

Harness Racing in New York State

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A few mornings ago, I was at work reading on the MSN web host page a story about the burrowing owl (cuckoo owl) – 9 to 11 inches in lengths with a wingspan of 20 to 24 inches that is now listed as an endangered species and is at risk of extinction, protected by the endangered species act. Believe it or not, to find the burrowing owl, those who go “birding” (that’s what they call it) have to climb some mountain in western Montana where they probably have a better chance of finding more Dead Sea scrolls than this particular bird.

Does anyone in this room care whether or not the burrowing owl goes extinct? Probably not, but hopefully for this particular bird, someone will.

Endangered species was an expression that originally referred to plants or animals that were in danger of dying out, but beginning in the mid 1980s, the term was extended to anything becoming rare. And about that time, it was used to describe the sport of harness racing.

In truth, the pari-mutuel harness racing industry has been “down for the count” more than a few times in the past decades.

Since I am speaking at an academic institution, let me bore you for a moment with the ramblings of a want-to-be economist and see if we can understand a little of what has happened.

As some of you know, I worked in Maryland for 18 years and operated the Preakness Stakes at Pimlico. About the mid 90’s, handle numbers at the track were down, and a reporter from the Washington Post asked me what I thought about the future of horseracing and what adjustments would have to be made for it to compete with other forms of gambling. After careful consideration, I answered by saying that I thought that there was a need for a reduction in live race days (nationwide) and more coordination by region (for example, Delaware, Maryland and Pennsylvania). Then, with the expansion of simulcast wagering at the tracks and OTBs, which was happening at the time, it would be possible to reduce the takeout (which is the price of a wager to the patron). I believed wholeheartedly at the time that by consolidation, coordination, and simulcasting, a reduction in takeout could be accomplished and indeed, was an absolute necessity in order for horseracing to compete with casino gambling and sports betting.

I know that takeout is a “well beat up – ad nauseam” subject of discussion, and specifically “old news” in New York State – but give me a minute to explain why I bring it up today because whether or not its “old news”, it’s exactly what we should be talking

about. Believe me, the takeout issue has come full circle and harness racing is now suffering because of our lack of attention to it.

But first, was my answer to the reporter correct? What was to happen in the 1990's that would change horseracing forever?

Let's take a short history lesson and through the use or misuse of some economic theory, try and figure it out.

Please refer to my handout.

Supply and demand describes how prices vary as a result of a balance between product availability at each price (supply) and the desire of those with purchasing power at each price (demand).

Price is on the vertical axis and quantity on the horizontal.

Demand curve – the willingness of patrons to bet on a horserace at variable price (price being takeout). As the takeout goes down, the willingness of patrons to wager goes up.

Supply – is the willingness of tracks to supply a horserace at variable price (again – price being takeout). As takeout goes up, in theory, the willingness of tracks to provide a horserace increases.

No difference really, from Baskin Robbins selling ice cream.

It was not long ago; let's say 1965, when the industry in New York State seemed to be in harmony. Very simple Principles of Economics - where the demand curve – D 1 crossed the supply curve - S, there was an equilibrium price for a wager (P1) – referred to as the takeout that is used by the tracks to pay purses, breeding fund, state taxes, and track expenses. Now in reality, the takeout was set by regulation, but because horseracing had a virtual monopoly on legalized gambling, the price legislated was actually pretty close to a market price – about 16%, and the tracks were packed with patrons.

The 1970's and 1980's brought dramatic changes to New York State. Casino gambling in Atlantic City was legalized. Meadowlands Race Track began operations. Off Track Betting was introduced with brand new laws and regulations. Sports betting, though illegal most everywhere, grew exponentially with the increased popularity of Pro Football and national television sports on ESPN and other networks. The result was that the demand for horseracing at the tracks declined – see D2 on the chart.

Did the equilibrium price of a wager (the takeout) change after the demand curve shifted? In theory, the price of a wager should have declined to P2 as you can see on the graph. But instead of price going down, as economic theory would seem to dictate, it went up to P3. At about this time, to answer the crisis, the takeout on wagers at the tracks, by law, was increased with the addition of new exotic wagers. Instead of a net 16% takeout, it

rose to 17, 19 and 25, depending on the type of wager, and the price of a wager was at 19% net, well above the market price. Sadly, the racetracks no longer had a monopoly on gambling and competition in the next decade was to become fierce.

New York State harness racing had one casualty – Roosevelt Raceway, and limped along into the 1990's, which brought with it more competition. Casino gambling (mainly Indian) was introduced. Internet gambling began late in this decade, poised to explode. Racetracks and OTBs expanded operations offering wagers on hundreds of races daily.

Let's say that for the sake of simplicity that during this time, the demand for betting on a horserace remained fairly constant. Tracks offered more betting opportunity, day and night, and in the mid nineties, simulcast wagering gave the tracks a quick shot of adrenalin that seemed to balance out the increased competition from casinos and other gambling. Unfortunately, it was short-lived.

The new millennium brought with it a mature Internet. Sports' betting at a takeout of 5% is now "quasi-legal". In addition, it is estimated that at any one time of day, over one-half million Americans are playing poker and casino games on line. National horserace betting companies such as YouBet, TVG and Xpressbet, companies that are not even licensed in New York State, are aggressively recruiting patrons residing in counties in and around the racetracks without interference - and in most cases, provide little or no revenue for smaller tracks. And the new millennium has brought with it expanded casino gaming – it fast becoming the major source of additional revenue for many states.

How has the industry responded? Well for one, it lowered takeout, but not in the conventional manner like NYRA did a few years ago. How was takeout lowered?

Tracks that could were to make deals with "rebate shops" - located outside the country. A rebate shop is an off track betting site that takes wagers on US race tracks – by telephone or Internet – offering patrons (specifically those who bet large sums of money) a percentage of wagers back in the form of a rebate – or a player reward. The tracks usually receive in payment a percentage of handle that is slightly higher than what it might receive from a US betting site.

National Internet horserace wagering sites (YouBet, TVG, Xpressbet, Ameritab) were to expand into many states and offer player rewards. Many tracks were to follow suit and offer player rewards – NYRA being the first in New York State.

OK

Let's go back to our industry supply and demand curve.

The rebate shops, simply put, circumvent state law and steal big bettors away from racetracks. A patron who wagers by telephone through a rebate shop receives anywhere

from 8-17% of total wagers back in player rewards. This means that the effective takeout offered to these patrons is well below that offered to patrons wagering at racetracks. Instead of an average takeout of some 19% - P3, these bettors wager at takeouts as low as 5% - P5. Rebate shops can afford to offer large incentives to big bettors because they are not required by any law to share the legislated takeout with horsemen, breeders, state or track. Believe me, I know first hand from my experience in Maryland, that the rebate shops' impact on the industry has been very understated by those who justify them.

Mirroring the rebate shops, the tracks and the Internet wagering sites (TVG, Xpressbet, YouBet) also offer player rewards (in the form of cash wagers) – for some, as high as 7%, giving participating bettors the opportunity to wager at a takeout level lower than non participating patrons. Instead of an average takeout of some 19%, these bettors wager at takeouts as low as 14%, pretty close to the takeout level in 1965 – P1.

A player reward, simply stated, reduces the takeout.

Of course, all patrons aren't so lucky. Sadly, the poor fellow who walks into a New York State OTB parlor must pay a surcharge on winning wagers. The takeout price for that patron is 25% or more – see P4.

So – for the same product, price varies by customer. This arises from the fact that the value of the product (wagering on a horserace) is subjective. In economic terms, a customer with low price elasticity of demand (the guy who walks into an OTB shop and knows no better or doesn't care) is less deterred by a higher price than a customer with high price elasticity of demand (the guy who wagers with a “rebate shop” and has full knowledge of his many options). Knowledge is power. Educated bettors who wager large sums of money may do so on horseracing at a takeout level that is competitive with sports betting, poker, and casino games. And unfortunately, very few of these bettors wager on races conducted at small harness tracks.

The proper academic term for this variance is First Degree Price Discrimination.

So as stated, the industry was a mess – and trouble was brewing on many fronts. In addition to the price discrimination, laws had become tedious and burdensome. The method for distribution of takeout from the regional OTBs to the tracks had become difficult to understand at best. Purses were declining at rapid rates. The sport was losing popularity – still is.

The savior was to come from an industry that was much more attractive to today's non-discriminating player – who was not looking for large rewards from “rebate shops” or tracks. These bettors were looking for “fast action” with “lottery-like” returns. That industry, of course, was video lottery machines. Harness racing in the new millennium was to become forever married to them – and become an industry that was granted monetary assistance that was regarded as being in the public interest.

Well - that's survival?

A few mornings ago, I was at work reading on the MSN web site host page a story about the burrowing owl – 9-11 inches in lengths with a wingspan - oops. I'm sorry. I lost my place for a second.

A few mornings ago, I was at work reading on the MSN web site host page a story about a harness track (Buffalo Raceway) – 60-70 acres in size with a half-mile track that is now listed as an endangered species and is at risk of extinction, protected by the slots act. Believe it or not, to find Buffalo Raceway, those who go “harness racing” (that’s what they call it) have to climb through bells and whistles in western Hamburg where they probably have a better chance of finding -- well you get the idea.

It’s difficult not to feel that way, sometimes – for those of us who love harness racing and have been proud to be associated with the pari-mutuel wagering industry.

I work for good people at the fairgrounds in Hamburg. We care about what we do. We care about the employees, the horsemen, and the entire industry – and please don’t misunderstand me, we are very thankful for the slots legislation.

The relationship between the two sides is generally good, however, there is a clear delineation between the operations that is obvious to all participants. The horsemen, patrons and employees know the numbers.

Incredibly, 75% of purses at Buffalo Raceway are derived from slots revenue. Think about that for a moment. 85 days of racing, 300 days and nights of simulcast wagering on tracks across the entire country – and the racetrack handle accounts for just 25%.

And to put it in further perspective, if Buffalo Raceway (live) is fortunate enough to be up 25% in handle next year, that increase would result in just \$55,000 in purses or \$640 a racing day. Even more amazing - that same 25% increase would result in less than \$40,000 net revenue to the racetrack’s bottom line.

The number of live race days and at what post time has become the two big issues.

Monticello races early afternoon. It has carved a successful niche in the off-track betting market. Batavia races 60 days a year, trying to keep average daily purses at a competitive level. Tioga will do the same. Saratoga Raceway, with its win per slot machine twice that of Buffalo Raceway can afford to race 170 days. Yonkers, now scheduled to race over 300 days will likely have so much purse money that who knows, they may have to race day and night to distribute it all. Buffalo Raceway, with 84 days in 2006, is considering a reduction in race days in 2007 in order to maintain the purse levels in 2006 - not to mention, to remain economically viable as a company. It is also considering an earlier post time.

There is clearly now a direct relationship between number of race days per track and win per slot machine.

Live racing is expensive. The difference between Buffalo Raceway racing 84 days and Batavia Downs racing 60 days is a negative \$100,000 to the racetrack's bottom line.

What to do? There are some highly unusual restrictions imposed by the Lottery regarding advertising and promotions at the facility. Up to 8% of slots revenue is refunded back to DN by the state to be used for marketing. Just hours after Buffalo Raceway employed me I tried to work an agreement with DN to access the company's 60,000 mailing list and to have racing included in their beautiful four-color monthly mailer. We intended on increasing its size to six pages for which one full page was to be dedicated to racing. We did not. There was a question of reimbursement because of the amount of space in the mailer dedicated to advertise and promote harness racing. I had to create independently, my own mailing list and produce a monthly mailer that paled tremendously with the "other side". The same issues came up when I proposed a concert series and other such promotions. Isn't that about the most ridiculous thing you have ever heard – that racing cannot be included in advertising and promotions – not on billboards - not in print advertising - not in radio – not in giveaways – not in nothing – unless it is considered by the lottery for purposes of reimbursement as very minimal? The result? The small harness track loses out, every time.

I could go on for hours and I better stop talking now before I get myself in trouble, but let me finish with a plea to the other two men on this panel. It is time now for the harness tracks to band together on some important non-slot issues. At a minimum, I suggest that

- 1 - We encourage all tracks and OTBs in the state to take wagers on all New York State harness tracks – and we should lobby for legislation that allows us all to do so more readily.
- 2 – We should set up a cooperative harness tracks telephone and Internet wagering network (when legal), offering competitive player rewards to our patrons.
- 3 – If possible, we should coordinate race days, especially in the western half of the state. Competition for horses in the next decade will become fierce.
- 4 - We must as one ask the New York State Racing and Wagering Board to help us in our fight against poachers from out of state that are stealing away our patrons by skirting New York State law.
- 5 - We must look into the possibility of creating a buying coop to protect us from increased signal fees imposed by the MAGNA and Churchill groups, and other major tracks that we depend on for simulcast content; and – finally – regarding the slots - we should lobby for a clarification on the restrictions imposed by the lottery regarding advertising and promotions at the racetracks – and try to change a few things. Why should racing be considered some kind of threat rather than a partner?

I thank Ben Lieberman and Albany Law School for asking me to speak, and appreciate you all for listening.

