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A Study in Contrasts

Gaming is quite different in Peru and Chile and the Innovation Group's Dino Guiliano explains why one country's approach seems to be more rational and thoughtful.

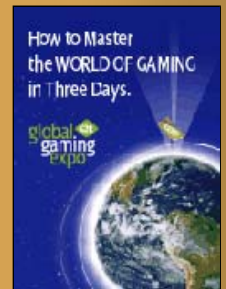
by Dino Guiliano

Chile's claim of a successfully transparent competitive bid process goes up in smoke, but decidedly victorious in its own mind, the SCJ (Superintendence of Casinos) moves forward to set the regulatory stage for the market boom it has taken the last two years to manufacture in such meticulous form. Chile happily welcomes to the mix one major international operator—Sun International—and a Canadian capital group with a hugely successful track record in gaming.

Meanwhile, Peru is basking in the rapid success it has encountered since legal reforms instituted by President Alan Garcia just a year ago, a response to the severe mess left behind after his predecessor's botched attempt at reform. An unexpected model of efficiency since the administration found some consensus and resolve in 2006, the country still has a long way to go to achieve transparency. While none will contest Peru is moving in the right direction, many wonder if the baby-steps approach will ultimately be forward-thinking enough to provide tangible results in the long term.

Beginnings

Given the unique paths these two countries have formulated toward achieving the same goal, it is impossible to examine their progress without considering the largely disparate circumstances leading up to their more recent actions. Moderate controls in Chile allowed for a largely fresh palette with which to work, yielding a meticulously detail-oriented master plan of how to pursue growth for the industry. This is in deep contrast to Peru's effort to tame the wild beast that the country's gaming industry had become as a result of incomplete policies of previous administrations.



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Chile outwardly sought the economic benefits of more gaming within its borders in a 2005 legislation aimed at enabling tightly controlled expansion of the industry under a competitive bid process that would allow for maximal transparency. At that point moderately developed legislation and some light oversight kept a lightly taxed and minimally invasive reign over the country's more than 3,500 slots and approximately 165 tables which operated in its seven existing facilities. A moderate but growing problem was also emerging at the time—a task force orchestrated by the national lottery in 2004 estimating some 10,000 clandestine slots scattered throughout the country, half of which could be found operating in the capital region. The bill would aim to clobber these also.

Contrastingly, from the start of his presidential term in 2006, Peru's Alan Garcia was faced with the task of controlling the sheer chaos that had developed following a far-from-comprehensive bill issued in 2002—under the previous administration of Alejandro Toledo—which indirectly allowed the open expansion of the industry sans a working regulatory structure. The situation was further exacerbated by a series of court injunctions (“amparos”) issued by provincial judges over the four-year period enabling slot halls to operate without concern for what little new legislative direction there was and, for the most part, without paying any gaming tax. Firms under this form of judicial protection frequently entered into partnerships with other businesspersons to open more gaming rooms under the same scheme.

Unsurprisingly, with such options so readily available, the number of illegal game rooms in the country in 2002 (215) mushroomed to 897 by the end of 2006, whereas proper applications were only pursued by a handful of operations. At the outset of Garcia's term, Peru's eight casinos and 930 game rooms (89 percent unregistered) housed 56,000 slots and employed over 12,000 people.

Making Progress

A controlled chaos approach in Peru seems to be functioning thus far. With a year of rampant success under his belt, the battle to revamp the Peruvian gaming industry is now President Garcia's to lose. However, his largely improvisational approach dissects and addresses issues in a piecemeal fashion, which in light of the sheer

mass of the industry may prove ineffective over time.

Meanwhile, through exacting political and procedural effectiveness, Chile has become the model for stability and control in Latin America, a trait which extends to efforts to develop and grow its gaming industry.

Peruvian municipalities had agreed to work together with the Ministry of Tourism (Mincetur) to bring the illegal operations under law 28.945, passed on Christmas Eve 2006, which provided the one-time offer to all operators of Peruvian casinos and slot houses whereby they should obtain authorization from Mincetur, register their gaming and agree to pay taxes or get shut down. Subsequently, 771 applications were submitted by 246 companies to formalize their position in the industry prior to the deadline.

Aiding the reformation, investigations in 2007 by the Internal Control Department of the office of Peru's attorney general found a provincial judge in the northern city of Cajamarca to have committed administrative crimes and acted beyond her capacity, issuing court injunctions to several local gaming companies, thus enabling several slot operations that had been closed down on licensing grounds to be reopened, circumventing established gaming regulations. Similar charges have been brought against at least three other judges to date, and more are expected. A follow-up court case in March 2007 determined that gaming businesses would be unable to stay open operating under the amparos. Authorities have since seized and destroyed hundreds of the illicit machines.

Manuel San Román, the Ministry of Tourism's Director of casinos and slot machines, is pleased with the results of Garcia's plan, and said the law and its

successful implementation thus far allowed the government to record significantly greater revenue from gambling operators during 2007 than in previous years. According to San Román, the government recorded average monthly gaming tax revenue of US \$4.75 million during the past year, up from approximately US \$1 million per month in 2006. The December 2006 law had also increased the tax to 12 percent of gross revenues rather than net incomes, which contributed to the boost.

In Chile, Law #19.995 of 2005 governed Chile's attempt to establish a new gaming identity. Through this, the Superintendence of Casinos (SCJ) was created and given the tools and authority to govern, regulate and enforce the letter and intent of the law. The legal body could license a maximum of 24 casinos, 22 which have already been distributed: seven of which pre-date the 2005 decree and 15 which resulted from it.

Licenses were distributed in an elaborate competitive bid process whereby the SCJ based its decision on criteria such as the likely impact of the proposal on tourism in the region in question, as well as the quality of the casino project itself. The process was designed to provide maximal transparency in all its facets.

Of these 15 licenses, one has already begun operations and the other 14 will be coming online between now and the first calendar quarter of 2009. The new licenses issued are expected to yield a near four-fold increase in positions over these next two years. The SCJ estimates that these 15 new casinos will generate approximately \$267.4 million in total in the first year of operations, yielding \$44.8 million in tax revenues. Tax streams generated for the country by the first 15 new facilities are anticipated to increase to \$204 million by the fifth year of operations.

The Next Steps

Limited by the 2005 legislation, the SCJ maintains a mandated cautionary stance and therefore a stronghold on the level to which gaming will proliferate throughout the various regions in the country, but the original bid process may not have been as righteous as it was intended. Several applicants, both international and domestic, called foul play, causing a temporary suspension in the process over an alleged lack of transparency, the very thing the painstakingly elaborate process was meant to provide.

In May 2007 an investigatory committee found that the process had, in fact, been "neither clear nor transparent." The committee's report went on to request the resignation of the SCJ's head Francisco Leiva, a request that was effectively denied when the Chamber of Deputies refused to endorse the findings of the committee. Critics

suggest that the chamber vote was a “disgrace” and proclaim the government’s intent to sweep the issue under the carpet.

The SCJ’s official response: “In a process in which there were 39 applicants and just 15 available places, some participants that did not obtain licenses took legal issue with the process and turned to the press in order to discredit it... We have the comfort that in 2008 or 2009, when the local, fiscal and economic benefits of this process materialize, those policies that have sought to obscure it and create suspicion, defaming people and risking the image of our country, will all be forgotten.”

With scandal largely averted (or ignored), the SCJ is free to continue along its planned path, which at this point includes awarding three new licenses and refining gaming regulation standards. Leiva explained, “The objective of our technical standards is to establish all the necessary requirements and controls in order to reassure casino-goers that gaming machines are fair, secure, reliable and subject to audit by the regulatory body... Once this international public consultation is concluded, everyone will be able to find out how machines in the 15 new casinos should work, what percentage they must pay out in prizes and how they are inspected by the Control Board.”

Working versions of the regulations call for such things as a minimum 85 percent payout and that all machine software and hardware must be certified by an internationally recognized testing facility.

Introducing new, comprehensive machine standards is also a stated goal of the Peruvian government, but the premier concern of Mincetur in 2008 is the installation of a server-based monitoring system for all licensed gaming venues, a directive of law 28.945. The online system is expected to be installed in the first quarter of 2008. Once functional, it will allow Mincetur and the Peruvian tax authority, Sunat, the ability to directly monitor slots throughout Peru.

...To New Beginnings

The SCJ has recently voted to allow ownership participation in two

more of the recently licensed 15 facilities. Now, joining the ranks are major operator Sun International as well as Clairvest, a Canadian equity group with a history of success in the gaming industry, bringing total planned investment to approximately \$700 million. With demonstrated ability to continually progress and the presupposition of transparency largely intact among insiders and outsiders alike, it is not hard to anticipate that 2009 will bring everything the Chilean government predicts.

Peru, to an extent, is still stumbling in the dark. Despite a new policy's immediate effectiveness, the call to blindly accept the supply situation for what it was following a three-year free-for-all, has yet to be proven an effective long-term approach for the people of this economy or the industry in general. Absent rapid and ample regulatory follow-up in 2008, Garcia's government could quickly see the deterioration of its apparent successes. It remains to be seen whether this administration has the wherewithal, uniformity of thought and general resolve to accomplish the grand task it has set out to achieve. 2008 will be telling.

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