

# ANALYSIS OF PRACTICES OF CASINO GAMING CONCESSIONS IN MACAO FROM THE PERSPECTIVE OF INSTITUTIONAL ECONOMICS

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**Abstract:** Under the institutional economics notions of formal rules and informal constraints and their changes, as well as business routines, we explore and analyze the major achievements and deficiencies of the practices of the casino gaming concessions that were granted by the Macao Special Administrative Region (SAR) government in 2002. An ex post facto analysis of the related hard evidence and statistics shows that the decision of the Macao SAR government to grant gaming concessions in 2002 and the related arrangements thereafter are obviously controversial but these might be in line with the contextual settings specific to Macao.

Actually, the practices of the gaming concessions have not only increased the potential long-term success of the Macao economy under the one country two systems policy framework with the Chinese government, but also established Macao as an internationally renowned casino resort destination thereafter. Nevertheless, as a socially controversial industry which might be easily associated with a variety of unorthodox business activities, the incompetence of the rules and regulations that govern these types of activities following the approval of related gaming concessions has evidently created a grey area that cultivates the

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rapid expansion of such activities. This has resulted in the unfolding of a self-undermining process which ultimately led to an in-depth adjustment of the industry between 2014 and 2016.

Based on the experiences gathered over the past 16 years and more since the gaming concessions were granted, it is worth pointing out that the establishment of an unambiguous and enforceable regulatory framework is an indispensable means of ensuring that there are correct incentives in the market, and hence secure the long-term effectiveness and efficiency of the gaming concessions. The Macao SAR government will find it especially important to proactively address these regulatory deficiencies for the upcoming new concessions in 2020/2022 because both the internal and external environments of the casino gaming industry in Macao have drastically changed since 2002.

**Keywords:** Gaming concession; institutional economics; law and regulation; Macao.

Despite the arguments posed by mainstream economists for free markets, history has shown that business practices in an economic society are directly influenced by its contextual settings, which are broadly framed by its culture and the political and legal systems. On the other hand, when introducing and enforcing economic laws and regulations, their ultimate effects on the incentive and behavior of market participants are interactively influenced by the culture and business routine of firms. The beliefs of these dynamic relationships indeed offer pragmatic grounds to explore the practices of the casino gaming concessions in Macao that have been granted by the Macao Special Administrative Region (SAR) government in 2002 and the related adjustments thereafter. Actually, the experiences of Macao may also provide interesting and valuable references to governments of other casino gaming jurisdictions when they are evaluating or formulating their gaming concessions/licenses.

### **Institutions and Practices of a Legal System**

In institutional economics, institution is commonly defined as “a set of socially prescribed patterns of correlated behavior” (Bush, 1987, 1076), or “the rules of the game in a society” (North, 1990, 3). To North (1990), institutions are broadly the amalgam of two interactive components – informal and formal constraints. In any economic society, informal constraints refer to the culture and customs (or the ways of business) that are commonly accepted as the norm by the market participants when they interact with each other.



On the other hand, formal constraints (or formal rules) refer to the written laws and regulations that specify the legal rights and responsibilities of individuals when they conduct their activities in the markets. Thus, as part of the institutions in a society, the practices of the legal system (in particular, the process in which the economic laws and regulations are being enforced and/or revised) might not be independent of the feedback from the other institutional entities.

### **Institutionalist Perspective on Practices of Laws and Regulations**

When exploring the practices of a legislation or regulation, the theoretical perspectives from institutional economics may offer a relevant and insightful approach for related studies. For example, when comparing the range of studies between those of the new institutional economics and law and economics, Posner (1993, 76) emphasizes that institutionalists “study not ‘the market,’ but the concrete institutions that enable markets to work”. In principle, while economic laws and regulations specify the legal scope and conducts for related activities that are undertaken by participants in the markets, it is the legal system that enforces the formal rules (i.e., carrying out the related laws and regulations). Alternatively speaking, one of the focuses under institutional economics is to scrutinize the implementation of formal rules and their interactions with the market participants in a society.

To a large extent, the attempts of a government to introduce or revise legislation or regulation for the sake of regulating and controlling market transactions based on public desire of one form or another are inevitably related to the behavior of the market participants since the government or a regulatory authority is an “outsider” of the market. In other words, the practices of a legal system may be influenced by the existing ways of business (or the behavior of the related participants) in the different markets. Indeed, North (1997, 1) states that “while formal rules can be changed overnight by the polity, informal constraints change very slowly”.

The aforementioned institutionalist perspective on the practices of a legal system provides a particularly meaningful context to explore the practices of related laws and regulations that are formulated for any of the socially controversial industries like the tobacco and alcohol industries, and of course casino gaming. As the practices of these industries are largely determined by the culture of the related market participants, their business routine might be rigid and slow to change. Thus, the practices of a new legislation or revised law in the market may resemble a tug-of-war between the related market participants and the legal/regulatory system.

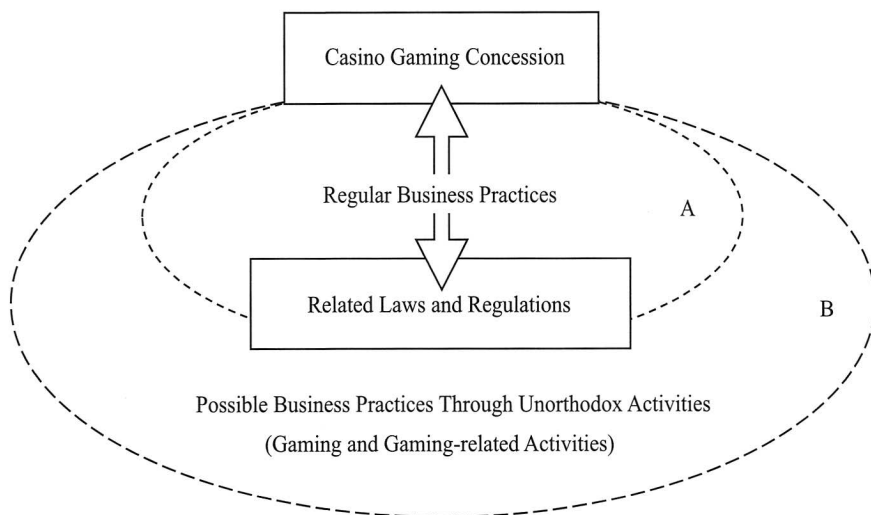
## A Paradigm of Practices of Casino Gaming Concessions

In many societies, especially the Chinese society, gambling is recognized as part of the culture and historically a favored pastime. Nevertheless, its legitimacy and business scale and scope in a modern economic society are determined by the related laws, which outline the licensing requirements (e.g., the gaming concessions in Macao, or the gaming licenses in Las Vegas), as well as the ways that the related businesses are regulated and controlled.

Notwithstanding, as an activity that can be easily carried out or organized, the policing cost of illicit gambling and related activities can be significant for a government in order to eradicate them. As depicted in Figure 1 for casino gaming, while the gaming concession and the related laws and regulations specify the scale and scope of regular businesses, unorthodox business activities may also be carried out in the market along with them.

Figure 1. Paradigm of practices of casino gaming concessions

To a large extent, the scale and scope of unconventional activities (e.g., Area B as shown in Figure 1) as compared to regular business (e.g., Area A in Figure 1) are determined by the coverage of the related gaming concessions, the associated laws and regulations for business operations, and their enforcements. Owing to



the essence of this business, there is little doubt that if the gaming concession and the related laws and regulations cover a wider range of the gaming business, and if they are highly enforced, room for unconventional activities such as illicit loaning and the fund flows related to gambling activities will be reduced.

In contrast, if a gaming concession and the related laws and regulations are loosely (or ambiguously) structured and enforced, there are more opportunities for profit-seeking unorthodox activities to pursue the related economic benefits. Since potential unorthodox business activities are not subjected (or not clearly subjected) to the formal rules, various powerful third parties are commonly seen to enter the market and then formulate their own rules to regulate the related transactions. In economic studies, these unorthodox activities contribute to the practices of the underground economy in which one or more powerful groups aspire “to acquire a rule-making role in a given area (be it geographical or economic) so as to levy taxes and impose regulation over legitimate and/or illicit businesses” (Fiorentini and Peltzman, 1997, 4). As a matter of fact, related practices have long been associated with the casino gaming concession in Macao – one of the most renowned casino gaming jurisdiction in the world (*see for e.g., Siu, 2006*).

### ***Ambiguities and Surprises in Practices of Gaming Concessions***

In line with the establishment of the Macao SAR at the end of 1999 and the expiration of the gaming concession of the former gaming monopoly (Sociedade de Turismo e Diversões de Macao or STDM) in 2001, the Macao SAR government revised and updated the related gaming law (i.e., Law no° 6/82/M hereinafter the “Gaming Law 1982”) which provides the government with the legal power to grant new gaming concessions. Based on Article 7(2) and related arrangements as specified in the new gaming law (i.e., Law no° 16/2001 hereinafter the “Gaming Law 2001”), three gaming concessions were granted by the Macao SAR Government in February 2002.

### **Approval of Three New Concessions in 2002**

Through international open tender, two of the gaming concessions were granted to the Wynn Resort from Las Vegas, and Galaxy, a Hong Kong-based company which entered a joint venture with Venetian of Las Vegas Sands. These world-class casino resort operators have rich and ample experience in facilitating the development of casino gaming with associated non-gaming businesses such as retail, entertainment and meetings, incentives, conferences and exhibitions (MICE). Although the third gaming concession was approved to a local casino operator (i.e., SJM Holdings Ltd.) which is a wholly owned subsidiary of the former casino gaming monopoly STDM, it was a reasonable decision which was not simply based on facilitating the smooth transition of this leading industry in Macao, but also that this local firm is very familiar with the Chinese-based market.

Despite some controversies about the concession granted to Galaxy

because this Hong Kong-based firm did not have any business experience in casino gaming at the time of the tender submission, its joint-venture partner, Venetian, is indeed a world-renowned pioneer who successfully integrated casino gaming with MICE business in Las Vegas and indeed met all the criteria which lent support to the decision made by the government. General speaking, the initial decisions on the three gaming concessions did gain a reasonable tradeoff between the contextual settings of the economic society in Macao and the public interest in revitalizing and modernizing this industry. There was the expectation in the market that the business practices from Las Vegas (especially its business integrity and range of non-gaming business components) would be introduced to Macao, and hence brand this gambling city as the Las Vegas of Asia.

### Ambiguities of “3+3”

Nevertheless, a critical controversy arose when the Macao SAR government approved Galaxy and Venetian under the same gaming concession to develop and operate independently at the end of 2002. To standardize this decision, the government further ratified a corporate partner from each of the other two concessionaires to develop their businesses respectively. Consequently, while MGM signed a deal with SJM to become its partner in 2005, Melco-Crown signed with the Wynn in 2006, and they started to develop their businesses thereafter. Thus, a total of six independent casino operators are practicing under the three gaming concessions (i.e., the practice of “3 + 3” in Macao’s gaming concessions).

Under an executive-led political system in Macao, even though the Macao SAR government may have the ultimate right to justify the three concessions with six independent casino resort operators, the ambiguities of the incorporated changes could hardly be clarified by using Gaming Law 2001. Thus, many might question and speculate whether the other three operators were actually practicing their businesses under the “sub-concession” arrangement that was approved by the government.

In addition, the scale and number of third-party gambling rooms and satellite casinos under individual concessions have indeed been increasing since 2002 as an extension of the historical phenomenon in which the Macao casino gaming business was largely practicing between law and custom (*see for e.g.*, Siu, 2006; Eadington and Siu, 2007). Again, the related additions might not be specified or foreseen by referring to the related articles as specified in Gaming Law 2001, but were endorsed by the Macao SAR government based on its legal authority. Actually, such practices led to the expansion of unorthodox business activities at the same time.

*Surprises from Practices of Gaming Concessions*

Despite the ambiguities associated with the three approved gaming concessions in 2002, their practices (especially the “3+3” arrangement) were surprising to the business performance of the industry in terms of the capital investment made by the related casino operators and the derived gross gaming revenue (GGR). Under the full support of the Chinese government, gaming operators and investors were excited by the unprecedented growth in the GGR of the industry. For example, the industry reported a 22.0% growth in its GGR in 2006 and a substantial growth of 45.8% in 2007.

Thereafter, extensive capital investment was made to expand the related hospitality capacity and facilities to further meet and stimulate the market demand for Macao’s casino tourism. For example, Mitchell and Lau quote a comment made by a senior executive in the industry, “(w)hat Las Vegas built in 40 years, Macau will build in 10” (Mitchell and Lau, 2006, cited in He and Siu 2018, 89). Consequently, practices of the related concessions (both the initial decisions in 2002 as based directly on the Gaming Law 2001 and the adjustments which were subject to controversies of one form or another) did lead to a continuous expansion in the scale of the regular casino gaming business (i.e., Area A as indicated in Figure 1; also see for e.g., He and Siu, 2018).

**A Self-undermining Process and Changes**

The contextual settings of the economic society in Macao leaves much room for the development and growth of unorthodox gambling related business activities (i.e., Area B in Figure 1) which was also observed to be growing at an unprecedentedly rapid pace under the practices of the gaming concessions. In particular, the business scale associated with traditional VIP gaming rooms that are mostly operated by prominent highly autonomous third-party operators under individual concessions expanded rapidly after 2009.

Even though there was the speculation that the business practices of the Vegas-style casino resort operators might contribute to new business routines in casino gaming in Macao, the VIP gaming sector preserved its own unique attributes and progressed independently (see for e.g., Siu 2007). Nevertheless, a self-undermining process had already emerged, which upset the prosperity that the industry enjoyed between 2009 and 2013, and left the industry in an ambiguous position in the market until mid-2016.

## **Dilemma Behind the Excitement**

Even though the casino gaming business in Macao has long been associated with (and even reliant on) the unorthodox business activities undertaken by the highly autonomous gaming agents in the VIP sector, their practices were not covered in Gaming Law 1982, and the licensing requirements for gaming agents were introduced only for the first time in Gaming Law 2001 under Article 23. Based on the new requirements, Administrative Regulation no° 6/2002 (hereinafter the “Gaming Agent Regulation”) was also promulgated in 2002 in attempts to regulate the business activities that were related to those of the gaming concessions.

Nevertheless, owing to the difficulties in enforcing the requirements under the Gaming Agent Regulation, the scale and scope of unorthodox yet controversial business activities persisted and sought alternative ways for expansion. Besides, business activities undertaken by various gaming agents were not properly monitored. For example, although the Gaming Agent Regulation specifies repeatedly (e.g., in Articles 8 to 14, 24, 33, etc.) that the “major employees” of the gaming agent firms are required to meet certain requirements and subjected to qualification checks, the definition of “major employees” is not found in any of the related legal documents. Combined with other ambiguities in the enforcement of the related laws and regulations (including the Casino Credit Law under Law no° 5/2004), there was much leeway for unconventional business activities in the VIP and high-end gaming sectors in Macao casinos.

Actually, much of the dramatic growth in the GGR in Macao between 2009 and 2013 originated from the large accumulation of VIP business revenue through unconventional business activities. In this four-year period, the GGR in Macao tripled from USD 14.9 billion to 45.1 billion, which undoubtedly caused much excitement among all of the related parties in Macao and global investors. However, uncertainties accompanied with the continual growth of the GGR under this business environment might also increase at the same time (as possibly reflected from the various semi-official and media reports between 2010 and 2013 which questioned the sustainability of such unorthodox business activities), unless the government turned a blind eye so that these activities continue to grow without restraint.

## **Tolerance levels**

As a SAR of China with an economy that relies heavily on Mainland Chinese patrons, the unconventional business activities have been widely posited as significant challenges to the regulatory system in Mainland China. Aside from the usual gambling issues, there was snowballing corruption and capital that was being drained out of Mainland China due to the practices of many (although not



all) gaming agents. Thus, a self-undermining process of business routines would evidently emerge.

In institutional economics, the expansion of certain unfavorable institutions in society “can be self-undermining and the behavior that they entail can cultivate the seeds of their own demise” (Greif and Laitin, 2004, 634). From this standpoint, it is then just a matter of time that the unorthodox business activities associated with the practices of the gaming concessions in Macao might be curbed if the tolerance levels to these entities are accumulated to a certain point at which society and the governing authorities would want to reconsider the appropriateness of these unorthodox gaming activities.

### **Instrumental Changes Since 2014**

When the Chinese government launched anti-corruption programs and anti-extravagance campaigns, as well as measures to rein the capital drain from Mainland China in the first quarter of 2014, the practices of the VIP and related gaming sectors in Macau were hit hard. In comparison to the record high quarterly GGR in the first quarter of 2014, the VIP sector dropped 59.1% from USD8.128 billion to USD3.325 billion in the second quarter of 2016 before the market recovered. In this same period of time, the decline in the GGR in the non-VIP sector was 32.6%. In principle, it is reasonable to hypothesize that the decline of the GGR is largely attributed to the collapse of the unorthodox gaming sector (i.e., a reduced Area B in Figure 1). In the all-encompassing adjustment, it is undeniable that regular business (i.e., Area A in Figure 1) is also very much affected and experiences a decline.

The instrumental changes that were put forth by the Chinese government in 2014 clearly conveyed to the Macao SAR government that they should take serious measures to address and manage the practices of gaming concessions in the future. That is, legislating the related laws and regulations, as well as strengthening the enforcement mechanisms to prompt appropriate practices of the gaming concessions are indispensable for the continuous growth of this leading industry in Macao. Thus, extensive changes carried out by the Macao SAR government were evidenced thereafter. For example, the regulations that reinforce the supervision of the business activities undertaken by the gaming agents, and legal measures that improve the surveillance of monetary and financial flow between Macao and other regions (especially Mainland China) have expanded and continuously strengthened since 2014.

## Conclusion and Remarks

When evaluating the practices of a gaming concession, the practices of the legal system (including the enforcement of related laws and regulations) for the related business activities have to be taken into consideration at the same time. This is because the practices of casino gaming might be easily associated with a variety of unorthodox and socially controversial business activities.

Taking into consideration the contextual settings and the extent of the gaming market in Macao, the business scale that stem from the practices of the gaming concessions has to be re-addressed proactively and strategically. This is especially a crucial topic for the Macao SAR government for 2020/2022 when the three current gaming concessions will expire. Besides, although cultivating the non-VIP gaming sector (i.e., the mass market) should be the emphasis in moving forward for the industry, the positive role of gaming agents on the practices of the gaming concessions in Macao should not be neglected.

Thus, to reap the most from the gaming operators, and hence ensure the long-term success and competitiveness of the gaming concessions, the possible downsides of their business activities have to be well-regulated. In line with the dynamic internal and external environments of Macao's casino gaming industry, the urgency for the Macao SAR government to make efforts to move quickly towards an effective and efficient regulatory system is evident. During the process, enforceability of the related rules has to be ensured.

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