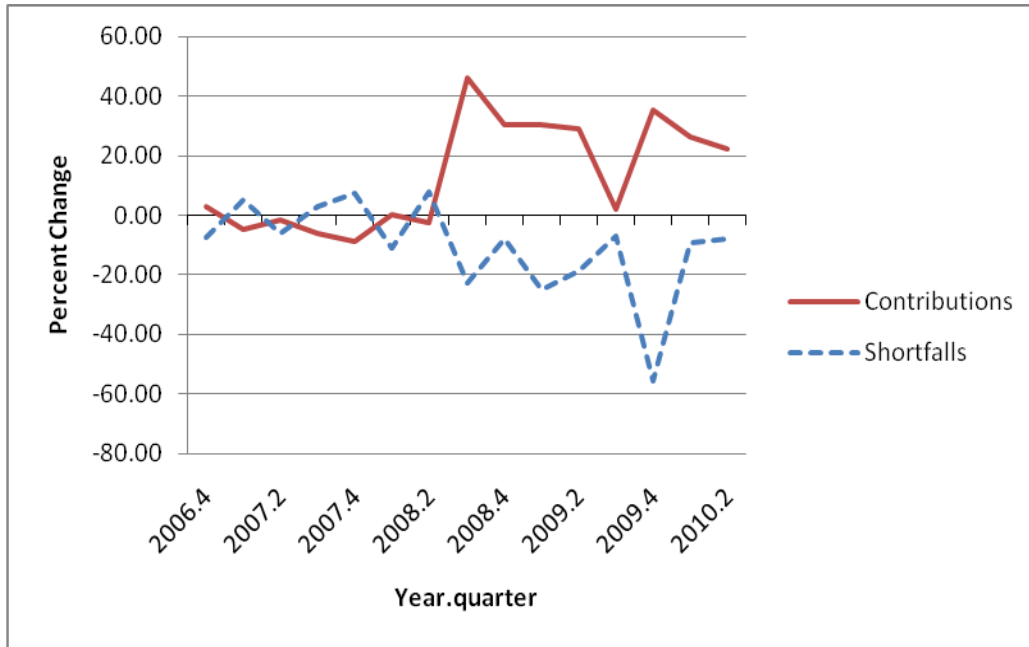


\* Source: California Gambling Control Commission (2010b)

As a final step in understanding the decline in shortfalls following 2007, Figure (6) presents the annual quarterly changes in both shortfalls and payments (Figure 4) from 2006 to 2010. As seen earlier, Figure 6 displays the dramatic quarter-to-quarter increase in contributions made by gaming tribes to the RSTF beginning in 2008. Conversely, the spike in contributions from gaming tribes corresponds to a substantial decrease in RSTF shortfall following the second quarter of 2008. Indeed, between the fourth quarter of 2008 and the fourth quarter of 2009, shortfalls declined by more than 50%, reflecting substantial progress in closing payment gaps. Furthermore, up until the third quarter of 2008, the RSTF shortfall varied little from year to year until the noticeable disturbance in the trend following 2007. Although it is difficult to attribute all of this change to the recent economic crisis as it has spread across the country, it does however appear that the gaming nations in California are shifting to more slot machine activity, a response witnessed in other states as well. Coupled with the revenue information reported by the NIGC, the steady, continuing increases in payments and declines in quarterly shortfalls in the RSTF suggest that these trends are most likely to persist for the remainder of 2010. While the economic conditions in California are certainly not comforting news to gaming tribes in the Golden

State, such changes in casino behavior has improved the operating position of the RSTF in meeting its fiduciary responsibility.

Figure 6. Annual Quarterly Percent Change in Shortfalls Relative to Payments to the RSTF from the Fourth of Quarter of 2006 to the Second Quarter of 2010\*



\* Source: California Gambling Control Commission (2010b)

### Concluding Remarks

As multiple reports and news accounts attest, the economic recession that has gripped the nation for the past three years has had profound impacts on the Golden State. The evidence we have reviewed would suggest this has had adverse consequences for the roughly 60 gaming nations in California. The most recent data released by the NIGC (2010) indicate a two-year decline in gaming revenues for the region, a region representing mostly California. Although indirect, there has been an accompanying increase in tribal payments to the California RSTF, indicating that the gaming nations collectively are putting more machines on casino floors. This action is consistent with the strategic response of gaming tribes in other states faced with declining revenues, as they have sought to cut labor costs and offer gaming alternatives promising greater returns for the house. One benefit of tribes in California responding in this fashion has been a significant reduction in RSTF shortfalls, as the fund has been able to cover more of the quarterly payments to “non-compact” nations, though the contributions still fail to cover the full cost of the payouts.

Given the large number of gaming nations in California, it is important to be careful in not over generalizing too much from this information. There are undoubtedly major differences in local economies and the experiences of various gaming nations, which would work against the plausibility of a singular explanation for what is unfolding in the Golden State. Our earlier case studies of New



Mexico and Oklahoma are a reminder that there are typically exceptions to what may appear to be the norm. What we do know with respect to California is that when taken together, the available data are consistent with the trends we detected when examining many of the gaming nations situated in other states. These trends have not suggested optimism with regard to the prospects for things turning around in the immediate future.

Of final note, the compacts in California limit gaming nations to a set number of licensed devices, with only a few exceptions, that come at a considerably high price thereby placing an artificial cap on expansion. While they have renegotiated the cap for several nations through amendments to the compacts (CGCC 2010a), this does serve as an impediment to further expansion should this prove to be successful in countering some of the negative consequences of the stalled economy. In the process, it denies the possibility of even greater payments to the RSTF, which could further reduce the shortfall it continues to experience. Freeing tribal leaders of this restriction would give these nations greater flexibility in responding to market forces and would potentially benefit the financial vitality of the RSTF.

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### Endnotes

1. For a more in-depth history of Indian gaming in California, see Michael Lombardi's (2010) three-part series of reports entitled "Long Road Traveled," available on the California Nations Indian Gaming Association (CNIGA) website (<http://www.cniga.com/facts/history.php>).
2. It is important to note that the NIGC compact database (see [http://www.nigc.gov/Reading\\_Room/Compacts.aspx](http://www.nigc.gov/Reading_Room/Compacts.aspx)) has tribal-state compacts in California dating back to the mid-1990s dealing with the establishment of Indian lotteries, which technically fall into the mildest form of Class III gaming as defined by the IGRA. However, the CGCC recognizes the 1999 compacts as the first official agreements between tribes and the state in adopting Class III gaming.
3. Since there is no single tribal-state compact governing Indian gaming activity across all nations in the State of California, we reference the CGCC (2010a) website where every ratified and amended compact for each nation is held when discussing generalities of these agreements.
4. The State of California has amended the original 1999 compact for several gaming nations in 2004 and 2006. Among other provisions, these renegotiated agreements have allowed certain tribes to operate a larger number of licensed gaming machines that exceeds 2,000, but at a higher fee per device (see CGCC 2010a).
5. It is important to note that, as mentioned earlier, several gaming nations have amended tribal-state compacts with the State of California in 2004 and 2006 that may affect payments to the RSTF. However, only a few nations under these agreements appear to be substantially increasing payments, thus suggesting that the observed increases are a combination of both renegotiated agreements and, more importantly, an increase in licensed machines on behalf of the remaining tribes under the original 1999 agreements.