

BACKGROUND PAPER

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Gambling with Tax Policy: States' Growing Reliance on Lottery Tax Revenue

By

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Introduction

Most Americans don't think of lotteries in terms of tax policy. The lottery conjures up images of smiling Powerball winners displaying \$10 million checks for the TV camera or perhaps stories of lottery players suffering financial ruin or gambling addiction. But in between these two extremes is the less glamorous but equally important issue of the lottery's effect on state tax policy.

In fiscal year 2005, total consumer spending on lotteries surpassed \$50 billion, and the average American spent \$177 playing the lottery. Over \$15 billion of this revenue was transferred to state coffers. The significant revenue raising potential of state lotteries raises serious tax policy concerns. Although no government agency is willing to call the lottery a tax, it is nonetheless a source of implicit tax revenue.

Lotteries are fundamentally different from other gambling in one important way: they are provided by the state, and only by the state. Therefore, they raise policy questions entirely separate from issues of morality and addiction. The lottery is more than a controversial way to add a little money to state coffers; it is a tax and should be evaluated as such.

When subjected to the tests of sound tax policy, it fails:

- Extensive evidence shows lotteries are regressive, meaning the poor shoulder a disproportionate share of the tax burden.
- The lottery is not economically neutral: it distorts consumer spending by applying an unusually high tax rate to a particular product.
- It is a hidden tax, lacking transparency.
- Lotteries unnecessarily complicate the tax system.
- Lottery revenues do not always benefit the programs for which they are earmarked, and voters may feel deceived when they approve lotteries for education only to find that legislators shuffle funds and their states' public education systems do not benefit significantly.
- Finally, the use of state-operated gambling monopolies to raise tax revenue poses serious policy questions about government accountability.

History of Lotteries

Lotteries are not a recent phenomenon. Americans have used them for recreation and raising revenue for nearly four centuries. The history of state-authorized lotteries in America is a 400-year roller coaster ride that has veered several times between outright prohibition and enthusiastic promotion. Despite two periods of prohibition and some vocal opposition to legal gambling, lotteries—whether state-sponsored, private or illegal—have always been part of the American economy, culture, and political landscape.

COLONIAL LOTTERIES

The United States' lottery tradition was imported from England in the 17th century and predates the founding of the republic. As early as the 16th century, lottery revenue in England was used for public projects, including the Westminster bridge and the navy.¹ In 1612 King James I created a lottery in London to aid Jamestown, the first British colony in America. The colonists enthusiastically embraced England's lottery tradition and started their own, organizing both public and private lotteries. Proceeds were used for various public works projects, such as bridges, libraries, roads and lighthouses. The line between public and private was often blurred and proceeds from state-run lotteries also benefited private universities and churches. There were over 160 colonial lotteries before the start of the Revolutionary War,² and they even provided some of the funding for the war.

Lotteries soon came to be seen as more of a civic responsibility than a form of entertainment or gambling.³ The colonists viewed them as a more palatable revenue raiser than explicit taxation. And, in fact, some people did see the lottery as a type of tax. Thomas Jefferson referred to the lottery as “a tax laid on the willing only,”⁴ and in 1892, A. R. Spofford, Librarian of Congress, wrote, “[The lottery was] not regarded at all as a kind of gambling;

the most reputable citizens were engaged in these lotteries.... It was looked upon as a kind of voluntary tax....”⁵ The profits raised by the first colonial lottery were, according to at least one source, considered to be tax revenue: twenty percent of the money collected was kept as a tax “for the use and service of this government.”⁶ Adding to the lottery's appeal was the shortage of other sources of public funding. Taxes were generally unpopular and, prior to 1790, there were only three incorporated banks. Lotteries therefore helped fill a void in both public and private financing.

During the colonial period and early 1800s—a period of strong opposition to explicit taxation—lotteries were often enacted solely to finance specific public improvements, and ended when the projects were completed. A group seeking funds for a public improvement would petition the government to permit a lottery, which was usually approved.⁷ For example, in 1808, the U.S. Congress authorized a lottery specifically to raise money to build a church in the District of Columbia. The lottery would raise “a sum of money not exceeding twelve thousand dollars” and the lottery operators would “give their bond to the United States of America ... that they will ... cause a church to be built in the town of Alexandria, in the district of Columbia, for the use of the Episcopal congregation in said town, and cause the same to be furnished in the best manner the sum of money raised by the lottery will admit.”⁸

Lotteries were especially popular during the period following the adoption of the Constitution and prior to the establishment of effective local taxation. From 1790 to 1860, 24 of the 33 states used them to finance jails, courthouses, hospitals, orphanages, libraries, schools, colleges and churches. While townships and institutions were sometimes granted permission to hold lotteries, they were mainly the province of the states, with a few dismal exceptions: between 1792 and 1842, Congress passed a series of federal lotteries to improve roads

1 Donald W. Gribbin and Jonathan J. Bean, “Adoption of State Lotteries in the United States, with a Closer Look at Illinois,” *The Independent Review* 10, no. 3 (Winter 2005): 353.

2 164 lotteries are mentioned in John Samuel Ezell, *Fortune's Merry Wheel: The Lottery in America* (Cambridge, MA: Harvard University Press, 1960), quoted in Louis Jordan, “Colonial Currency,” Robert H. Gore, Jr. Numismatic Endowment, University of Notre Dame, available at <http://www.coins.nd.edu/ColCurrency/CurrencyText/MA-44descrip.html>, and Jordan notes that more have been discovered since 1960.

3 Charles T. Clotfelter and Philip J. Cook, *Selling Hope: State Lotteries in America* (Cambridge, MA: Harvard University Press, 1989), 20.

4 Thomas Jefferson, *The Writings of Thomas Jefferson*, ed. Andrew A. Lipscomb (Washington, D.C.: Thomas Jefferson Memorial Association, 1903), vol. 17, 450.

5 A. R. Spofford, “Lotteries in American History,” *Annual Report of the American Historical Association*, 1892 (Washington, D.C.: Government Printing Office, 1893), 174-175, quoted in Clotfelter and Cook, *Selling Hope*, 35.

6 Louis Jordan, “A Description of the First Colonial Government Lottery,” Robert H. Gore, Jr. Numismatic Endowment, University of Notre Dame, available at <http://www.coins.nd.edu/ColCurrency/CurrencyText/MA-44descrip.html>.

and infrastructure in Washington, D.C. Tickets sold well, but the agents conducting the lottery absconded with the proceeds.

NINETEENTH-CENTURY LOTTERIES AND PROHIBITION

The 19th century brought a proliferation of shops that sold only lottery tickets; in 1831, in Philadelphia alone, there were over 100 such shops.⁹ In 1832, eight eastern states raised a total of \$66.4 million in lottery revenue—four times the federal expenditure of the same year.¹⁰ However, despite their rapid geographical and financial growth, state-authorized lotteries were not without problems. Private firms gradually took over more of the day-to-day operations, and fraud became rampant. Many lotteries awarded fewer prizes than advertised or none at all. States found themselves unable to regulate the industry and began to consider prohibition. Anti-gambling sentiment became part of the social reform movement already underway, which included abolition of slavery and promotion of women's rights and temperance. People began to see gambling in general and lotteries in particular as a way of taking advantage of the poor. States started banning them, first in the Northeast, then in the South and West. Some researchers also speculate that states were willing to relinquish lotteries at this point in part because stronger centralized governments at the federal, state, and local levels were increasingly able to collect taxes, rendering lotteries less important as a revenue source.¹¹ State governments began collecting income taxes, and property taxes soon became the main revenue source for state and local governments.¹²

There was a short-lived lottery resurgence after the Civil War. The South needed funds to rebuild, and lottery revenue raised for Reconstruction was seen as a voluntary tax.¹³ In 1868, Louisiana legislators accepted bribes in exchange for granting the Louisiana Lottery Company a 25-year charter as

A Lottery Proposal from the Past

In 1934, when no legal lotteries existed, a report by the Tax Policy League titled “Lotteries—A Mediaeval Throwback” foreshadowed their resurgence:

We make progress slowly. Discredited institutions of one century, thought to have been permanently abolished after a long struggle, are revived in later centuries and the battle has to be fought all over again.

Once again America is picking up the lottery enthusiasm from Europe. Four legislatures—Pennsylvania, Maryland, Maine and Massachusetts—considered lottery bills last winter and will go into the matter more thoroughly this year.... A Federal lottery to raise \$1,000,000,000 a year for veterans' benefits will be proposed to Congress by Representative Kenny.

The report also describes a plan that had recently been approved by the New York Municipal Assembly to establish a lottery-like membership league, “organized by outstanding public spirited and charitably minded citizens.” Members would pay dues of \$2.50 per year and would hold as many memberships as they wished. A board of trustees, appointed by the mayor and serving without compensation, would randomly select officers. Officers would receive salaries paid from the dues and the remainder of the dues would benefit “the unemployed and ... other needy persons in the City of New York.”

The report touches on some of the drawbacks to state-run lotteries, including the fact that they are a regressive form of taxation, and ends on a note of sarcasm:

Last week's deliberations by New York's city fathers concerning tax expedients ... give a rather melancholy picture of the period's official mentality. The “lottery plan” equally stupid in conception and in form, may be said to have made the picture perfect. Why, if determined on reviving a discreditable past, the Municipal Assembly should not have discussed a tax on windows, doors, furniture or a New York City “octroi” [a local tax levied on certain goods brought into a city] it is difficult to say.

the sole proprietor of the state lottery, and by 1878 Louisiana had the only legal—albeit scandal-ridden—lottery in the country. It finally came to an

7 Robert G. Blakey, “State Conducted Lotteries: History, Problems, and Promises,” *Journal of Social Issues* 35: 65, quoted in Gribbin and Bean, 354.

8 U.S. Congress. House. 10th Congress, 2nd session, (Dec 15, 1808), available at <http://memory.loc.gov/cgi-bin/ampage?collId=llhb&fileNa me=043/llhb043.db&recNum=334>.

9 Spofford, 190, quoted in Clotfelter and Cook, *Selling Hope*, 37.

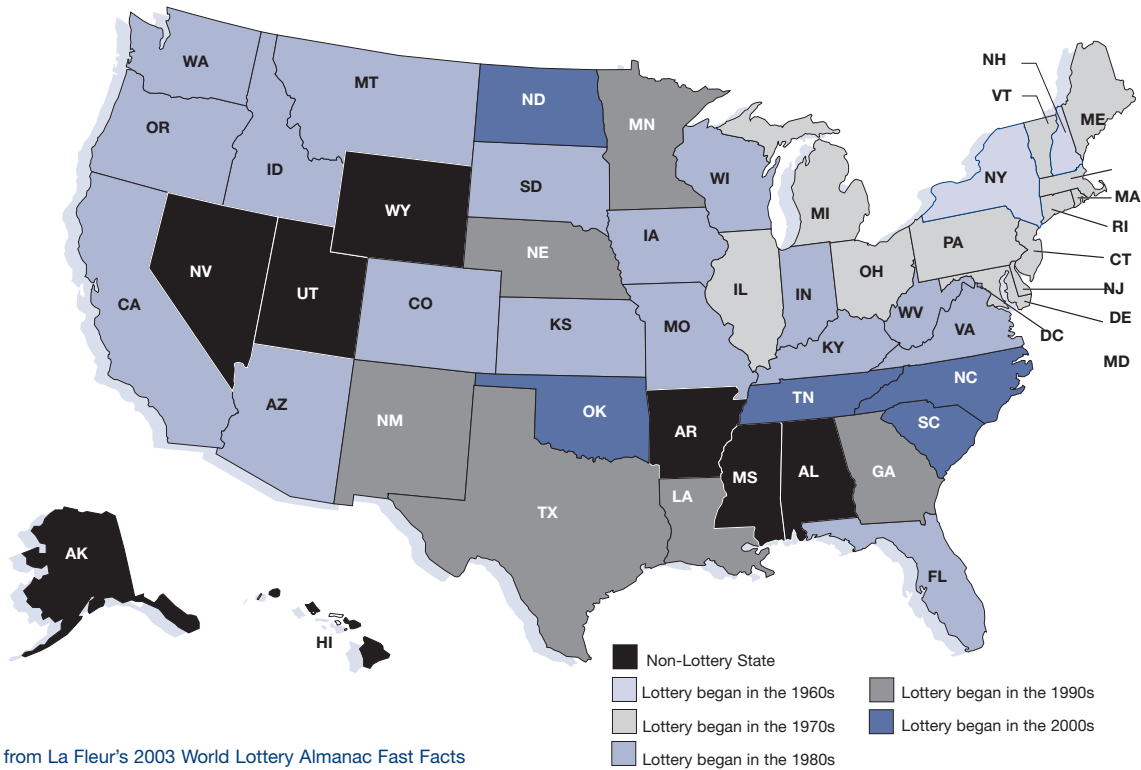
10 Blakey, 68, quoted in Gribbin and Bean, 354.

11 Richard McGowan, *State Lotteries and Legalized Gambling: Painless Revenue or Painful Mirage?* (Westport, Conn.: Praeger, 1994), 12, quoted in Gribbin and Bean, 354.

12 David Niebert, *Hitting the Lottery Jackpot: Government and the Taxing of Dreams* (New York: Monthly Review Press, 2000), 27, quoted in Gribbin and Bean, 354.

13 I. Nelson Rose, “Gambling and the Law: Pivotal Dates,” (1999), available at <http://www.gamblingandthelaw.com/dates.html>.

Figure 1
The Spread of State Lotteries



Source: Data from La Fleur's 2003 World Lottery Almanac Fast Facts

end in 1890 when Congress enacted a prohibition against interstate commerce involving lottery tickets, followed by a prohibition against all mail related to lotteries. By 1894 there were no legal state lotteries and 35 states had constitutional prohibitions against them.

There followed a 70-year period of prohibition against lotteries, from 1894 to 1964. However, at no point were they forgotten by the public or by elected officials. A group of New York philanthropists founded the National Conference for Legalizing Lotteries to support enactment of state and federal lotteries to fund hospitals and other charitable causes. During the Great Depression, there was a flurry of proposals for lotteries at both the state and federal levels to fund unemployment relief, and during World War I, members of Congress introduced lottery bills to help defray the

costs of the war. Public support for these proposals was usually high, with every poll taken after 1938 showing more support than opposition.¹⁴ Meanwhile, illegal lotteries, known as “policy” and “numbers,” flourished, and in 1930, approximately 13 percent of Americans participated in the Irish Sweepstakes, purchasing tickets that had been smuggled into the country.¹⁵

TWENTIETH-CENTURY LOTTERIES

In 1931 Nevada re-legalized casinos, and 33 years later New Hampshire ushered in the modern era of state lotteries. In 1964, after 27 years of annual lottery bills’ failing in the state legislature (one passed in 1955 but was vetoed by the governor), New Hampshire introduced a lottery, approved by 76 percent of the voters in a public referendum. The

¹⁴ Clotfelter and Cook, *Selling Hope*, 43.

¹⁵ *Ibid*, 38.

¹⁶ Commission on the Review of the National Policy toward *Gambling*, *Gambling in America* (Washington, DC: Government Printing Office, 1976), 17-18, quoted in Clotfelter and Cook, *Selling Hope*, 143.

state sidestepped a federal excise tax on wagering, which the IRS intended to apply to the lottery, and 70-year-old federal anti-lottery statutes by labeling the lottery, somewhat misleadingly, a sweepstakes and modeling it after the Irish Sweepstakes. The winning numbers were tied to the winner of a horse race since horse racing was exempt from the tax.¹⁶ Tickets were sold only at racetracks and state-run liquor stores and drawings were held only twice a year. In the first year of operation 80 percent of tickets were sold to residents of neighboring states.¹⁷

In the years leading up to 1964, there was not only a growing acceptance once again of gambling in general, but also a growing opposition to tax increases. New Hampshire had no sales or income tax and relied heavily on property and excise taxes, with over half of the state revenue coming from excise taxes on alcohol, tobacco and horse racing.¹⁸ The lottery was thought to be part of a continued resistance to a sales tax, and also a way to increase state aid to education and deal with the state's budget deficit.

New Hampshire paved the way for New York to establish a lottery in 1967, followed by New Jersey in 1970. Between 1963 and 1965 legislatures in six other states had considered and rejected lottery bills. It was approved in New York, despite considerable opposition, in part because legislators had recently increased the sales tax and were reluctant to increase sales or income taxes further. Lotteries spread rapidly across the country, first in the Northeast and then the West and Midwest, with the South the last holdout. (See Figure 1.) In many states a referendum or initiative was necessary to remove a constitutional ban. In the 1980s, convenience stores and private suppliers of lottery equipment began lobbying for the passage of lotteries and conducting petition drives among voters in states where legislators were hesitant or opposed. Almost all of the referenda and initiatives passed, although some states enacted lotteries through legislation alone. (See Table 1.)

In 1986 North Dakota became the first state to vote against starting a lottery in a referendum. After rejecting it twice more in 1988 and 1996, North Dakotans approved a lottery in 2002. In 1985, three states—Maine, New Hampshire and

Vermont—joined forces to form the first multi-state lottery, Tri-State Lotto. In 1988, five more states—Oregon, Iowa, Kansas, Rhode Island and West Virginia—and Washington, D.C. discovered the appeal of large jackpots and created the Multi-State Lottery Association. Later that year they launched Lotto America, now known as Powerball. Two states started lotteries in the 1960s, 12 in the 1970s, 18 in the 1980s, six in the 1990s and five since 2000 (see Figure 1). Currently, 42 states and the District of Columbia have lotteries. Oklahoma and North Carolina are the most recent states to enact them.

CONTROVERSY IN NORTH CAROLINA

In March 2006, the North Carolina lottery sold its first ticket. Lottery enactment had been a controversial issue in the state for 20 years. North Carolina's road to lottery enactment was longer, more contentious, and more partisan than many states' and highlights some of the concerns people have long had about lotteries. As in other southern states, there was considerable opposition to lotteries, but worries about "losing" money to nearby states prompted North Carolina's neighbors to succumb. When South Carolina and Tennessee gave in, North Carolina was completely surrounded by lotteries and the only state on the East Coast without one. A recession in 2001 nudged the state even closer to lottery enactment.

North Carolina's governor was an outspoken supporter of a lottery to fund education, and he even included a projected \$425 million in lottery revenue in the state's FY 2006 budget before the lottery legislation had been approved. The legislature had long been divided, mainly along partisan lines. North Carolina Democrats largely supported the lottery, while the state Republican Party platform states, "A state lottery ... places the burden of taxation most heavily on those who are least able to afford it." Approval of the FY 2006 budget was delayed over a month into the fiscal year, in part because of debate over the proposed lottery. Finally, in August, when it looked as if the bill were dead for the year, the senate passed it with a tie vote that was broken by the lieutenant governor. The house had passed the bill in April in a very close vote. The state then spent more than \$6 million to set up a

17 I. Nelson Rose, "The Legalization and Control of Casino Gambling," *Fordham Urban Law Journal* 8 (1980): 256n, quoted in Clotfelter and Cook, *Selling Hope*, 143.

18 David Weinstein and Lillian Deitch, *The Impact of Legalized Gambling: The Socioeconomic Consequences of Lotteries and Off-Track Betting* (New York: Praeger, 1974), 14-15, quoted in Clotfelter and Cook, *Selling Hope*, 142.

*Table 1
State Lottery Profiles
Dollars Cumulative, FY 1964-2004*

State	Agency	Set-Up of Agency	Start Date	How Authorized/ Percentage in Favor
AZ	Arizona Lottery Commission	Independent	July 1, 1981	Initiative/51%
CA	California State Lottery Commission	Independent	October 3, 1985	Initiative/58%
CO	Colorado Lottery	Dept. of Revenue	January 24, 1983	Initiative/60%
CT	Connecticut Lottery Corporation	Independent	February 15, 1972	Legislation
DC	D.C. Lottery & Charitable Games Control Board	Independent	August 22, 1982	Initiative/66% (est.)
DE (1)	State Lottery Office	Dept. of Finance	October 31, 1975	Legislation
FL	Department of the Lottery	Independent	Jan 12, 1988	Referendum/64%
GA	Georgia Lottery Corporation	Independent	June 29, 1993	Referendum/52%
ID	Idaho Lottery Commission	Independent; part of the Dept. of Self-Governing Agencies	July 19, 1989	Referendum/51%
IL	Lottery Division	Dept. of Revenue	July 30, 1974	Legislation
IN	State Lottery Commission of Indiana	Independent	October 13, 1989	Referendum/62%
IA	Iowa Lottery Authority	Independent	August 22, 1985	Legislation
KS	Kansas Lottery Commission	Independent	November 12, 1987	Referendum/64%
KY	Kentucky Lottery Corporation	Independent	April 4, 1989	Referendum/60%
LA	Louisiana Lottery Corporation	Independent	September 6, 1991	Referendum/65%
ME	Liquor & Lottery Commission	Dept. of Administrative and Financial Services	June 27, 1974	Referendum/61%
MD	Maryland State Lottery Agency	Office of the Attorney General	May 15, 1973	Referendum/80%
MA	Massachusetts State Lottery Commission	State Treasury	March 22, 1972	Legislation
MI	Michigan Bureau of State Lottery	Independent	November 13, 1972	Referendum/67%
MN (3)	Minnesota State Lottery	Independent	April 17, 1990	Referendum/57%
MO	Missouri State Lottery Commission	Dept. of Revenue (4)	January 20, 1986	Referendum/70%
MT	Montana Lottery Commission	Independent	June 27, 1987	Referendum/70%
NE	Nebraska Lottery	Department of Revenue	September 11, 1993	Referendum/63%
NH	New Hampshire Lottery Commission	Dept. of Education	March 12, 1964	Legislation
NJ	Division of State Lottery	Treasury Dept.	December 16, 1970	Referendum/82%
NM	New Mexico Lottery Authority	Independent	April 27, 1996	Legislation
NY	Division of the State Lottery	Dept. of Taxation and Finance	June 1, 1967	Referendum/61%
NC	North Carolina Lottery Commission	Independent	March 30, 2006	Legislation
ND	North Dakota Lottery	Office of Attorney General	March 25, 2004	Referendum/64%
OH	Ohio Lottery Commission	Independent	August 13, 1974	Legislation
OK	Oklahoma Lottery Commission	Independent	October 12, 2005	Referendum/65%
OR (1)	Lottery Commission	Independent	April 25, 1985	Initiative/66%
PA	Pennsylvania State Lottery	Dept. of Revenue	March 7, 1972	Legislation
RI (2)	Rhode Island Lottery (2)	Independent	May 18, 1974	Referendum/76%
SC	South Carolina Education Lottery Commission	Independent	January 7, 2002	Referendum/54%
SD	Lottery Commission	Independent	September 30, 1987	Referendum/60%
TN	Tennessee Education Lottery Corporation	Independent	January 20, 2004	Referendum/58%
TX	Texas Lottery Commission	Independent	May 29, 1992	Referendum/65%
VT	Vermont Lottery Commission	Independent	February 14, 1978	Referendum/66%
VA	State Lottery Department	Independent	September 20, 1988	Referendum/57%
WA	Lottery Commission	Independent	November 15, 1982	Legislation
WV (1)	West Virginia Lottery	Dept. of Taxation and Revenue	January 9, 1986	Referendum/67%
WI	Wisconsin Lottery	Dept. of Revenue	September 18, 1988	Referendum/65%

Total U.S.

(1) VLT net machine income is listed as sales. Total prizes do not include VLT prizes, which reduces the lottery's prize payout.

(2) VLT sales are listed as "cash in." Total prizes includes cash VLT prizes ("cash out").

(3) 6.5% of sales is collected as in-lieu-of-sales tax, in addition to the profits kept by the state. This tax is used for the same programs as the profit.

FY 2005 Revenue Uses	Sales (\$Millions)	Prizes (\$Millions)	Government Transfers (\$Millions)	Prizes (% of Total Sales)	Government Transfers (% of Total Sales)	State
General fund, mass transit, county assistance, Court Appointed Special Advocate Fund, economic development, Heritage Fund, Local Transportation Assistance Fund, Healthy Arizona, dept. of gaming	\$5,109.8	\$2,611.3	\$1,677.7	51%	33%	AZ
K-12 education, state colleges and universities, California Youth Authority	\$42,963.4	\$21,875.6	\$15,901.2	51%	37%	CA
Parks and recreation, conservation trust fund, school health and safety, Great Outdoors Colorado	\$5,575.9	\$3,198.4	\$1,510.6	57%	27%	CO
General fund	\$14,527.9	\$8,111.3	\$5,294.9	56%	36%	CT
General fund	\$3,834.8	\$1,913.0	\$1,269.0	50%	33%	DC
General fund	\$5,543.0	\$1,007.1	\$2,127.3	18%	38%	DE (1)
Educational Enhancement Trust Fund	\$37,144.2	\$18,466.5	\$14,246.1	50%	38%	FL
College (Hope Scholarship program), voluntary pre-kindergarten program	\$21,427.8	\$11,442.3	\$6,841.1	53%	32%	GA
Public Education (K-12 and college), State Permanent Building Fund	\$1,216.4	\$700.0	\$274.7	58%	23%	ID
Common School Fund (K-12 public schools)	\$33,026.2	\$16,996.8	\$12,318.8	51%	37%	IL
Police/firefighter pensions, teachers' retirement, Build Indiana	\$8,627.2	\$4,927.6	\$2,517.1	57%	29%	IN
General fund, Vision Iowa (development of community tourism facilities)	\$3,263.0	\$1,773.7	\$883.0	54%	27%	IA
General fund, economic development, prisons, problem gambling fund	\$2,523.5	\$1,316.4	\$766.3	52%	30%	KS
General fund, adult and child literacy programs, Kentucky Educational Excellence Scholarship Program	\$7,925.2	\$4,731.3	\$2,091.9	60%	26%	KY
Problem gambling program, Minimum Foundation Program (public education)	\$4,205.0	\$2,107.9	\$1,505.6	50%	36%	LA
Outdoor Heritage Fund, general fund	\$2,492.7	\$1,393.6	\$694.8	56%	28%	ME
General fund, Maryland Stadium Authority	\$22,911.8	\$11,989.4	\$8,502.0	52%	37%	MD
Cities and towns (5)	\$54,371.3	\$33,867.2	\$13,526.0	62%	25%	MA
Michigan School Aid Fund (K-12 public schools)	\$32,121.6	\$16,657.5	\$12,340.5	52%	38%	MI
General fund, Environment and Natural Resources Trust Fund	\$4,679.3	\$2,765.4	\$1,115.0	59%	24%	MN (3)
Education (college and K-12)	\$7,170.1	\$4,084.5	\$2,241.6	57%	31%	MO
General fund	\$496.8	\$247.7	\$114.7	50%	23%	MT
Education Innovation Fund, Nebraska Scholarship Fund, Environmental Trust Fund, state fair, Compulsive Gamblers Assistance Fund	\$818.6	\$528.0	\$202.4	65%	25%	NE
K-12 education	\$2,902.0	\$1,583.1	\$930.1	55%	32%	NH
Education and institutions (includes community colleges, Department of Military and Veterans Affairs, and Department of Human Services)	\$34,262.2	\$17,858.1	\$13,913.8	52%	41%	NJ
Lottery Success Scholarship Fund	\$930.9	\$501.2	\$217.0	54%	23%	NM
K-12 education	\$63,489.5	\$31,545.9	\$24,692.7	50%	39%	NY
Lottery had not started as of FY 2005. Currently, proceeds are used for education (K-12 and college).	N/A	N/A	N/A	N/A	N/A	NC
Problem gambling fund, general fund	\$5.8	\$2.8	\$1.6	48%	27%	ND
Education	\$37,966.4	\$21,116.3	\$13,037.7	56%	34%	OH
Lottery had not started as of FY 2005. Currently, proceeds are used for education (K-12 and college).	N/A	N/A	N/A	N/A	N/A	OK
Economic development, state parks, salmon restoration, K-12 public schools, problem gambling treatment	\$16,868.3	\$9,966.5	\$3,779.5	59%	22%	OR (1)
Senior citizens' programs (including property tax/rent rebate program)	\$37,472.6	\$19,090.3	\$14,361.5	51%	38%	PA
General fund	\$9,627.0	\$6,333.8	\$1,990.3	66%	21%	RI (2)
College scholarships and other higher education programs	\$2,009.8	\$1,166.3	\$588.0	58%	29%	SC
General fund, Capital Construction Fund, Property Tax Reduction Fund	\$7,453.6	\$4,786.9	\$1,205.7	64%	16%	SD
College/vocational scholarships; pre-K programs and after-school programs.	\$427.7	\$217.0	\$123.3	51%	29%	TN
Foundation School Fund	\$36,165.5	\$20,381.2	\$11,755.9	56%	33%	TX
Vermont Education Fund	\$1,149.3	\$683.1	\$315.6	59%	27%	VT
K-12 education	\$14,318.0	\$7,747.9	\$4,913.1	54%	34%	VA
Education (K-12 and college), stadium construction	\$7,217.1	\$4,053.8	\$2,139.4	56%	30%	WA
Education, senior citizens, tourism	\$6,357.3	\$1,394.4	\$2,205.7	22%	35%	WV (1)
Property tax relief	\$6,378.3	\$3,605.2	\$2,107.7	57%	33%	WI
	\$606,976.7	\$324,746.1	\$206,240.4	54%	34%	Total U.S.

(4) Though housed in the Dept of Revenue, according to statute the Director of the Revenue Department has no control of the Lottery Commission.

(5) Cities and towns are permitted to decide how funds will be used--in effect, a general fund.

Source: La Fleur's 2005 World Lottery Almanac; state lottery web sites

163-employee lottery agency in three months,¹⁹ which sold only instant tickets at first, soon followed by entry into the multi-state game Powerball.

Since its approval, the lottery has been plagued by scandal and controversy.

First, there were accusations that the senate bill had been passed through deceptive, underhanded maneuvering after the legislative session had ostensibly ended. Second, there are allegations of criminal activity and corruption involving a company that hoped to land the multi-million-dollar contract to run the new lottery, starting with the discovery that the house speaker's political director was on the company's payroll and the company had written part of the lottery legislation. State and federal criminal investigations followed, and three of the nine lottery commissioners resigned within a month of their appointments. One commissioner has been sentenced to four years in prison.

Policymakers often give the impression that a lottery will cause money for education or other worthy causes to simply materialize out of thin air, as if the state will become richer without any citizen's becoming poorer.

Another controversy involves the growing suspicion that funds raised will partially supplant rather than supplement the state's \$6.6 billion education budget, contrary to a pledge made by the governor.²⁰ The governor has stated his intention to use approximately half of the projected lottery funds to

replace the \$203 million in general fund tax money that is spent annually to reduce class size and fund pre-kindergarten programs. The governor's staffers, however, claim that the displaced general fund money will still be used to support education in other ways—for example, to raise teachers' salaries. Residents of western North Carolina were even more upset about the lottery's education funding prospects when they learned that their school districts will receive less lottery money than the rest of the state will. The lottery law disproportionately aids counties with above-average property tax rates, as a form of property tax relief.

Finally, there is the lawsuit. A group represented by the North Carolina Institute for Constitutional Law filed suit against the state in December 2005, asking a judge to block the lottery's start. The group argues that lottery "profits" are tax revenue and that the legislature breached the state's constitutional requirement that revenue bills be voted on in both houses on three separate days. In March 2006, a judge ruled that the lottery is not a tax, and therefore the bill was passed constitutionally and the lottery could proceed with ticket sales. The case has been appealed, and the verdict could have far-reaching implications for the future of lotteries in other states. (See Tax Foundation Brief of Amicus Curiae in Support of Petitioners—Heatherly v. State of North Carolina for more on this case.²¹)

OKLAHOMA LOTTERY STARTED IN 2005

Oklahoma had a less eventful start to its lottery in October 2005. Oklahomans approved a referendum in November 2004 for a lottery to support public education. They had rejected the referendum in 1994, but the 65% who voted in favor this time may have been swayed by the expensive pro-lottery campaign conducted by a large coalition of education groups. Some of the opposition was based on the Lottery Commission's decision to allow pawn shops, check-cashing businesses, and payday loan companies to sell tickets. A groundswell of

19 *Lottery Post*, "N.C. Lottery begins today," (March 30, 2006), available at <http://www.lotterypost.com/thread/131516.htm>.

20 *Lottery Post*, "N.C. Lottery funding controversy widens," (February 16, 2006), available at <http://www.lotterypost.com/news/128654.htm>.

21 Chris Atkins and Kevin W. Benedict, "Brief of Amicus Curiae in Support of Petitioners—Heatherly v. State of North Carolina," *Tax Foundation Special Brief*, filed January 19, 2007, <http://www.taxfoundation.org/news/show/22415.html>.

22 *Lottery Post*, "Oklahoma Lottery unveils scratch ticket designs," (October 4, 2005), available at <http://www.lotterypost.com/news/120697.htm>.

opposition forced the commission to reconsider the day before ticket sales began. The lottery is projected to generate \$219 million in sales in FY 2006,²² 30 percent of which will go into state coffers (35 percent after the first two years) ostensibly to benefit public education.

Reasons for Lottery Adoption

What motivates some states to enact lotteries, even in the face of political and social opposition, while others resist? There are most likely numerous factors that work in tandem.

FISCAL CRISES

The most obvious reason would seem to be the desire to raise revenue in a way that is not unpopular politically, especially in times of fiscal crisis. However, the fiscal-crisis factor is not as simple as it seems. Some studies have found that, in general, fiscal crises are not reliable predictors of lottery adoption, especially for states that adopted lotteries in the 1980s and 1990s.²³ States that adopted them prior to 1980 were probably motivated by fiscal stress more than lottery latecomers were. Several studies have shown a positive correlation between short-term state debt and lottery adoption, especially for lotteries that started between 1964 and 1977²⁴, and no correlation between lottery adoption and long-term state debt.²⁵

THE INFLUENCE OF NEIGHBORING STATES

Even states that are not experiencing fiscal crises are likely to enact lotteries simply to avoid losing money to neighboring states. Significant numbers of people who live in border areas of non-lottery states travel to neighboring states to play the lottery, and many legislators view money spent on other states' lotteries as "lost" revenue. One study showed that non-lottery states do not "lose" a significant

Bubba Helps Bring Lottery to North Carolina

Before North Carolina had a lottery of its own, North Carolinians flocked to other states, including Virginia and South Carolina, to purchase tickets, spending an estimated \$400 million per year on other states' lotteries.²⁹ North Carolina was the last state on the East Coast without a lottery, so its residents had no shortage of other locations in which to play. South Carolina once faced the same problem, with residents playing the lottery in Georgia before they voted for one at home.

Pro-lottery groups pushing for lottery enactment in North Carolina and South Carolina made this cross-border spending and "lost" revenue the centerpiece of a massive advertising campaign aimed at persuading voters to approve the lottery in a referendum.

In South Carolina they created TV commercials featuring a fictional Georgia store clerk named Bubba, who happily sold lottery tickets to South Carolinians and thanked them for boosting Georgia's education budget. The ads worked, and South Carolina caved in to the lottery. Suddenly Bubba was reborn as a South Carolina clerk with the same act, but this time the taunting, pro-lottery message was directed at North Carolina. The North Carolina commercial was created by a group called the North Carolina Lottery for Education Coalition, which supposedly wanted a lottery to raise money for public education and to keep North Carolinians' money in state.

In the end, North Carolina's lottery was enacted through legislation alone, rather than the referendum that was originally planned, but the topic of lost revenue became a major theme in the debate, both in the legislature and in the press.

amount of money to neighboring states unless there is a population of 25,000 or greater within 50 miles on each side of the shared border,²⁶ although legislators in all states seem to fear the loss of revenue regardless of the size of the border populations. A state whose neighbor has a lottery is more likely to enact one itself, due to concerns that its citizens are spending money in other states, and the pragmatic, defeatist notion that people are going to gamble anyway, so they may as well spend their money at home. It has been suggested that certain states function as leaders or trendsetters, not just in lottery

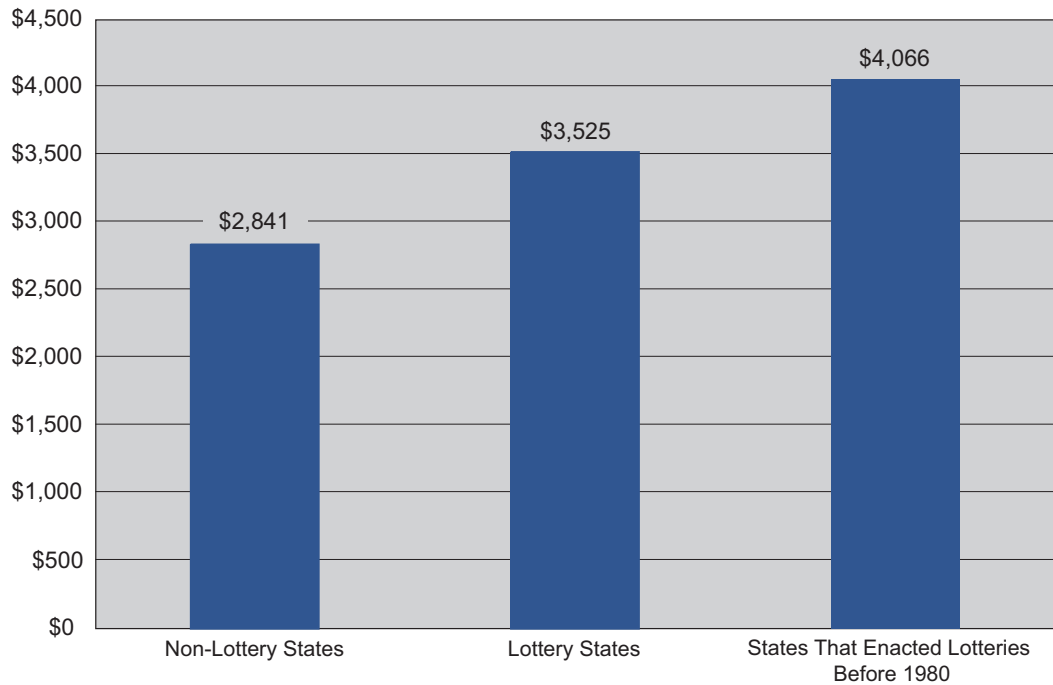
²³ See, for example: James Alm, Michael Mickee and Mark Skidmore, "Fiscal Pressure, Tax Competition, and the Introduction of State Lotteries," *National Tax Journal* XLVI (December 1993): 463-476; Frances Stokes Berry and William D. Berry, "State Lottery Adoptions as Policy Innovations: An Event History Analysis," *American Political Science Review* 84 (June 1990): 395-415; Mark M. Glickman and Gary D. Painter, "Do Tax and Expenditure Limits Lead to State Lotteries? Evidence from the United States: 1970-1992," working paper (1999); Gribbin and Bean, 352; and Clotfelter and Cook, *Selling Hope*, 159.

²⁴ Melanie Kathleen Patrick, *Ticket to Ride: What State Lotteries Teach Us about State Government*, Ph.D. diss., Brown University (1999), 297, quoted in Gribbin and Bean, 358.

²⁵ Alm, Mickee and Skidmore, 463-476.

²⁶ Alm, Mickee and Skidmore, 467.

Figure 2
Per Capita State and Local Tax Collections in Lottery States Vs.
Non-Lottery States, FY 2004



Source: Department of Commerce, Bureau of the Census; Tax Foundation calculations

adoption but in other state innovations as well, and nearby states follow if they like the results.²⁷

INCREASING SPENDING WITHOUT RAISING TAXES

A more cynical view of lottery enactment is that policymakers want to have their cake and eat it too. That is, they want more money to spend but don't want to face the political consequences of raising income, sales or property taxes. The spread of state lotteries coincides with rapidly growing state and local government expenditures, as well as growing public opposition to higher taxes.²⁸ Confusing the need for revenue with the desire to spend more, legislators may turn the desire for increased spending into a perceived fiscal crisis, convincing voters that approving a lottery is the only way to avoid new taxes.

If the alleged purpose of the proposed lottery is to boost education spending, lawmakers are not only able to say that they've avoided raising taxes; they may also garner public approval by expressing their support for education. Many states have

increasingly turned to revenue from various types of gambling, including casinos, video slot machines at racetracks, and lotteries, to fund state programs, reasoning that voters will be more accepting of raising revenue through gambling than through increases in other taxes. Policymakers often give the impression that a lottery will cause money for education or other worthy causes to simply materialize out of thin air, as if the state will become richer without any citizen's becoming poorer.

Lottery States Versus Non-Lottery States

The states that do not have lotteries are: Alabama, Alaska, Arkansas, Hawaii, Mississippi, Nevada, Utah and Wyoming. In some of these states, it is easy to pinpoint factors that may partially explain the absence of lotteries. For example, in Utah, Mississippi and Alabama, there is widespread religious opposition to gambling. Nevada's casino industry has a vested interest in preventing the competition lotteries could create. Alaska and Hawaii's

geographic isolation means they do not have to worry about losing money to neighboring states.

ECONOMIC DIFFERENCES

There are some characteristics that lottery states, especially those that adopted lotteries early, share, although these characteristics are not necessarily precipitating factors. States that have lotteries tend to have higher per capita incomes, higher state/local tax burdens and later Tax Freedom Days (Tax Freedom Day is calculated annually by the Tax Foundation and measures total taxes as a percentage of income). In addition, one study found that between 1970 and 1992 states with tax and expenditure limits (TELEs) on property assessment increases were more likely to enact lotteries.³⁰

Although many people believe that lotteries help state governments keep taxes lower,³¹ per capita state/local tax collections in FY 2004 were higher in lottery states (\$3,525 per year) than in non-lottery states (\$2,841 per year), and state/local taxes in states that enacted lotteries prior to 1980 were even higher: \$4,066. (See Figure 2.) Of course, per capita tax collections in lottery states would be even higher if state governments counted lottery “profits” as tax revenue.

OTHER DIFFERENCES

A 1989 study showed that the electorate of states that adopted lotteries before 1980 were more liberal in their political views than voters in other states, as measured by their presidential election votes and views on various social and political issues.³² It has also been shown that heavily and densely populated states were more likely to enact early lotteries, most

likely since the potential revenue is greater due to the larger supply of players and larger jackpots with which to lure players.³³

Lottery Revenue

PUBLIC OPINION AND SPENDING ON LOTTERIES

In 2005, 90 percent of the U.S. population lived in states that ran lotteries (not including Oklahoma, whose lottery started midway through 2005) and many others played in neighboring states. While estimates vary as to how many Americans play the lottery, polls generally show that over half have participated in any recent year, which makes lotteries the most popular form of commercial gambling.³⁴ The number who say they approve of lotteries is even higher—nearly three-quarters in one recent survey.³⁵ In one poll, 21 percent of respondents said playing the lottery is “the most practical strategy for accumulating several hundred thousand dollars” for retirement.³⁶

Clearly, the majority of Americans have overcome any reservations they may have had about state lotteries. They not only play the lottery in droves; they also spend large sums of money—\$52 billion in FY 2005. In 2004 lotteries accounted for 27 percent of the takeout (consumer spending minus prizes, also sometimes referred to in the gaming industry as “gross revenue”) of the commercial gambling industry, making them the second most lucrative form of legal gambling, eclipsed only by casinos. (See Figure 3.)

27 See, for example: Jack L. Walker, “The Diffusion of Innovations among the American States,” *American Political Science Review* 3 (Sept. 1969): 897, quoted in Clotfelter and Cook, *Selling Hope*, 150; and Berry and Berry.

28 Ronald Fisher, *State and Local Public Finance* (Chicago: Irwin, 1996), quoted in Cletus C. Coughlin, Thomas A. Garrett, and Rubén Hernández-Murillo, “The Geography, Economics, and Politics of Lottery Adoption,” *Federal Reserve Bank of St. Louis Review* (May/June 2006):165-180.

29 *Lottery Post*, “N.C. Lottery begins today,” (March 30, 2006), available at <http://www.lotterypost.com/thread/131516.htm>.

30 Glickman and Painter, 19.

31 See, for example, GTech Corporation, *The Vital Signs of Legalized Gaming in America: GTech's 8th Annual National Gaming Survey*, (2000), 8.

32 Clotfelter and Cook, *Selling Hope*, 147.

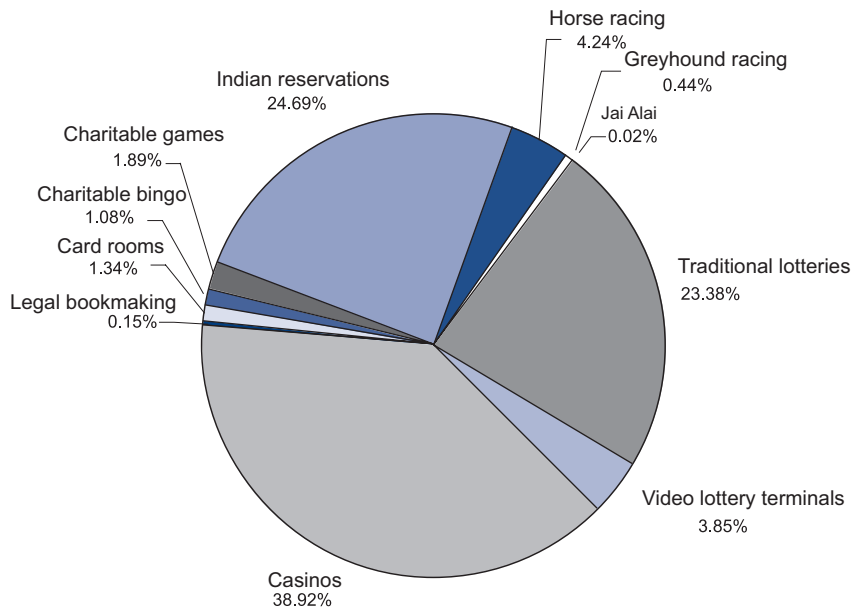
33 Alm, McKee and Skidmore, 468.

34 See, for example: GTech Corporation, 5; The Gallup Organization, *Gambling in America* (1999), quoted on North American Association of State and Provincial Lotteries Web site, <http://www.naspl.org/faq.html>; American Gaming Association, *State of the States: The AGA Survey of Casino Entertainment* (2003); National Opinion Research Center, “Gambling Impact and Behavior Study: Report to the National Gambling Impact Study Commission,” (1999), 7; and *Gambling: As the Take Rises, So Does Public Concern*, Pew Research Center (May 23, 2006), 4.

35 Pew Research Center, 1.

36 Andrea Coombes, “Six-figure savings? Most say ‘unlikely,’” *MarketWatch* (Jan 9, 2006). For an analysis of saving for retirement via the lottery vs. investing in the stock market, see Alicia Hansen and Gerald Prante, “Lottery Taxes Divert Income from Retirement Savings,” *Tax Foundation Fiscal Fact* No. 45 (Jan. 19, 2006). Available at www.taxfoundation.org/publications/show/1302.html.

Figure 3
Gross Gambling Revenue (Takeout) by Industry, 2004



Note: These amounts represent each industry's takeout (consumer spending minus prizes/winnings awarded) rather than total consumer spending.
Note: Due to differences in reporting methods, data in this chart may not exactly match other sources' data in other charts in this report.
Source: Data from Christiansen Capital Advisors in *International Gaming and Wagering Business*; Tax Foundation calculations.

In FY 2005, the average American spent \$177 on lottery games. (See Table 2.) Taking into account only residents of lottery states, this figure rises to nearly \$200. If slightly older data are used, lottery spending can be compared to other categories of consumer spending, including other types of recreational activities. In 2004, the average American spent more money on lotteries (\$165.81) than on reading materials (\$130.00) and attending movies (\$32.55—theater admissions only) combined. (See Figure 4.)

SPENDING VARIES GREATLY BY STATE

Lottery spending varies considerably from state to state (see Table 2). New York boasts the highest FY 2005 sales (\$6.3 billion), followed by Massachusetts (\$4.5 billion) and Texas (\$3.7 billion). At the bottom of the list are North Dakota (\$19.2 million), Montana (\$33.8 million—an 8 percent decrease from FY 2004), and Vermont (\$92.6 million).

Large and densely populated states have a clear advantage in terms of raising large amounts of lottery revenue, so a better measure of a lottery's revenue-raising ability is per capita spending, which also varies greatly by state. FY 2005 per capita spending was highest by far in Rhode Island, with the average resident spending \$1,518.33. South Dakota was a distant second at \$873.66 and Delaware was a close third at \$823.72. It should be noted that all three

Figure 4
Lottery Spending vs. Spending on Other Leisure Activities, Fiscal Year 2004



Source: North American Association of State and Provincial Lotteries; Bureau of Labor Statistics, Consumer Expenditure Survey; Motion Picture Association of America; Tax Foundation calculations.
Note: North Dakota and Tennessee were included in this calculation although their lotteries started in the middle of FY 2004.
Note: Due to differences in reporting methods, data in this chart may not exactly match other sources' data in other chart in this report.

Table 2
Lottery Sales and Profits, Fiscal Year 2005

State	Total Sales (\$ Millions)	Rank by Total Sales	Per Capita Sales (Dollars)	Rank by Per Capita Sales	Sales Per Adult (over 18) (Dollars)	Total Profits (Tax Revenue) (\$ Millions)	Rank by Total Profits	Percent of Revenue Kept by State	Rank by Percent of Revenue Kept by State	Implicit Tax Rate (3)	Rank by Implicit Tax Rate	Per Capita Implicit Tax Burden (\$ Dollars)	Percent Change in Sales from FY 2004 to FY 2005
Arizona	\$397.6	29	\$68.08	37	\$92.44	\$116.8	26	29.4%	20	41.6%	20	\$20.00	8.5%
California	\$3,333.6	5	\$92.63	28	\$125.92	\$1,175.8	2	35.3%	5	54.5%	5	\$32.67	13.2%
Colorado	\$417.0	27	\$89.99	29	\$119.78	\$103.7	30	24.9%	30	33.1%	30	\$22.39	3.9%
Connecticut	\$932.9	18	\$266.20	10	\$350.39	\$268.5	18	28.8%	22	40.4%	22	\$76.62	2.8%
Delaware (1)	\$689.3	23	\$823.72	3	\$1,086.95	\$234.0	19	33.9%	6	51.4%	6	\$279.64	7.5%
District of Columbia	\$233.4	31	\$422.59	6	\$502.52	\$71.1	31	30.4%	15	43.8%	15	\$128.63	-4.7%
Florida	\$3,470.7	4	\$197.34	16	\$254.52	\$1,103.6	3	31.8%	13	46.6%	13	\$62.75	13.0%
Georgia	\$2,922.3	6	\$324.87	8	\$439.00	\$802.2	8	27.5%	25	37.8%	25	\$89.18	7.8%
Idaho	\$113.5	37	\$80.38	31	\$110.31	\$26.0	37	22.9%	35	29.7%	35	\$18.41	3.8%
Illinois	\$1,842.9	11	\$144.68	24	\$193.78	\$614.0	11	33.3%	8	50.0%	8	\$48.20	7.8%
Indiana	\$739.6	21	\$118.35	27	\$158.27	\$189.0	22	25.6%	28	34.3%	28	\$30.25	0.6%
Iowa	\$210.7	33	\$71.18	36	\$93.67	\$51.1	34	24.3%	31	32.0%	31	\$17.26	0.4%
Kansas	\$206.7	35	\$75.47	33	\$101.08	\$62.3	33	30.1%	17	43.1%	17	\$22.74	-7.8%
Kentucky	\$707.3	22	\$170.11	20	\$223.68	\$158.2	23	22.4%	36	28.8%	36	\$38.05	-2.5%
Louisiana	\$307.0	30	\$68.00	38	\$92.18	\$108.9	28	35.5%	3	55.0%	3	\$24.12	-9.7%
Maine	\$209.3	34	\$158.76	22	\$203.41	\$50.3	35	24.0%	32	31.7%	32	\$38.18	12.6%
Maryland	\$1,485.7	13	\$266.22	9	\$353.80	\$477.1	13	32.1%	12	47.3%	12	\$85.49	6.5%
Massachusetts	\$4,484.7	2	\$700.40	5	\$903.33	\$936.1	5	20.9%	38	26.4%	38	\$146.20	2.4%
Michigan	\$2,069.5	10	\$204.65	15	\$273.17	\$667.6	9	32.3%	10	47.6%	10	\$66.02	5.2%
Minnesota	\$408.6	28	\$79.88	32	\$106.20	\$106.2	29	26.0%	27	35.1%	27	\$20.76	5.6%
Missouri	\$785.0	20	\$135.82	26	\$180.00	\$218.6	21	27.8%	24	38.6%	24	\$37.82	-0.8%
Montana	\$33.8	40	\$36.30	40	\$47.53	\$6.2	41	18.4%	40	22.5%	40	\$6.68	-8.0%
Nebraska	\$100.7	38	\$57.41	39	\$76.99	\$23.9	38	23.7%	33	31.1%	33	\$13.61	8.7%
New Hampshire	\$227.9	32	\$174.70	19	\$228.11	\$69.3	32	30.4%	16	43.7%	16	\$53.12	-3.9%
New Jersey	\$2,273.8	8	\$261.31	11	\$345.58	\$804.4	7	35.4%	4	54.7%	4	\$92.45	3.9%
New Mexico	\$139.3	36	\$72.70	35	\$98.94	\$32.2	36	23.1%	34	30.1%	34	\$16.82	-6.3%
New York	\$6,270.5	1	\$325.44	7	\$425.97	\$2,062.7	1	32.9%	9	49.0%	9	\$107.05	7.2%
North Dakota	\$19.2	41	\$30.09	41	\$39.25	\$6.5	40	33.7%	7	50.9%	7	\$10.15	N/A
Ohio	\$2,159.1	9	\$188.45	17	\$249.16	\$645.1	10	29.9%	18	42.6%	18	\$56.31	0.2%
Oregon (1)	\$943.1	17	\$260.80	12	\$340.99	\$415.5	15	44.1%	1	78.7%	1	\$114.89	5.6%
Pennsylvania	\$2,644.9	7	\$213.09	14	\$276.65	\$852.6	6	32.2%	11	47.6%	11	\$68.69	12.4%
Rhode Island (2)	\$1,636.8	12	\$1,518.33	1	\$1,966.34	\$313.5	16	19.2%	39	23.7%	39	\$290.77	10.6%
South Carolina	\$957.0	16	\$226.42	13	\$299.59	\$277.5	17	29.0%	21	40.8%	21	\$65.66	0.7%
South Dakota (2)	\$675.6	24	\$873.66	2	\$1,169.72	\$119.3	25	17.7%	41	21.5%	41	\$154.30	1.7%
Tennessee	\$844.3	19	\$142.43	25	\$187.70	\$227.4	20	26.9%	26	36.9%	26	\$38.36	N/A
Texas	\$3,662.5	3	\$161.59	21	\$222.89	\$1,076.8	4	29.4%	19	41.6%	19	\$47.51	26.1%
Vermont	\$92.6	39	\$148.82	23	\$191.08	\$20.4	39	22.0%	37	28.2%	37	\$32.71	0.3%
Virginia	\$1,333.9	15	\$177.28	18	\$233.18	\$423.5	14	31.7%	14	46.5%	14	\$56.29	5.7%
Washington	\$457.6	25	\$73.25	34	\$96.74	\$115.6	27	25.3%	29	33.8%	29	\$18.50	-4.9%
West Virginia (1)	\$1,399.1	14	\$770.96	4	\$983.29	\$588.3	12	42.0%	2	72.6%	2	\$324.16	7.3%
Wisconsin	\$451.9	26	\$81.86	30	\$107.91	\$128.5	24	28.4%	23	39.8%	23	\$23.29	-6.4%
Total U.S.	\$52,290.7		\$177.24		\$236	\$15,750.3		30.1%		43.1%		\$55.59	7.9%
Total lottery states	\$52,290.7		\$197.02		\$262	\$15,750.3		30.1%		43.1%		\$61.79	7.9%
Average lottery state	\$1,275.4		\$252.54		\$331	\$384.2		28.6%		41.1%		\$70.65	3.5%

(1) Includes net VLT sales (cash in less cash out).

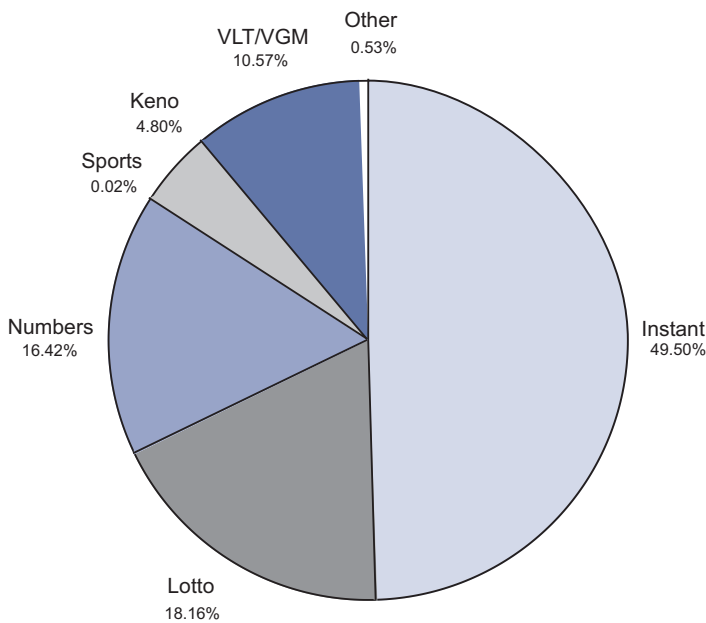
(2) Include gross VLT sales (cash in).

(3) The implicit tax rate measures the tax revenue (profits) as a percentage of the value of the lottery ticket (prize money plus administrative costs). The implicit tax rate does not take into account federal or state income tax on winnings.

Note: FY '05 data is unaudited, and due to differences in reporting methods, data in this chart may not exactly match other sources' data in other charts in this report.

Source: North American Association of State and Provincial Lotteries; California State Lottery; Census Bureau population data; Tax Foundation calculations.

Figure 5
Lottery Sales by Type of Game, Fiscal Year 2005



Note: Due to differences in reporting methods, data in this chart may not exactly match other sources' data in other charts in this report.

Source: Data from Christiansen Capital Advisors in *International Gaming and Wagering Business*; Tax Foundation calculations.

states have video lottery terminal (VLT) income, which may skew the results somewhat since VLTs tend to generate much larger amounts of revenue than other types of lottery games, and states with VLTs do not all use the same revenue-reporting methods. Looking only at states without VLTs, the state with the highest per capita spending was Massachusetts at \$700.40, followed by the District of Columbia at \$422.59 and Georgia at \$324.87. At the other end of the spectrum are North Dakota (\$30.09), Montana (\$36.30), and Nebraska (\$57.41). The median was Texas, with \$161.59 spent per person.

Per-person spending figures are even more dramatic when only adult lottery players are considered. (No state allows minors to purchase tickets, although these laws are not always strictly adhered to.) In FY 2005 the average American adult spent \$236 on the lottery. In Rhode Island the average adult spent nearly \$2,000 on the lottery, including VLTs. In Delaware and South Dakota, both states with VLTs, the average adult spent slightly

over \$1,000, and the average West Virginian spent almost \$1,000.

SPENDING VARIES BY TYPE OF GAME

Lottery games are not all equal in terms of consumer spending. (See Figure 5.) Instant games generate the most money, accounting for half of all sales in FY 2005. Lotto, including single-state games and multi-state games like Powerball, is a distant second at 18 percent, and three- and four-digit numbers games are third at 16 percent. VLTs account for 11 percent, followed by Keno at 5 percent. Sports-themed games, offered only in Oregon, bring in only .02 percent of sales. Despite the excitement generated by multi-state games with large jackpots, such as Powerball, these games don't yet account for a large share of the total lottery market, although sales are increasing: the average multi-state game saw an increase of 44.6 percent in sales from FY 2001 to FY 2002, which prompted *Public Gaming International Magazine* to dub FY 2002 the "Year of the Multi-State." (For a description of the various types of lottery games, see Alicia Hansen, "Lotteries and State Fiscal Policy," *Tax Foundation Background Paper*, No. 46 (Oct. 2004).)

BREAKDOWN INTO PRIZES, OPERATING COSTS AND TAX REVENUE

Lottery tickets generally cost between 50 cents and \$30. Of every dollar spent, slightly over half is returned to players in the form of prizes. The percentage is lower than in other forms of gambling but has been increasing somewhat and varies from state to state. Of the remainder, part is transferred to the state governments (this portion is the implicit tax) and part is used to cover operating costs, including vendor commissions and advertising. Nationwide, in FY 2005, 30.1 percent of revenue—or over \$15 billion—was transferred to state coffers. (See Table 2.) From the New Hampshire lottery's inception in 1964 through FY 2004, lotteries generated cumulative sales of \$606 billion. (See Table 1.) Of this amount, 54 percent was returned to consumers as prizes and 34 percent went into government coffers. The remaining 12 percent covered operating costs, including retailer commissions.

The breakdown of prizes, administrative costs and government transfers varies considerably from state to state. (See Table 2.) In FY 2005, as

a percentage of total sales, Oregon transferred the most revenue to the state government (44.1 percent), followed by West Virginia (42.0 percent) and Louisiana (35.5 percent). Meanwhile, South Dakota transferred the least—only 17.7 percent. Montana had the second lowest percentage (18.4 percent) and Rhode Island was third from the bottom (19.2 percent). (It should be noted that Rhode Island, West Virginia, South Dakota and Oregon all have VLT income and, due to differences in reporting methods, these figures may not be strictly comparable to one another or to other states' figures.) These transfers to state governments are generally called “profits” by the states, but, as will be discussed later, they are actually tax revenue.

When VLTs are taken out of the equation (see Table 3), New Jersey reported the largest “profit” (implicit tax revenue) as a percentage of sales (35.3 percent), followed by Louisiana (35.0 percent) and Illinois (34.3 percent). The three lowest percentages were found in Oregon (15.5 percent), Montana (18.2 percent) and South Dakota (20.6 percent). With regard to operating expenses (also excluding VLTs), Massachusetts was the most efficient (7.5 percent of sales), followed by New Jersey (9.1 percent) and Connecticut (9.8 percent). Montana spent the highest percentage on operating costs (29.2 percent), followed by South Dakota (23.1 percent) and Iowa (21.8 percent). States with larger populations and/or higher sales should be expected to have lower operating costs due to economies of scale. Some states place a cap on administrative costs. In FY 2005, not including VLT income, Massachusetts gave customers the best deal, returning 71.9 percent of each dollar as prizes. Oregon was next (68.1 percent), followed by Kentucky (64.7 percent). North Dakota was the lowest (47.5 percent), just below Louisiana (49.9 percent) and the District of Columbia (51.3 percent).

LOTTERY TAX REVENUE AS A PERCENTAGE OF TOTAL STATE REVENUE

In FY 2004 the amount of money raised by lotteries did not comprise more than about 6 percent of any state's own-source (excluding transfers from other levels of government) revenue. (See Table 4.) The amount ranged from a high of 6.15 percent in West Virginia to a low of 0.22 percent in Montana. (North Dakota's percentage is lower, but, as North Dakota's lottery started midway through FY 2004, this figure is not comparable to

other states.) Rhode Island had the second highest percentage (5.44 percent), followed by Delaware (4.78 percent) and South Dakota (4.41 percent). The top four states all have VLTs. After Montana, other states with relatively low percentages were

In 2004 the average American spent more money on lotteries than on reading materials and attending movies combined.

Nebraska (0.33 percent), Washington State (0.42 percent) and Minnesota (.43 percent). The average lottery state raised 1.56 percent of its own-source revenue from lotteries. The median was 1.22 percent (Virginia).

EARMARKING

Lottery revenues are usually allocated, or “earmarked,” for specific programs. All but five states specify uses for proceeds and the rest simply transfer the proceeds to the state's general fund (see Table 1). Some states earmark part of the proceeds for specific programs and transfer the rest to the general fund. Massachusetts distributes the money to cities and towns, which are free to spend it as they wish—in effect, a general fund. Uses for which proceeds have been earmarked include: parks and recreation (Colorado), senior citizens programs (Pennsylvania), salmon restoration (Oregon), juvenile detention (Montana), pension relief fund for police officers and fire fighters (Indiana), affordable housing trust fund (Kentucky) and lower license plate taxes (Indiana). Ironically, some states give part of the proceeds to research or treatment programs for compulsive gambling. South Dakota and Wisconsin use part of the proceeds to help lower property taxes. Lottery funds have also been used to build stadiums, enhance mass transit, aid local food banks and fund programs for Vietnam veterans.

The most common program for which revenue is earmarked is education. Twenty-three states earmark all or part of their proceeds for public education, including elementary, secondary, college and vocational education. Collectively, states have reportedly earmarked over \$222 billion for education from the start of the first lottery in 1964

Table 3
Lottery Revenue/Expense Analysis, Traditional (non-VLT) Games Only,
Fiscal Year 2005 (\$Millions)

State	Sales	Prizes	Operating Expenses	Operating Income (6)	Net to Beneficiaries (7)	Operating Income as a Percentage of Total Sales	Operating Expenses as a Percentage of Total Sales	Prizes as a Percentage of Total Sales	Operating Income as a Percentage of Takeout	Operating Expenses as a Percentage of Takeout
Arizona	\$397.6	\$220.3	\$61.2	\$116.1	\$116.4	29.2%	15.4%	55.4%	65.5%	34.5%
California	\$3,333.6	\$1,795.3	\$400.4	\$1,137.9	\$1,148.8	34.1%	12.0%	53.9%	74.0%	26.0%
Colorado	\$417.0	\$249.5	\$64.1	\$103.4	\$103.7	24.8%	15.4%	59.8%	61.7%	38.3%
Connecticut	\$932.9	\$573.0	\$91.1	\$271.2	\$271.9 (1)	29.1%	9.8%	61.4%	75.4%	25.3%
D.C.	\$234.9	\$120.5	\$43.5	\$70.9	\$71.5	30.2%	18.5%	51.3%	61.9%	38.1%
Delaware	\$114.1	\$59.8	\$18.9	\$35.3	\$35.0	31.0%	16.6%	52.5%	65.2%	34.8%
Florida	\$3,470.7	\$2,044.2	\$340.4	\$1,091.9	\$1,103.6	31.5%	9.8%	58.9%	76.5%	23.9%
Georgia	\$2,922.3	\$1,821.3	\$304.4	\$801.4	\$802.2	27.4%	10.4%	62.3%	72.8%	27.6%
Idaho	\$113.5	\$69.6	\$19.8	\$24.1	\$26.0	21.3%	17.5%	61.3%	54.9%	45.2%
Illinois	\$1,814.3	\$1,042.9	\$191.7	\$621.6	\$619.5 (2)	34.3%	10.6%	57.5%	80.6%	24.8%
Indiana	\$739.6	\$455.3	\$98.5	\$185.8	\$188.9	25.1%	13.3%	61.6%	65.3%	34.7%
Iowa	\$210.7	\$113.5	\$45.9	\$51.6	\$51.1	24.5%	21.8%	53.9%	53.1%	47.2%
Kansas	\$206.7	\$112.6	\$32.9	\$62.3	\$65.4	30.1%	15.9%	54.4%	66.1%	35.0%
Kentucky	\$707.3	\$457.7	\$92.5	\$157.0	\$158.2	22.2%	13.1%	64.7%	62.9%	37.1%
Louisiana	\$307.0	\$153.3	\$46.3	\$107.4	\$110.4	35.0%	15.1%	49.9%	69.9%	30.1%
Maine	\$209.3	\$128.9	\$32.4	\$50.3	\$50.3	24.0%	15.5%	61.6%	62.6%	40.4%
Maryland	\$1,485.7	\$856.2	\$149.0	\$480.5	\$477.1	32.3%	10.0%	57.6%	76.3%	23.7%
Massachusetts	\$4,465.7	\$3,211.5	\$335.2	\$936.1	\$936.1 (3)	21.0%	7.5%	71.9%	74.6%	26.7%
Michigan	\$2,069.5	\$1,162.0	\$245.0	\$663.5	\$668.6 (2)	32.1%	11.8%	56.1%	73.1%	27.0%
Minnesota	\$408.0	\$241.3	\$61.3	\$105.4	\$106.2 (4)	25.8%	15.0%	59.1%	63.2%	36.8%
Missouri	\$785.6	\$487.9	\$87.8	\$210.2	\$218.6 (2)	26.8%	11.2%	62.1%	70.6%	29.5%
Montana	\$33.8	\$17.8	\$9.9	\$6.2	\$6.2	18.2%	29.2%	52.7%	38.5%	61.7%
Nebraska	\$100.7	\$58.4	\$18.8	\$23.5	\$26.4	23.4%	18.7%	58.0%	55.6%	44.4%
New Hampshire	\$228.0	\$132.7	\$27.4	\$68.8	\$69.3 (3)	30.2%	12.0%	58.2%	72.2%	28.8%
New Jersey	\$2,273.8	\$1,296.8	\$206.9	\$802.0	\$812.0 (2)	35.3%	9.1%	57.0%	82.1%	21.2%
New Mexico	\$139.2	\$80.9	\$26.3	\$32.0	\$32.2	23.0%	18.9%	58.1%	54.8%	45.2%
New York	\$6,038.8	\$3,523.5	\$599.4	\$1,915.9	\$1,915.1	31.7%	9.9%	58.3%	76.2%	23.8%
North Dakota	\$19.1	\$9.1	\$3.7	\$6.4	\$6.1	33.5%	19.5%	47.5%	63.8%	37.2%
Ohio	\$2,159.1	\$1,280.8	\$231.5	\$652.5	\$645.1	30.2%	10.7%	59.3%	74.3%	26.4%
Oregon (5)	\$360.2	\$245.1	\$58.8	\$56.0	\$28.0	15.5%	16.3%	68.1%	48.7%	51.1%
Pennsylvania	\$2,644.9	\$1,529.4	\$281.5	\$834.8	\$852.6	31.6%	10.6%	57.8%	74.8%	25.2%
Rhode Island	\$241.9	\$146.8	\$37.9	\$60.6	\$61.8 (2,3)	25.1%	15.6%	60.7%	63.7%	39.8%
South Carolina	\$957.0	\$573.6	\$109.4	\$277.1	\$279.7	29.0%	11.4%	59.9%	72.3%	28.5%
South Dakota	\$32.5	\$18.4	\$7.5	\$6.7	\$9.5	20.6%	23.1%	56.5%	47.4%	53.1%
Tennessee	\$844.3	\$504.9	\$104.7	\$238.4	\$234.3	28.2%	12.4%	59.8%	70.2%	30.8%
Texas	\$3,662.5	\$2,228.0	\$366.2	\$1,069.2	\$1,070.3	29.2%	10.0%	60.8%	74.5%	25.5%
Vermont	\$92.6	\$57.9	\$13.8	\$20.9	\$20.5	22.5%	14.9%	62.5%	60.2%	39.9%
Virginia	\$1,333.9	\$774.6	\$141.6	\$417.8	\$423.5	31.3%	10.6%	58.1%	74.7%	25.3%
Washington	\$458.1	\$280.9	\$62.6	\$114.6	\$115.6	25.0%	13.7%	61.3%	64.7%	35.3%
West Virginia	\$194.2	\$117.1	\$31.5	\$58.0	\$36.0	29.8%	16.2%	60.3%	75.2%	40.9%
Wisconsin (5)	\$451.9	\$262.3	\$61.1	\$128.5	\$143.4	28.4%	13.5%	58.1%	67.8%	32.2%
Total	\$47,612.5	\$28,515.5	\$5,163.0	\$14,073.9	\$14,117.4	29.6%	10.8%	59.9%	73.7%	27.0%

(1) All Connecticut income figures include funding for regulation and chronic gamblers fund.

(2) All income figures in Illinois, Michigan, Missouri, New Jersey and Rhode Island includes unclaimed prize fund/forfeited prizes.

(3) All income figures include net proceeds from the charitable gaming divisions of lotteries in Massachusetts, New Hampshire and Rhode Island.

(4) All Minnesota income figures include taxes-in-lieu-of-sales-tax, compulsive gambling fund and unclaimed prizes paid to state.

(5) Unaudited

(6) Operating income is the net revenue generated from current-year operations before non-operating items such as interest income, interest expense, and any changes in the value of investments.

(7) Net to beneficiaries is the actual revenue transferred to the various funds that are beneficiaries of lottery revenue.

Note: Due to differences in reporting methods, data in this chart may not exactly match other sources' data in other charts in this report.

Source: *International Gaming and Wagering Business*; Tax Foundation calculations.

through the end of FY 2005.³⁷ A few states make the intended use of proceeds clear in the name of the lottery itself, e.g., the South Carolina Education Lottery. As will be discussed later, earmarked revenue tends to be fungible, and education does not benefit from lottery revenue as much as lottery supporters would have voters and lottery players believe.

Are Lottery Profits Tax Revenue?

The discussion of issues such as earmarking, government revenue and state spending raises the question, Is the lottery a tax? No government—state or federal—labels it as such (although Minnesota does consider part of its ticket sales to be an “in-lieu-of-sales tax” of 6.5 percent). However, despite the lack of a formal definition as a tax by a government agency, lottery “profits” constitute an implicit tax. After prizes have been awarded and operating costs have been covered, the remaining money is transferred to state coffers as implicit tax revenue. When state governments removed lottery prohibitions from their constitutions, they did so only for themselves. Seeing lotteries as a potential gold mine for state coffers, they maintained the ban on private lotteries and created for themselves a monopoly and, in effect, a source of tax revenue.

THE VOLUNTARY NATURE OF LOTTERY SPENDING

Lottery proponents argue that a tax is a mandatory or compulsory payment, and playing the lottery is voluntary, so lottery revenue cannot be a tax. Rhode Island’s lottery agency, for example, describes the lottery as “the largest voluntary source of income for the state.”³⁸ But this argument confuses the purchase of a product with the payment of the tax on the product. True, the purchase of a lottery ticket is voluntary, but the tax portion of the ticket price is not, just as a sales or excise tax is compulsory on a voluntary purchase of alcohol, clothing or books. No one doubts that excise taxes on alcohol and tobacco are truly taxes, yet one is no more required to purchase a lottery ticket than to purchase alcohol or tobacco. The voluntary nature of the purchase

Table 4
Lottery Revenue as a Percentage of Own-Source Revenue, Fiscal Year 2004

State	Percentage	Rank	State	Percentage	Rank
Arizona	0.65%	29	New Hampshire	1.64%	14
California	0.58%	30	New Jersey	1.94%	9
Colorado	0.56%	31	New Mexico	0.43%	35
Connecticut	1.82%	11	New York (1)	2.15%	7
Delaware (1)	4.78%	3	North Dakota (3)	0.04%	40
Florida	1.80%	12	Ohio	1.05%	22
Georgia	3.04%	5	Oregon (1)	1.79%	13
Idaho	0.45%	34	Pennsylvania	1.52%	16
Illinois	1.21%	21	Rhode Island (2)	5.44%	2
Indiana	1.00%	23	South Carolina	1.93%	10
Iowa	0.50%	33	South Dakota (2)	4.41%	4
Kansas	0.89%	24	Tennessee (3)	0.83%	25
Kentucky	1.35%	19	Texas	1.61%	15
Louisiana	0.73%	27	Vermont	0.66%	28
Maine	0.74%	26	Virginia	1.38%	18
Maryland	2.09%	8	Washington	0.42%	37
Massachusetts	2.80%	6	West Virginia (1)	6.15%	1
Michigan	1.48%	17	Wisconsin	0.50%	32
Minnesota	0.43%	36			
Missouri	1.22%	20	All lottery states	1.38%	
Montana	0.22%	39	Average state	1.56%	
Nebraska	0.33%	38			

(1) Includes net VLT sales (Cash in less cash out)

(2) Include gross VLT sales (Cash in)

(3) Lottery started midway through FY 2004, so this figure is not comparable to other states’ percentages.

Source: North American Association of State and Provincial Lotteries; Census Bureau; Tax Foundation calculations.

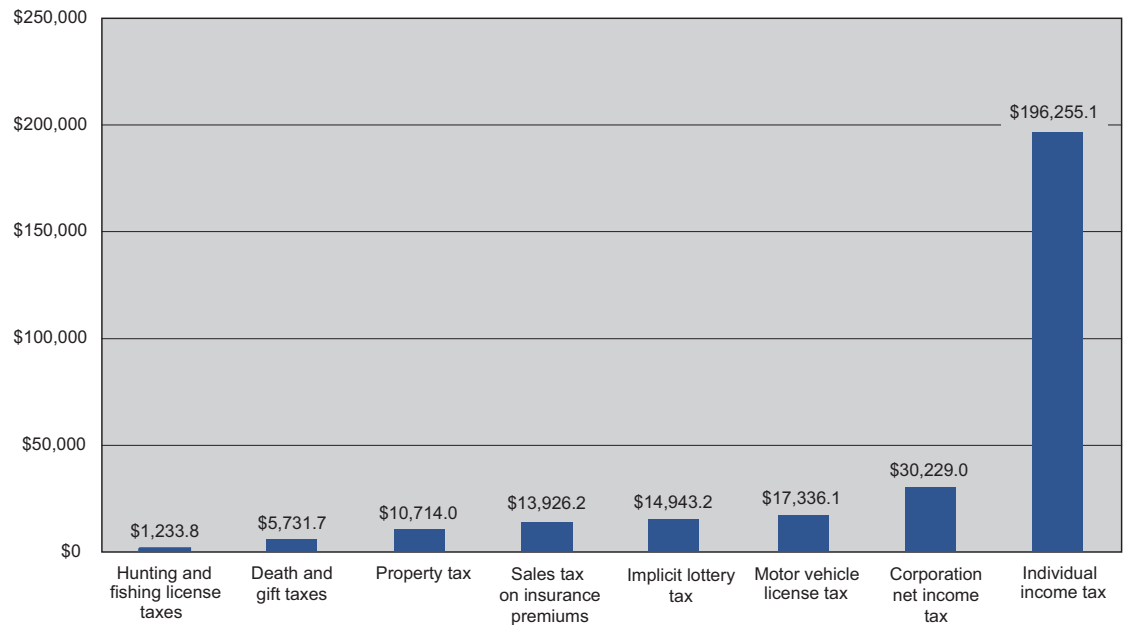
does not make the tax any less of a tax. Using the lottery supporters’ rationale, one would have to say that because the purchase of a book is voluntary, the sales tax on the book is not really a tax. The only difference between the lottery tax and sales or excise taxes is that the lottery tax is built into the price of the ticket, rather than reported separately.

At the heart of the spurious “if it’s voluntary it can’t be a tax” argument is the assumption that, since the lottery is a recreational activity, not a necessity, only people who can afford it and enjoy it—those who are willing and able to pay for tickets—will participate. Presumably, government revenue that is contributed enthusiastically and voluntarily is preferable to revenue that is contributed under duress. This argument seems to suggest that

³⁷ North American Association of State and Provincial Lotteries, “Cumulative Lottery Contributions to Beneficiaries,” available at <http://www.naspl.org/benefits.html>.

³⁸ Rhode Island Lottery, “About the Rhode Island Lottery,” available at <http://www.rilot.com/about.asp#description>.

Figure 6
Implicit Lottery Tax Revenue Compared to Other Sources of State Tax Revenue, FY2004
 (\$Millions)



Source: North American Association of State and Provincial Lotteries; Department of Commerce, Bureau of the Census

the lottery is akin to a sort of user fee, or a charge paid to the government for a specific service, by the people who use that service, e.g., fees for the use of publicly owned parking facilities or camp grounds.

TYPES OF GOVERNMENT REVENUE

An understanding of the different categories of government revenue can shed some light on the classification of lottery revenue. The Census Bureau Government Finance and Employment Classification Manual considers lottery proceeds “miscellaneous general revenue,” and lotteries a “general government activity.” The Census Bureau divides government revenue into six basic categories:

- Intergovernmental revenue
- Insurance trust revenue
- Utility and liquor store revenue

Examples: Revenue from state-run liquor stores; utilities such as public mass transit, operations of public electric power supply systems and operations of public water supply systems

- Tax revenue: “Compulsory contributions exacted by a government for public purposes, other than from special assessments for capital improvements and from employee and employer contributions or ‘taxes’ for retirement and social insurance systems.”

Examples: Individual income tax, property tax, death and gift tax, general sales tax, motor fuels sales tax, alcoholic beverage sales tax and pari-mutuels sales tax.

- Current charges: “Amounts received from the public for performance of specific services which benefit the person charged and from sale of commodities or services other than utilities and liquor stores.” (“Current charges” as defined by the Census Bureau correspond to user fees or user charges.)

Examples: Sales of postage by the U.S. Postal Service; fees from turnpikes, toll roads, ferries, bridges and public parking facilities; sale of defense materials to non-federal sources; airport hangar rentals; and tuition and other expenses at public institutions of higher education.

- Miscellaneous revenue: “Miscellaneous general revenues which do not fall into one of the above Tax, Intergovernmental Revenue, or Current Charges categories.”

Examples: Interest earnings, donations from private sources, proceeds from sale of land and improvements associated with housing and community development programs, rental of unused land or property, timberland leases and net lottery revenue.

DIFFICULTIES IN DISTINGUISHING DIFFERENT TYPES OF GOVERNMENT REVENUE

It is widely recognized that the lines between these categories are sometimes blurred:

Courts in many states have tried to create a clear distinction between taxes and fees. This is a very difficult task, however, and the result has been a lack of consistency among the states about the legal distinction between taxes and fees.³⁹

There are three questions state courts often ask when making distinctions between taxes and fees.⁴⁰ First, is the fee or tax levied by the state’s revenue department or by a regulatory authority? If the state revenue department has the authority, and the legislation originated in a tax-writing committee, it is more likely to be considered a tax. In the case of lotteries, some agencies are independent but many others are part of a revenue, finance or treasury department. Lottery bills have originated in many different legislative committees in different states, including Ways and Means, Appropriations, Travel and Tourism, Labor and Commerce, and Education.

The second consideration is the intent of the governing body: “Is the purpose and intent of the fee or tax to raise revenues to benefit the community at large, or is it to meet the infrastructure and other needs of the fee or tax payer?”⁴¹ If it is the latter, it is more likely to be considered a fee than a tax. The lottery falls into the former category: lottery revenue is used to fund projects that benefit

the community at large, and legislators make the intended use of funds abundantly clear when they write legislation to enact lotteries.

Third, how are the funds used? Are they deposited into the general fund or into a special fund that covers regulatory or other costs of providing the good or service in question? If the amount of revenue generated is more than the amount needed to provide the good or service, and if the revenue is used to fund unrelated government activities, courts are likely to consider it a tax rather than a fee. This is certainly the case with lotteries. Operating costs in FY 2005 accounted for only 27 percent of the takeout (the term the gambling industry uses to describe the revenue that is left after prizes have been awarded) from traditional (non-VLT) lottery games; the rest was kept by state governments as “profit”—really tax revenue—and used to fund projects that were, for the most part, entirely unre-

The purchase of a lottery ticket is voluntary, but the tax portion of the ticket price is not, just as a sales or excise tax is compulsory on a voluntary purchase of alcohol, clothing or books.

lated to lotteries. This use of revenue from taxes and fees is important not just from a tax policy standpoint, but also in terms of administrative accountability: “If user charges exceed the cost of providing services, or if separate accounting is not used, governments are vulnerable to court rulings that such charges are taxes. Taxes are subject to much stricter court scrutiny. ... Also, a court ruling that a fee is really a tax may subject it to voter approval or supermajority requirements imposed on tax increases in some states.”⁴² This may partly explain why legislators are reluctant to call lottery “profit” a tax.

The National Conference of State Legislatures issues guidelines for user charges, including: “User

39 National Conference of State Legislatures, “The Appropriate Role of User Charges in State and Local Finance,” (July 1999), available at <http://www.ncsl.org/programs/fiscal/fpufmain.htm>, 3.

40 Ibid.

41 Ibid.

42 Ibid., 13.

With both lottery tickets and alcohol, the consumer purchases a product from the government and pays a price above and beyond what it costs the government to provide the product, with the profit going to unrelated programs.

charges should cover the cost of the services provided. They should not be used to generate excess revenues that are diverted to unrelated programs or services.”⁴³ The U.S. Office of Management and Budget describes a similar guideline for federal user charges: “[U]ser charges will be sufficient to recover the full cost to the Federal Government... of providing the service, resource, or good when the Government is acting in its capacity as sovereign.”⁴⁴ A state government acts in its capacity as sovereign when it has a monopoly on lottery provision, but it recovers more than the cost of providing the good.

Clearly, as the answers to the above questions indicate, the lottery is not a type of user fee. That would not necessarily rule out the possibility that “miscellaneous revenue” is the most appropriate classification. However, the other items that the Census Bureau classifies as “miscellaneous revenue” (see list above for examples) do not have much in common with the lottery; they do not involve the sale of a good or service on which the government has a monopoly, with proceeds going to fund other, unrelated programs.

Items listed in the category of “Utility and Liquor Store Revenue” are somewhat similar to the lottery. These items are all fees for utilities, with the exception of state-run liquor store revenue. In the case of utilities like water and electricity, there are reasons governments, rather than private vendors, provide these services. Alcohol, on the other hand, does not need to be sold by the government. Lottery and alcohol revenue (in

Alcoholic Beverage Control states) therefore should be considered implicit taxes.

There is no reason to put the lottery—or alcohol—in a miscellaneous catch-all category if it would fit better in a more clearly defined category. Of all the categories, “tax revenue” is the only one the implicit lottery tax belongs in. Of course, state revenue departments do not consider taxes to be implicit or explicit; they consider revenue to be simply tax or non-tax.

WHAT IS THE DIRECT BENEFIT OF PURCHASING A LOTTERY TICKET?

It’s not the mere fact that lottery revenue is used to support government programs that makes it a tax; it’s the fact that the government programs supported are unrelated to the product that generates the revenue. In the North Carolina lottery court case discussed above, the Superior Court stated correctly, “A tax is a forced contribution to government; it differs from a fee in that it has no necessary immediate relationship to a benefit conferred.”⁴⁵ However the court continued, incorrectly,

If individuals do purchase tickets, they will receive benefits in the form of opportunities to win prizes. It is this receipt of a special benefit, as a quid pro quo so to speak, that distinguishes taxes from non-regulatory charges such as the purchase price of lottery tickets.

The court is mistaken about what constitutes the benefit purchased by lottery players. It is true that consumers do receive the special benefit of winning or potentially winning a prize; however, this benefit is what consumers receive for paying the 65 cents per dollar that North Carolina returns as prizes and uses to cover operating costs. This does not account for the additional 35 cents per dollar kept by the state as profit. This money is unrelated to the benefit of winning a prize. The only benefit conferred to the lottery player by the 35 percent profit is the allegedly increased state education funding, which is, in any other context, entirely unrelated to the purchase of a lottery ticket. After prizes have been distributed and administrative costs have been

43 Ibid.

44 Office of Management and Budget, “Circular No. A-25, Revised,” 3.

45 Brief of Defendants at 22, *Heatherly v. State*, No. 05-CVS-17197 (Sup. Ct. Wake County March 21, 2006).

46 Brief of Defendants, *supra* note 42, at 22.

covered, the money that is left from ticket sales is used to confer benefits—such as aid to public education—that are unrelated to the purchase of lottery tickets. The 65 percent prize/operating costs confer to the individuals who play the lottery the benefit of possibly winning a prize; the 35 percent profit confers to all citizens of the state the benefit of increased education spending (allegedly).

The court also wrote, “[T]he payment of a tax is compulsory and not optional, and it entitles the taxpayer to receive nothing in return, other than the rights of government which are enjoyed by all citizens alike.”⁴⁶ This describes the implicit lottery tax perfectly. The payment is compulsory for anyone who purchases a ticket, and the tax portion (separate from the prize money and operating costs) does not confer any benefit to a lottery player other than the general enjoyment of the state education system, which is enjoyed by all citizens alike.

IMPLICIT LOTTERY TAXES ARE ANALOGOUS TO ALCOHOL EXCISE TAXES IN ABC STATES

An analogy can be drawn between lottery states and Alcoholic Beverage Control (ABC) states, in which the sale of alcohol is limited to and regulated by the government. In ABC states, the government raises revenue (which it considers non-tax “profits”) from the operation of liquor stores, as well as from license taxes and alcohol excise taxes. The Census Bureau and state revenue departments do not consider profits from the sale of alcohol to be tax revenue, but they do classify alcohol excise taxes as tax revenue. Tax-wise, what, really, is the difference between lottery profits and alcohol excise taxes in ABC states, other than bureaucratic semantics?

With both lottery tickets and alcohol, the consumer purchases a product from the government and pays a price above and beyond what it costs the government to provide the product, with the profit going to the state. In both cases the government legalized a previously illegal product, granted itself a monopoly on the sale of that product and collects revenue from the sale of the product. A pri-

vate vendor could easily sell lottery tickets and, in many states, private vendors do sell alcohol. With both lotteries and alcohol, the government has granted itself a monopoly on the sale of a product that does not need to be sold by the government. There is nothing inherent in lottery tickets—or alcohol—that mandates it be sold exclusively by the state and taxed heavily, with profits going to unrelated government programs.⁴⁷ The only use of lottery proceeds that is even tangentially related to the sale of lottery products are programs to prevent and treat compulsive gambling, which are run by some states. The State of Maine clearly recognizes the similarity between these products: there is a Maine Bureau of Alcoholic Beverages and Lottery Operations, as well as a Liquor and Lottery Commission.

Because the government has a monopoly on both products, the total price can be set at any amount the state chooses, and the rate can easily be raised or lowered to raise revenue or even to discourage consumption. In the case of lotteries, the takeout rates are increased to raise revenue since the state does not want to discourage lottery consumption, although excise taxes on any form of gambling could in theory be raised to discourage participation. If the rationale of the heavy implicit lottery tax were simply to discourage consumption (as is sometimes said to be the case with tobacco taxes), then the government would not advertise the lottery. The National Gambling Impact Study Commission recognized the similarity between lotteries and products like alcohol and tobacco when it correctly referred to the lottery as a “sin tax.”⁴⁸

LOTTERY REVENUE ANALOGOUS TO TAXES ON PRIVATE GAMBLING

A more obvious analogy can be made between lottery profits and taxes on privately run gambling enterprises such as casinos. Despite the administrative differences, the result is the same: more money in state coffers to fund various programs which are unrelated to the activity that generated it. The state extracts a portion of casino revenue just as it does

⁴⁷ Many lottery proponents argue that lotteries must be government-run to be fair. According to the North American Association of State and Provincial Lotteries, “The public has a right to demand both the security and integrity of lotteries, to ensure that everyone stands an equal chance of winning, that all advertised prizes are in fact paid out, and that the lottery does not resort to unscrupulous business practices.” (<http://www.naspl.org/faq.html#lotreg>) But why should consumers have a greater right to security and integrity with lotteries than with any other business transaction? With private lotteries, consumers would have legal recourse in the case of fraud, as they do with other businesses, and—as with any business transaction—the buyer must beware. Why should the government guarantee the integrity of gambling, of all things? Lotteries are, after all, a gamble, and gambling in any form involves risk.

⁴⁸ National Gambling Impact Study Commission Final Report (Washington, DC: Government Printing Office, 1999), ch.2, 3, available at <http://govinfo.library.unt.edu/ngisc/reports/2.pdf>.

lottery revenue, and the casino revenue is labeled a tax. If any state privatized its lottery and extracted a portion of the profits to fund education or for the general fund, there would be no doubt that it was levying a tax.

VISIBILITY

The U.S. Census Bureau states that in order to be considered a tax, a transfer of money must be visible to the consumer as a tax (the “visibility test”).⁴⁹ However, excise taxes are not always visible as taxes to the average consumer; a liquor store receipt does not itemize all federal, state and local taxes included in the price. This lack of visibility does not prevent an alcohol excise tax from being considered a tax, and it should not prevent the lottery from being considered a tax. Lottery taxes may actually be more apparent to the consumer than alcohol taxes, simply because of all the advertising lotteries receive, paid and unpaid. Ads often mention that the lottery is

If lottery proceeds were officially labeled tax revenue by the Census Bureau and by state revenue departments, anti-tax sentiment might stem the tide on the growth of lotteries.

raising money for education, so consumers may be aware that a portion of their ticket price is kept by the government, ostensibly for public education. However, they are most likely not aware of the amount.

If lottery proceeds were officially labeled tax revenue by the Census Bureau and by state revenue departments, anti-tax sentiment might stem the tide on the growth of lotteries. State revenue departments would have to take the first step in reclassifying lottery revenue, as the Census Bureau’s “visibility test” would be an obstacle: if a state government does not first itemize a payment as a tax, the Census Bureau will not consider it a tax. If more people viewed the lottery as a tax, perhaps participation would decrease. Of course, pro-lottery legislators do not want to see this happen, as it would mean they would have to explicitly—and honestly—raise taxes or cut spending.

IMPLICIT TAX RATE ON LOTTERIES

It is possible to calculate the implicit tax rate on lotteries and compare it to other taxes. Because the lottery tax is built into the price of the ticket, the rate is not easy to calculate and varies from year to year and state to state, but it’s always staggering—far higher than any state’s sales tax and higher than the effective tax rate on most states’ casinos. In FY 2005, 30.1 percent, or 30 cents, of every dollar spent on lottery tickets was kept as “profit”—not to cover administrative costs or retailer commissions—by state governments. (This does not take into account federal and state income tax on winnings.) The implicit tax rate can be calculated as a percentage of the net-of-tax price (the portion of the purchase price that is returned to the players in the form of prizes combined with the portion that covers operating costs—in other words, the value of the ticket).⁵⁰ Total U.S. sales in FY 2005 were \$52,290,700,000. The net-of-tax price was \$36,540,394,000, and the implicit tax revenue was \$15,750,306,599. This translates to a tax rate of 43.1 percent ($\$15,750,306,599/\$36,540,394,000$). (See Table 2.)

The state with the highest implicit lottery tax rate in FY 2005 was Oregon (78.7 percent) followed by West Virginia (72.6 percent). (Different reporting methods for VLT sales in these states mean these rates are not strictly comparable.) The third highest was Louisiana (55.0 percent) (no VLTs), followed by New Jersey (54.7 percent). The lowest rates were found in South Dakota (21.5 percent), Montana (22.5 percent), and Rhode Island (23.7 percent). (South Dakota and Rhode Island have VLTs.) The average lottery state had an implicit tax rate of 41.1 percent, and eight states had implicit lottery tax rates over 50 percent. The average American paid \$55.59 in implicit lottery taxes in FY 2005, and the average resident of a lottery state paid \$61.79. The average West Virginian paid \$324.16 in implicit lottery taxes—more than they paid in state motor fuels taxes or state corporate income taxes.

Tax Policy Problems

We have established that the lottery is a tax, but why does it matter whether it’s a tax? Lottery supporters counter that, regardless of the tax implications, lotteries are a voluntary activity in which the majority of consumers wish to participate, and, as such, should be allowed to continue. This argument

may be plausible when applied to private gambling, but it simply doesn't work for state-run gambling. If the state outlawed the sale of bread at private grocery stores and started selling bread itself at \$20 a loaf, or started selling and advertising cigarettes to raise money for public schools, the purchase of bread and cigarettes would still be voluntary, but people would be outraged. The voluntary nature of state-run lotteries does not absolve them from the same scrutiny to which we subject other government activities. Lotteries are a government enterprise and a source of tax revenue, and must be evaluated as such. State-run lotteries are examples of poor tax policy, for a number of reasons.

ECONOMIC NEUTRALITY

From a tax policy standpoint, the main concern with lotteries is that they are not economically neutral. One principle of sound tax policy is that the tax system should be neutral, not favoring the consumption of one good over another. Taxes should not distort consumer spending. Other types of commercial gambling are taxed, but the high government "profit" rate on lotteries makes the payout rate (percentage of spending returned as prizes) lower than in other forms of gambling. The higher the government's cut, the lower the payout and the higher the implicit tax. So lotteries are singled out for a higher tax rate than other forms of gambling, just as alcohol is singled out among beverages for a high excise tax rate, with certain types of alcohol taxed more heavily than others.

Neutrality, in a broad sense, means fairness: the tax code should treat all goods and services the same, and, since tax revenue pays for general public services, it is important that taxes be levied as broadly as possible rather than on a subset of the population who happen to enjoy a particular product or service. Singling out one product for a high tax rate is economically inefficient. Consumers will likely shift away from that product and find less highly taxed substitutes. When a tax causes consumers to change purchasing decisions in order to avoid the tax, it decreases the efficiency of the market and ultimately damages the economy.

Policymakers, reluctant to make the politically unpopular move of raising income or sales taxes, reason that voters will be more accepting of a high tax on a recreational activity like gambling—especially one that many people consider immoral or unhealthy. The same rationale applies to other types of "sin taxes," like high excise taxes on alcohol and cigarettes, but how much of a sin do policymakers really believe the lottery to be, given how heavily they advertise it?

TRANSPARENCY

Another principle of sound tax policy is that the tax system should be as simple and clear as possible. Taxpayers should understand what is being taxed and what the tax rates are. The implicit nature of the lottery tax, however, makes transparency impossible. Even a taxpayer who understands that a portion of the ticket price will be kept by the state probably does not know the percentage. Lottery retailers do not give customers receipts at the time of purchase that list the percentage of the ticket price going to the state government. It is easy for the tax to be disguised, raised or lowered without taxpayers' knowledge. Lottery agencies can raise or lower the lottery tax in several ways: by introducing new games, by changing the percentage of the sale price that ends up in state coffers, by increasing the ticket price, or by introducing an entirely new type of product, like VLTs, with a different payout rate than previous games. They can make many of these changes without legislation. Prices are set based on the amount of revenue needed, not on a market price for lottery tickets (since they are not sold by private vendors), so there is incentive for frequent changes—generally increases—in the lottery tax rate, which decreases transparency and government accountability.

The state creates a monopoly for itself and builds the tax into the price of the tickets, then advertises the lottery as a recreational activity rather than a revenue-raising activity. The government never has to acknowledge that its share is tax revenue. Lottery agencies are willing to provide consumers with information on the breakdown

49 The visibility test: "One important feature of tax revenue is the need to pass a 'visibility test.' That is, the tax levy must be visible to the taxpayer as being a tax and not buried under the guise of another revenue. Take, for instance, a tax on utility services provided by the government levying the tax. If the utility bill does not itemize the tax but incorporates it into its user charge rate (therefore being invisible to the customer as a tax), then that so-called 'tax' is reported as a utility revenue for Census Bureau purposes." U.S. Census Bureau, *Government Finance and Employment Classification Manual*, 7.21, published December, 2000, available at http://www.census.gov/govs/www/class_ch7.html#S7.21.

50 Clotfelter and Cook, *Selling Hope*, 232.

of profits, prizes and administrative costs upon request, but they do not call the profit “tax revenue.” This simple choice of words is what creates the lack of transparency. Minnesota does consider part of its ticket sales to be an “in-lieu-of-sales tax” of 6.5 percent. But this simply creates more confusion, implying that the rest of the government’s share is not tax revenue.

Policy makers often try to create a false dichotomy between lotteries and taxes. They talk about enacting a lottery to keep taxes low or to avoid a tax increase, not realizing—or refusing to acknowledge—that the lottery is a tax. In the recent North Carolina lottery battle, the governor proclaimed, “It’s either going to have to be lottery, a lottery for education, or it’s going to have to be a tax.”⁵¹ The legislation authorizing the California lottery states, “... the purpose of this Act is support for preservation of the rights, liberties and welfare of the people by providing additional monies to benefit education without the imposition of additional or increased taxes.”⁵²

VIDEO LOTTERY TERMINALS

The lack of transparency is a problem with traditional lotteries, but video lottery terminals, or VLTs, present an even greater threat to transparency. VLTs are a controversial, relatively new type of lottery game and are available in only a handful of states. They are player-operated devices connected to a centralized computer network that offer electronic games of chance such as blackjack, slots and poker. They are played on video screens, and prizes are distributed immediately from the retailer. Generally, states permit them only at racetracks and establishments with liquor licenses. They often resemble casino games so closely that players may not realize

the games are run—and taxed—by the state lottery agency. When people think of “playing the lottery,” they think of buying a ticket and perhaps waiting days to find out whether they won, not playing slots at the track.

Currently, six states—Delaware, Oregon, Rhode Island, West Virginia, New York and South Dakota—offer VLTs, although New York calls its machines “video gaming machines” (VGMs) rather than “video lottery terminals.” New York, Delaware and Rhode Island all have machines located only at pari-mutuel facilities—racetracks in New York and Delaware, and greyhound racing and jai alai facilities in Rhode Island. Oregon has machines at racetracks and liquor license establishments (which only serves to reinforce the parallel between lottery taxes and excise or “sin” taxes). South Dakota allows the machines only at establishments with liquor licenses. West Virginia has the largest number of venues: racetracks (both horse and greyhound racing), liquor license establishments and fraternal and veterans’ associations.

In 2004 New York added racetrack video gaming machines (VGMs) to its lottery line-up. Lottery officials were careful to distinguish their video slot machines from traditional slot machines, which are unconstitutional in New York, although the difference was mainly a technicality. Even after the machines were installed, there was concern that they would be found unconstitutional. In July 2004, a New York appellate court ruled that the machines are lottery games rather than traditional slot machines, and therefore constitutional. However, the fact that the issue had to be resolved in court speaks volumes.

For several years Iowa offered TouchPlay machines—games similar to slot machines and

51 Gary D. Robertson, “North Carolina Governor Brings in Georgia Officials to Talk up Lottery,” *Lottery Insider*, (July 4, 2001), available at <http://www.lotteryinsider.com/lottery/ntcarol.htm>.

52 California State Lottery Act of 1984, available at <http://info.sen.ca.gov/cgi-bin/displaycode?section=gov&group=08001-09000&file=8880-8880.14>.

53 *Lottery Post*, “Iowa Legislators start spinning TouchPlay debate today,” (March 13, 2006), available at <http://www.lotterypost.com/news/130455.htm>.

54 Eugene Martin Christiansen, “Central Systems for Machine Gaming: A Good Policy?,” Christiansen Capital Advisors, LLC, (Dec. 2003), 4.

55 American Gaming Association, “Tax Contributions,” available at http://www.americangaming.org/Industry/factsheets/statistics_detail.cfv?id=10.

56 See, for example: *National Gambling Impact Study Commission Final Report*, ch.7; Clotfelter and Cook, *Selling Hope*, 222-230; Mary O. Borg and Paul M. Mason, “The Budgetary Incidence of a Lottery to Support Education” *National Tax Journal* 41 (March, 1988): 75-85; Charles T. Clotfelter, Philip J. Cook, Julie A. Edell and Marian Moore, *State Lotteries at the Turn of the Century: Report to the National Gambling Impact Study Commission* (Washington, DC: Government Printing Office, 1999), 12; Christopher Cornwell and David B. Mustard, “The Distributional Impacts of Lottery-Funded Aid: Evidence from Georgia’s Hope Scholarship,” unpublished paper, University of Georgia (2001), 2-3; Virginia Lottery, “Who Plays the Lottery,” (1997), quoted in Charles T. Clotfelter, “Do Lotteries Hurt the Poor? Well, Yes and No,” *Duke Policy News* (Summer 2000) (summary of testimony given to North Carolina House Select Committee on a State Lottery, April 19, 2000).

VLTs. The lottery agency introduced them in 2003, in response to directions from the legislature to increase funds for state spending.⁵³ The machines, which are called “monitor vending machines” (MVMs) were differentiated from slot machines and VLTs only by a technicality. They were available in convenience stores, grocery stores, bars and other locations, but then raised public concern due to their similarity to casino-style games. In 2006, only three years after their unveiling, the state banned the machines.

The addition of VLTs, VGDs, VGMs and MVMs to state lotteries has created a grey area of lottery finance and administration. State laws vary broadly in their definitions of VLTs and distinctions between VLTs and traditional casino gaming machines. Some laws are vague as to what constitutes a video lottery terminal. Delaware’s law, for example, seems broad enough to include all gaming devices.⁵⁴ Compounding the problem is the fact that VGDs are not regulated the same way in every state. They can be administered by the state lottery, or regulated by the state under casino laws or pari-mutuel laws. (Pari-mutuels are games where the prize is shared by multiple winners in proportion to the amount they bet. They include horse racing, jai-alai and dog racing.) Louisiana’s devices are regulated by the state police, not the lottery, but they are often referred to as VLTs. In some states, the operator (the track, bar or retail establishment) owns the machines with the state providing maintenance and oversight, while in others the state owns the machines.

VLTs allow players to bet repeatedly in a short period of time and tend to bring in large amounts of revenue, often surpassing traditional lottery games. In Oregon, for example, VLTs generate four times as much revenue as all other lottery games in the state combined. The top four states in per capita sales all have VLTs. (It should be noted that both Rhode Island and South Dakota report gross VLT sales rather than net sales, which are reported by West Virginia, Oregon and Delaware, so VLT states’ revenue data—both total and per capita sales—are not strictly comparable.)

STATES COULD MAKE IMPLICIT LOTTERY TAXES EXPLICIT

States could make the implicit lottery tax explicit simply by acknowledging that it is a tax, and by requiring lottery vendors to give customers receipts clearly itemizing the tax portion of the ticket price. In states where the lottery-enacting legisla-

tion does not specify the percentage of sales to be transferred to government coffers, legislators would need to determine the rate before applying the tax. Sound tax policy requires that taxpayers not only understand what is being taxed, but also know the amount of the tax.

Or lotteries could be run privately and taxed by state governments the same way casinos and pari-mutuels are. Other forms of legal gambling are already taxed at the federal, state and local levels. In 2005, commercial casinos paid almost \$5 billion in tax revenue to state and local governments, including taxes on profits, admissions, amount wagered and equipment.⁵⁵ Pari-mutuels are also subject to a variety of taxes. The Census Bureau publishes a chart titled “Gross Revenue from Pari-Mutuel and Amusement Taxes and Lotteries,” in which lottery revenues are reported alongside tax revenues collected from enterprises such as state racetracks. From a revenue standpoint, the lottery is no different from the pari-mutuel taxes; once the money is in state coffers, it can be directed to a particular program or to the general fund.

There are several reasons legislators and lottery officials would rather not label the lottery a tax. It would be politically unpopular; a legislator who wants to create a state lottery, add a new product to an already existing lottery or raise the percentage of sales that goes to the state would be “raising taxes” rather than “raising money for education.” Changing the distribution of revenue would also be more complicated. In addition, lottery agencies would be subject to greater government oversight and scrutiny. Lottery officials and pro-lottery legislators have a vested interest in maintaining the current system and, because they have a monopoly on lottery provision, they’re able to. They do not make explicit the nature of the lottery tax because, quite simply, they do not have to.

REGRESSIVITY

An important consideration with any tax is whether it is regressive—that is, whether low-income individuals bear a disproportionately heavy share of the tax burden. Numerous studies on the distribution of lottery sales conclude that the poor spend more on lotteries as a percentage of their income,⁵⁶ which means the lottery is a regressive form of taxation. The extent of the regressivity varies depending on the state and/or metropolitan area, time frame and game studied. For example, some research has shown that Powerball and other high-jackpot games

may be less regressive than lower-jackpot games like numbers and instant tickets.⁵⁷

Lottery supporters often misunderstand—or refuse to acknowledge—the meaning of regressivity. A regressive tax is one that falls disproportionately on low-income individuals and takes a larger percentage of income from low-income taxpayers than from upper-income taxpayers. Regressivity measures the percentage of income spent on taxes, not the dollar amount. Some lottery agencies and associations claim to study regressivity when in fact they focus simply on rates of participation—how many people in each income bracket play the lottery, and how often—which has nothing to do with regressivity. They cite studies showing that the poor in

In fiscal year 2005, eight states had implicit lottery tax rates over 50 percent.

a certain state spend less money on lotteries than the middle class and wealthy do, but this also is not a true measure of regressivity since it does not take into account money spent as a percentage of income. \$500 worth of lottery tickets in one year may be a drop in the bucket to an upper-income individual, but it is a significant portion of a poor person's income. Taking into account only the dollar amount spent misses the point.

This misunderstanding is illustrated by a recent news story titled “Study proves lottery not ‘regressive tax’ played mostly by poor,” which states, “National studies frequently show ... that the dollar amount spent on lotteries generally does not fluctuate much over income brackets.”⁵⁸ However, if people in different income brackets spend roughly the same amount on the lottery, then the implicit lottery tax is regressive. Therefore, this article actually proves the opposite of what it claims to.

The National Gambling Impact Study Commission (NGISC), which was created by

Lottery Advertising: Marketing a Regressive Tax

The operation of lotteries is one of the most visible activities of state government.⁵⁹ Until 1975, federal law banned lottery advertisements, but today lotteries not only pay for advertising; they also benefit from free advertising when TV stations, Web sites and newspapers report each day's winning numbers. State lotteries are unique among government agencies in that they actively encourage participation in an activity that they prohibited only 40 years ago—an activity from which they now profit. If government-run liquor stores were advertised this extensively, a public outcry would likely ensue.

Many people have qualms about lottery advertising. In 1986 concerns over the Illinois Lottery's regressivity were heightened by a marketing campaign in Chicago. The lottery began there in 1974, after legislators claimed it was “the only way to produce much-needed new state revenue without raising taxes.”⁶⁰ Twelve years later, controversy erupted over the lottery's marketing tactics. The agency placed a billboard in a poor Chicago neighborhood that read, “How to get from Washington Boulevard to Easy Street.” Some claim the billboard also read, “This could be your ticket out,”⁶¹ although the Illinois Lottery denies this.⁶² Even though similar billboards were placed around the city with different street names, angry Chicagoans boycotted the lottery, claiming it was taking advantage of the poor. The billboards are gone, but concerns over the lottery's regressivity remain.

Congress in 1996 to “conduct a comprehensive legal and factual study of the social and economic impacts of gambling,” commissioned a study to determine whether lotteries were regressive and concluded that they were a “highly regressive

57 Emily F. Oster, “Are All Lotteries Regressive? Evidence from the Powerball,” *National Tax Journal* LVII no. 2 (June 2004): 179-187.

58 *Lottery Post*, “Study proves lottery not ‘regressive tax’ played mostly by poor,” (June 14, 2006), available at <http://www.lotterypost.com/news/136392.htm>.

59 Clotfelter and Cook, “State Lotteries,” 19.

60 John Elmer, “State Unit OKs Bill on Lottery,” *Chicago Tribune*, April 27, 1972, quoted in Gribbin and Bean, 356.

61 Collin Hitt, “Losing Proposition: The Lottery, Education, and the Exploited Poor,” Illinois Policy Institute, (Sept. 15, 2006), available at <http://www.illinoispolicyinstitute.org/articles.php?articleid=22>.

62 Duane V. Burke, “Top Ten Myths About Lottery (and Why They Are Not True),” Testimony to Gaming Study Commission (August 20, 1999), available at <http://www.naspl.org/burke899.html>.

sources of income.”⁶³ The study found that in 1997, although people at all points on the income spectrum played the lottery, players with household incomes under \$10,000 spent almost three times as much money on lotteries as those with incomes over \$50,000.⁶⁴ Not only did the poorest participants spend a higher percentage of their incomes on the lottery; they also spent more as a dollar amount. Those with household incomes under \$10,000 spent more per capita (\$597) than those with incomes from \$10,000 to \$24,999 (\$569) and considerably more than those with incomes of \$25,000 to \$49,999 (\$382), \$50,000 to \$99,999 (\$225) and over \$100,000 (\$196).⁶⁵ Other studies show that the poor do not spend more as a dollar amount, but they do spend more as a percentage of income.

Some critics have also claimed that the use of earmarked proceeds in certain states adds to the regressivity. For example, in states where funds are earmarked for college or vocational education, lower-income individuals—the very people who are more likely to spend heavily on lotteries—are less likely to benefit from the earmarked proceeds because they are less likely to attend college. While the use of tax revenue does not alter the regressivity or progressivity of the actual tax collections, it can affect the regressivity of the overall fiscal distribution. From a 2007 Tax Foundation study on fiscal incidence:⁶⁶

Initially, households earn market-based incomes from productive activity throughout the economy. Federal, state and local governments then levy taxes, withdrawing resources from households. Finally, governments return resources to households through various spending programs. Once the full effect of taxes and spending is accounted for, the result is the after-tax, after-spending distribution of household resources that is directly observable throughout the economy. This combined impact of taxes and spending on households is referred to as the “net fiscal incidence” of government tax and spending policy.

The study also notes that higher education is “disproportionately utilized by affluent households” and dominates the government spending received by the upper income quintiles. The average household in the top 20 percent of income earners received \$1,306 of state/local higher-education spending in 2004, while the middle 20 percent received \$725 per household, and households in the bottom quintile received only \$487.

The effect of lottery earmarking on fiscal redistribution can be seen clearly in Georgia, where “profits” are earmarked for college scholarships, universal pre-kindergarten, and K–12 infrastructure spending. The HOPE (Helping Outstanding Pupils Educationally) college scholarship program has become wildly popular both with policymakers and citizens and has even been used as a model for other states’ lottery earmarking, but few Georgians seem to notice that the lottery is redistributing money from lower-income lottery players to higher-income scholarship recipients.

A 2002 study⁶⁷ of the Georgia Lottery found the following:

Consistent with numerous other studies, we find that spending on lottery products is highly regressive. We also find that higher income households tend to receive a higher level of benefits from lottery-funded programs than do lower-income households, though these benefits represent a higher proportion of income to lower-income households. Taken together, we find a highly regressive pattern of net benefits. Lower income households (those reporting under \$25,000 annual income) spend more on the lottery than they receive in benefits, while higher income households (those reporting over \$50,000 annual income) receive a positive net benefit.

Much of the regressivity of net benefits is caused by patterns of spending on lottery products and by the HOPE Scholarship program. Since the program provides subsidies to students pursuing higher education, it is not

63 *National Gambling Impact Study Commission Final Report*, Executive Summary, 14.

64 *Ibid.*

65 *Ibid.*

66 Andrew Chamberlain and Gerald Prante, “Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004,” *Tax Foundation Working Paper*, No. 1 (March 2007), 11, available at <http://www.taxfoundation.org/files/wp1.pdf>.

67 Ross Rubenstein and Benjamin Scafidi, “Who Pays and Who Benefits? Examining the Distributional Consequences of the Georgia Lottery for Education,” *National Tax Journal* LV (June 2002): 236.

surprising that more educated, higher income families would receive a disproportionate share of the benefits. The benefits of the other lottery-funded programs—particularly pre-kindergarten—appear to be only weakly related to ... income.

Lottery proponents counter the regressivity claim by arguing that the lottery is voluntary and that the poor spend a disproportionate amount of their income on other consumer items as well,⁶⁸ but this argument ignores the fact that, unlike other

consumer goods, lottery tickets are sold and promoted by the government. Should the government be in the business of selling, marketing and profiting from an item on which the poor spend—albeit voluntarily—a higher percentage of their income (or even a higher dollar amount) than do the middle class and the wealthy?

EARMARKING

While lotteries have ostensibly raised a large amount of money for education, it is not clear that the funds are always used for the causes for which they are earmarked. Skeptics say that earmarking is at best ineffective and at worst a misleading political tactic to persuade voters to approve lottery referenda and play the lottery.⁷¹ Legislators can simply shuffle funds; lottery revenue allows them to use the money that would have been allocated for education for other purposes—sometimes referred to as the “lottery shell game.” Voters and lottery players, however, may be under the impression that lottery funds will significantly increase the total amount of money spent on education. Therefore, voters may be misled when they approve lottery referenda or initiatives, and consumers may be misled when they play the lottery and assume that if they do not win, at least the money will benefit public education. Indeed, one survey showed that 54 percent of respondents considered education the most appropriate use of lottery proceeds and 65 percent would be more likely to play the lottery if proceeds were earmarked for a specific purpose.⁷²

The relevance of the earmarking controversy is apparent when we consider that lotteries may be the only tax that politicians: 1) actively, enthusiastically lobby for, 2) do so without acknowledging that a

Measuring Regressivity in New Jersey's Lottery

One tool used to analyze lottery data is sales records in various ZIP codes. A number of studies have shown that lottery spending is higher in low-income ZIP codes.⁶⁹ If there is a strong enough correlation between high per-capita sales and low per-capita income in a certain ZIP code, the lottery is said to be regressive in that area.

While ZIP-code studies are useful to a certain extent, there are limitations. Lottery players often purchase tickets in ZIP codes in which they do not reside. Areas with large “daytime populations”—people who work in an area but do not reside there—will show high ticket sales that do not accurately reflect residents’ purchases.

The authors of a recent Newark Star-Ledger article⁷⁰ took this into account when analyzing five years of lottery data and Census income data by ZIP code. They used Census Bureau data to account for the extra daytime purchases and found that in ZIP codes with lower per capita incomes, significantly more tickets were purchased, especially for 3- and 4-digit numbers games and instant games. In communities with average household income below \$52,000, the lottery sold an average of \$250 of tickets per person annually. That was more than double the amount for ZIP codes with average incomes above \$100,000. The study concluded that the lottery “is a regressive form of taxation.”

A state representative has introduced a bill that would require the lottery to break down sales by town.

Few Georgians seem to notice that the Georgia lottery is redistributing money from lower-income lottery players to higher-income scholarship recipients.

lottery is, for all intents and purposes, a tax, 3) ask citizens to approve in initiatives or referenda, and 4) remove longstanding state constitutional bans in order to enact. The purported and actual uses of

proceeds are therefore relevant insofar as they affect voters' decisions to approve a lottery.

A number of studies have attempted to prove or disprove the suspicion that earmarked funds are fungible and tend to simply replace rather than supplement education expenditures, but of course it is impossible to know how much money would have been spent on education in the absence of lottery funds. However, there is not much evidence that these funds add significantly to the total amount of money spent on public education, especially K-12 education. In 1999 the National Gambling Impact Study Commission concluded that there was no reliable way to know whether earmarked money was used for the intended purpose:

When expenditures on the earmarked purpose far exceed the revenues available from the lottery, as is the case with the general education budget, there is no practical way of preventing a legislature from allocating general revenues away from earmarked uses, thus blunting the purpose of the earmarking.⁷³

While lottery agencies are generally enthusiastic about their contributions to education, they are not unaware of the controversy and the potential for misallocation. South Carolina, for example, states in its 2002 lottery legislation: “[P]roceeds of lottery games must be used to support improvements

and enhancements for educational purposes and programs as provided by the General Assembly and that the net proceeds must be used to supplement, not supplant, existing resources for educational purposes and programs.”⁷⁴ Montana, however, had a different experience. In 1995, after nearly 20 years of earmarking proceeds for education, the state legislature began transferring revenue to the general fund instead. The president of the Montana Education Association stated that it was an “illusion” that lottery funds significantly benefited public schools.⁷⁵ Georgia, which earmarks funds for its HOPE scholarship program, revealed in 2003 that \$1.8 billion worth of lottery proceeds that should have been used for education had instead been spent on other projects, including museums, security fences and metal detectors, and renovations of historic buildings.⁷⁶ And in Florida, a school district budget director recently stated, “When we all voted for the lottery to go to education we thought it would be an enhancement but the lottery came in and replaced funding from other areas. It became a replacement.”⁷⁷

Earmarking also presents a problem for voters considering education funding at the polls. A survey in Florida revealed that some voters would reject school bond proposals, assuming that lottery revenue would fill any gaps in the education budget.⁷⁸ Lottery supporters continue to promote lotteries as a way of supporting public education, and voters seem to believe the promise.

68 North American Association of State and Provincial Lotteries, “Who Plays Lotteries?”, available at <http://www.naspl.org/faq.html#whoplays>.

69 See, for example: Craig Whitlock, “Lottery Sales Highest Among the Poor,” *Washington Post*, October 23, 2003, PG06; Leah Samuel, “The Poor Play More,” *The Chicago Reporter*, October 2002; and Charles Walston, “Has the Gamble Paid Off?”, *Atlanta Constitution*, February 25, 1996, p. D1.

70 Judy DeHaven and Rob Gebeloff, “The High Price of a Dream,” *The (Newark) Star-Ledger*, Dec. 4, 2005, p. A1.

71 See, for example, Charles J. Spindler, “The Lottery and Education: Robbing Peter to Pay Paul?” *Public Budgeting and Finance* 15 (Fall 1995): 54-62, quoted in Clotfelter and Cook, “State Lotteries,” 6; Noel D. Campbell, “Do Lottery Funds Increase Educational Expenditure?: Evidence from Georgia’s Lottery for Education” *Journal of Education Finance* 28 (Winter 2003): 383-402; Donald E. Miller and Patrick A. Pierce, “Lotteries for Education: Windfall or Hoax?” *State and Local Government Review* 29 (1997): 34-42; William N. Evans and Ping Zhang, “The Impact of Earmarked Lottery Revenue on State Educational Expenditures,” working paper, University of Maryland (November 2002); David Nicklaus, “Illinois may be on right track with scheme for its lottery,” *St. Louis Post-Dispatch*, May 26, 2006; Gribbin and Bean, 361; Susan A. MacManus, “State Lotteries Aren’t a Windfall for Education,” *Wall Street Journal*, February 14, 1989; National Association of State Auditors, Comptrollers and Treasurers, NASACT News 18 (May 1998), 5; and Clotfelter and Cook, *Selling Hope*, 166.

72 GTech Corporation, 10.

73 Clotfelter and Cook, “State Lotteries,” 6.

74 South Carolina Education Lottery, “How Education Wins,” (May 13, 2004), available at <http://www.sceducationlottery.com/HowEducationWins.asp>.

75 Evans and Zhang, 30.

76 James Salzer, “Special projects shrink lottery proceeds,” *The Atlanta Journal-Constitution*, November 11, 2003, available at <http://www.ajc.com/metro/content/metro/hope/11hopewaste.html>.

77 Nicol Jenkins and John Johnston, “The lottery: a mixed blessing – and less blessed by the day,” *Boca Raton News*, April 27, 2007, available at <http://www.bocaratonnews.com/index.php?src=news&refno=19579&category=Main%20>.

78 *Lottery Post*, “N.C. Lottery misunderstandings could derail bonds,” (Dec. 26, 2005), available at <http://www.lotterypost.com/news/125351.htm>.

RELATIVE AUTONOMY OF LOTTERY AGENCIES

If the lottery were properly labeled a tax, lottery agencies would be subject to greater oversight and scrutiny. In many states, they are not bound by the same rules that other government agencies must follow. Some lottery agencies are part of a department of state government, usually the department of revenue (see Table 1). However, the majority of states have established separate agencies, which do not have to abide by all of the rules that govern other state agencies. In a few states, the lottery agency is independent and quasi-public. In 2003 the Iowa Lottery Division switched from a state-agency model, under the Department of Revenue and Finance, to a business model and became the Iowa Lottery Authority. If the switch proves “profitable,” others might follow suit. Connecticut is the only other state to make this change, although many of the newer lotteries have been organized as corporate-model entities from their inception. The Tennessee Lottery recently came under fire for its handling of workplace harassment allegations. Lottery officials

claimed that the lottery, as a quasi-governmental agency, need not abide by the state’s new harassment laws. A lottery spokesperson defended the refusal to abide by state laws, saying the lottery is “not a state entity. They’re not a taxpayer-funded mechanism. They’re customer-funded.”⁷⁹

It is argued that this independence is necessary for the lottery to operate as a business and generate as much revenue as possible. This sometimes means paying managers salaries comparable to those in the private sector but not generally allowed for government employees. The Tennessee Lottery was recently criticized for paying its CEO \$700,000 in salary and bonuses her first year on the job—more than the governor earns.⁸⁰ This raises the question of whether the goal of raising as much revenue as possible is compatible with the goals of responsible government.

VOLATILITY

It has been argued that lotteries are a volatile, unreliable revenue source. For the most part, lottery sales and government proceeds continue to increase every

Lottery experts Charles Clotfelter and Phillip Cook call the lottery “the state government’s biggest business venture.”⁸¹ Following are some examples of the business mentality that pervades the operation of state-run lotteries:

- “Washington’s Lottery is a business. Lottery staff and business partners constantly look for innovative ways to operate the Lottery more efficiently, while increasing sales, expanding services, and keeping up with the latest technologies.”
— *From the Web site of Washington’s Lottery*⁸²
- “The Colorado Lottery treats its Corporate Image like a product.”
— *From the Web site of the Colorado Lottery*⁸³
- “The lottery is, above all else, a business.”
— *New Jersey Lottery spokesperson*⁸⁴
- “When a player buys a Virginia Lottery ticket, it’s a source of entertainment; however, behind the scenes, the Lottery is a business.”
— *Virginia Lottery Executive Director*⁸⁵
- “State lotteries have always been a bit of an orphan: They operate almost like a for-profit corporation.”⁸⁶
— *Spokesperson for GTech Corp., Illinois’s main lottery contractor*
- “This is fundamentally a retail business, and governments are not equipped to manage retail businesses.”
— *John Filan, chief operating officer of the state of Illinois*⁸⁷

Some taxpayers may think middle- and high-income homeowners are more deserving of a tax break than mostly low-income gamblers are, but the tax code should not be used to impose such moral judgments.

year (see Table 2). Total U.S. sales increased 8 percent from FY 2004 to FY 2005 and total “profits” (tax revenue, or transfers to state treasuries) during this time increased by 14 percent. However, there are exceptions. From FY 2004 to FY 2005, 10 states saw a drop in total sales, including a 10 percent drop in Louisiana. While most states continue to enjoy increasing sales and profits, it could still be problematic for a state to rely too heavily on a revenue source that is not more predictable. A state’s lottery revenue might fall if a neighboring state enacts a lottery, and changing cultural attitudes toward gambling could in theory affect lottery spending.

SIMPLICITY AND EFFICIENCY

A good tax is simple, easy to understand and easy to comply with. While it is certainly easy for a lottery player to comply with the tax by purchasing a ticket, the administrative burden and cost of operating lotteries make the tax system overall more complex and less efficient. The problem is compounded in states that use lottery revenue specifi-

cally to lower other taxes. The Wisconsin Lottery states that since 1988, \$2 billion—or 32% of revenue—has been “returned to eligible Wisconsin taxpayers in the form of property tax credits.”⁸⁸ In addition, when retailer commissions, prizes, and property tax relief are added together, at least 95 percent of total lottery revenue has “gone back to the people of Wisconsin.” The agency boasts further, “That money stays in Wisconsin’s economy for the good of everyone.” However, private businesses could keep that revenue in the state’s economy just as easily; a state-run gambling monopoly is not necessary to keep money in the state, and if legislators want to lower property taxes, rates can simply be lowered. Conversely, if more money for education is needed, property tax rates can be raised. It only complicates the tax code to raise money through one tax in order to lower another tax. The only thing the Wisconsin lottery really accomplishes is a redistribution of tax revenue from lottery players to property owners. Some taxpayers may think middle- and high-income homeowners are more deserving of a tax break than mostly low-income gamblers are, but the tax code should not be used to impose such moral judgments.

It is important that taxes be levied as broadly as possible rather than on a subset of the population who happen to enjoy a particular product or service.

79 *Lottery Post*, “Tenn. Lottery says it need not obey state policies,” (January 9, 2006), available at <http://www.lotterypost.com/news/126276.htm>.

80 Skip Cauthorn, “Lottery adjusts Paul pay,” *The (Nashville, Tenn.) City Paper*, November 30, 2004, available at http://www.nashvillecitypaper.com/index.cfm?section=9&screen=news&news_id=37535.

81 Clotfelter and Cook, “State Lotteries,” 19.

82 <http://www.walottery.com/sections/AboutUs/>

83 <http://www.coloradolottery.com/about/index.cfm?location=6>

84 DeHaven and Gebeloff, A1.

85 *Lottery Insider*, “Virginia Lottery Creates Strategic Partnership; Contract Expected to Increase Profits for Public Education (k-12),” (June 16, 2004), available at <http://www.lotteryinsider.com/vol27/no12.htm>.

86 *Lottery Post*, “Sale of Illinois Lottery could start a trend,” (May 25, 2006), available at <http://www.lotterypost.com/news/135189.htm>.

87 Charles Duhigg and Jenny Anderson, “Illinois Is Putting Lottery on Block for Quick Payoff,” *New York Times*, January 23, 2007, available at <http://www.nytimes.com/2007/01/23/business/23lotto.html?ex=1327208400&en=ddd6c6e229a4bec1&ei=5088&partner=rssnyt&emc=rss>.

88 Wisconsin Lottery, “Where the Money Goes,” available at <http://www.wilottery.com/wiswins.asp>.

Recent Lottery Trends

STATES ATTEMPT TO FIX BUDGET WOES WITH GAMBLING REVENUE

In recent years, elected officials and candidates for political office in many states and cities have touted gambling as a way to deal with budget shortfalls and calls for increased spending—real or perceived fiscal crises—and they have come increasingly to rely on gambling to fill state coffers, whether through casino taxes, Indian gaming, slot machines at race-tracks, or lotteries.⁸⁹ California,⁹⁰ Massachusetts,⁹¹ Texas,⁹² Pennsylvania,⁹³ and Detroit⁹⁴, among others, have turned to gambling expansion, and in many states the lottery has also felt the fiscal pressure and become a part of this expansion. In New Jersey, for example, lottery meeting minutes from the past five years show that state officials, faced with budget shortfalls, are pressuring the lottery agency to increase revenue.⁹⁵

INCREASING THE TICKET PRICE

One way some lottery agencies are answering the call for increased revenue is by increasing the price of instant, or scratch-off, tickets. One dollar used to be the most common price for this type of ticket, but many states have recently increased the price of some of their instant tickets to \$10, \$20 or even \$30. It seems to be working: the tickets are selling quickly wherever they are offered,⁹⁶ and instant tickets now comprise half of all lottery sales, eclipsing even high-jackpot multi-state lotto games like Powerball. So far, Maryland, Michigan, Ohio, Delaware, Maine, Virginia, Indiana, Illinois, Texas and Connecticut all offer \$20 games, and Texas and Connecticut sell \$30 tickets. In May the Michigan Lottery's most expensive game, priced at \$50 per ticket, sold out after less than three days on sale.⁹⁷

PLAYING THE LOTTERY ON THE INTERNET: CLICK HERE TO PAY HIGHER TAXES

Three states have recently considered increasing lottery revenue by allowing players to purchase tickets on the Internet. In March 2005 the Georgia House of Representatives passed a bill that would have allowed the lottery to create individual online accounts. Customers would have been able to purchase tickets on the agency's Web site, with a \$5-per-day limit on purchases made with credit cards.

Should the government be in the business of selling, marketing and profiting from an item on which the poor spend—albeit voluntarily—a higher percentage of their income than the middle class and the wealthy?

The bill did not pass the senate. Supporters argued that this measure would increase the lottery's progressivity by attracting higher-income players, since lower-income individuals would be less likely to have access to computers.

Illinois's governor is determined to find a way to use the lottery to finance school construction bonds—either by privatizing the lottery, adding keno, or allowing online sales.⁹⁸ In 2005 and 2006 the legislature considered bills to allow Internet ticket sales.

Internet ticket sales may also be a possibility in North Carolina. The lottery legislation specifically refers to online games. However, there is some confusion as to what "online" means; Kansas and New

89 Fox Butterfield, "As Gambling Grows, States Depend On Their Cut to Bolster Revenues," *The New York Times*, March 31, 2005, p. A24; and National Conference of State Legislatures, "Gambling Developments in the States," (Nov. 5, 2004) available at <http://www.ncsl.org/programs/econ/gamblingdev04.htm>.

90 International Gaming and Wagering Business, "Legislature May Reconvene over Slots," (Sept. 12, 2006), available at http://www.ascend-gaming.com/igwb/headline_detail.htm?id=6237.

91 Cristina Silva "Gabrieli supports building casinos in Bay State," *The Boston Globe*, August 2, 2006, available at http://www.boston.com/news/local/politics/candidates/articles/2006/08/02/gabrieli_supports_building_casinos_in_bay_state/.

92 Jeff Carlton, "Friedman says legalizing casinos can fund schools," *El Paso Times*, Sept. 8, 2006, available at http://www.elpasotimes.com/news/ci_4302792.

93 Pennsylvania Economy League, "Gambling Toward Property Tax Relief: New Legislation Signed by Governor," (June 2006), available at <http://www.issuespa.net/articles/16575?curCategory=16201>.

94 Gambling News, "Kilpatrick Has Plan To Tax Winners At Detroit's Casinos," (July 3, 2005), available at <http://www.gamblingmagazine.com/managearticle.asp?C=280&A=14690>.

Jersey have both offered games that allow customers to find out whether they're holding winning tickets online, but tickets must be purchased at a store. The legislation also permits the state to offer any game underway in other states, which means that North Carolina might be able to offer Internet sales at some point regardless of the interpretation of "online."

If any state introduces Internet lottery sales, it is likely that others will follow suit.⁹⁹ However, any state pursuing Internet sales must be prepared for a possible challenge from the U.S. Department of Justice, since Internet lottery sales may be a violation of a federal law prohibiting the use of wire communication to place wagers.

SELLING THE LOTTERY: SPEND NOW, PAY LATER

A handful of states have recently considered surprising methods of increasing state revenue: selling, capitalizing or privatizing all or part of the lottery operations or future profits. While the idea of lottery privatization is not new,¹⁰⁰ it is only in the past year that any state has seriously considered it.¹⁰¹ The constant search for new sources of state revenue and the desire to avoid explicitly and visibly raising taxes has led legislators and governors to try new methods of squeezing as much money out of their state lotteries as possible. The lottery business has become a game of one-upmanship in which every state looks for ways to convince its residents and out-of-staters to play the lottery more often and spend more—joining multi-state games, installing VLTs, raising ticket prizes, etc. This search has finally come almost full-circle, leading some policymakers to speculate that there is a pot of gold to be had from privately run lotteries, just as the early colonies benefited from private lotteries several centuries ago. There is a lot of money at stake: a 2007 study by a consulting firm specializing in the gambling industry calculated the privatized value of United States

Skeptics say that earmarking is at best ineffective and at worst a misleading political tactic to persuade voters to approve lottery referenda and play the lottery.

lotteries at over \$200 billion.¹⁰²

There are several variations on this type of plan: partially privatizing some lottery operations but maintaining government control, capitalizing the lottery by selling it to another state agency, leasing the lottery to a private vendor, and selling the lottery outright.

Wisconsin

The least extreme version of the privatization idea was considered in Wisconsin in 2005 when the governor revived a plan proposed by one of his predecessors a decade ago: privatizing parts of the lottery's operations to decrease the state payroll and make lottery operations more efficient. The governor wanted to privatize half of the lottery's operations, including sales and marketing, ticket warehousing and distribution, product development, special events and Web site operations. State employees would remain in charge of prize payouts, contract management, and other oversight functions. He believed the money saved on state payroll and from increased lottery efficiency would generate more property tax relief. However, the Legislature's Joint Finance committee voted down his proposal.

Maine

Maine's lottery capitalization plan is different from the other states' plans to sell their lotteries in that

95 DeHaven and Gebeloff, A1.

96 Dennis Cauchon, "A lot of scratch: Big games reinvigorate lottery sales," *USA Today*, June 25, 2006.

97 *Detroit Free Press*, "Lottery's \$50 Super Raffle tickets sold out," May 9, 2007, available at http://hosted.ap.org/dynamic/stories/M/MI_SUPER_RAFFLE_MIOL-?SITE=MIDTF&SECTION=HOME&TEMPLATE=DEFAULT.

98 Lottery Post, "Illinois Lottery exploring Internet sales again," (January 20, 2006), available at <http://www.lotterypost.com/news/126950.htm>.

99 *Lottery Post*, "Lotteries may gamble on Internet," (April 22, 2005), available at <http://www.lotterypost.com/news/111585.htm>.

100 See, for example, Michael D. LaFaive, "Place a Bet on Lottery Privatization," Mackinac Center for Public Policy (February 11, 2003), available at <http://www.mackinac.org/print.asp?ID=5021>.

101 The Iowa Lottery Division and Connecticut Lottery Corporation started as state agencies and were turned into nonprofit corporations but have not technically been privatized.

102 Christiansen Capital Advisors, LLC, "Report Issued by Christiansen Capital Advisors, LLC Estimates the Privatized Value of United States Lotteries over \$200 Billion," (March 27, 2007), available at <http://www.cca-i.com/insight/32707.press.htm>.

the Maine lottery would have remained entirely in government control. In 2005 Maine's governor outlined a controversial plan to sell \$250 million worth of bonds based on future lottery revenues to the Maine State Retirement System. His plan came in the wake of a 2004 referendum requiring the state to fund 55 percent of local education. Maine is a high-tax state already, and the governor was determined to comply with the ruling without explicitly raising taxes. Although the proposal passed the house, it has largely been abandoned due to growing skepticism in the legislature and the Retirement System's lack of interest. If the lottery borrowing scheme had gone into effect, the Maine State Retirement System and the state would have a vested interest in residents' gambling heavily—the state would essentially be gambling on its residents' gambling.

Illinois

Illinois has received extensive publicity for the governor's plan to fund education by leasing or selling the lottery to a private firm for a minimum of \$10 billion upfront. Schools would receive \$1 billion a year for the next four years and the remaining \$6 billion would fund an annuity, which would generate a \$650 million annual payment to replace the lost lottery revenue until FY 2025. If the lottery were sold rather than leased, it is unclear what would happen in 2025, and the uncertainty worries some legislators. First introduced in May 2006, the proposal has stalled amid criticisms that it is short on detail and too risky.

Indiana

Indiana governor Mitch Daniels proposed a plan similar to Illinois's, although Indiana lawmakers have been more skeptical of the potential for increased revenue from the private sector, given that the Hoosier Lottery is run as a quasi-governmental agency. This means it already has more leeway than traditional state agencies.

This has not dissuaded the governor and others from portraying lottery privatization as a path to improved higher education. The governor's plan

involves leasing the lottery to a private company for 30 years in exchange for an upfront payment of at least \$1 billion plus an annual revenue stream of \$200 million. The revenue would fund public pensions, provide auto excise tax relief and fund the governor's Brain Gain plan, which would offer college scholarships to high-achieving students in the form of loans that would be forgiven for students who remain in the state for three years after graduation. The plan would also create a fund to attract scholars in the life sciences field to the state's universities.

One of the arguments the governor has used to increase support for his plan is that privatization would allow the state to avoid the fluctuations of state-run lottery revenue and would provide a constant, reliable stream of revenue.

Skeptical legislators, fearing that a private company would increase sales primarily by offering new casino-style games such as keno, included a prohibition of VLTs and keno in the privatization bill, but other, still-skeptical lawmakers point out that a private company could simply lobby its way out of those restrictions. The bill also stipulates that any private operator would be audited regularly, would be required to implement a program to curb compulsive gambling among lottery players, and would be regulated by the Indiana Gaming Commission, which currently regulates riverboat casinos.

Opponents of the plan also point out the irony of increasing education funding through a lottery, given a recent study which found that the education and incomes of Indiana's heaviest lottery players are both below the state median.¹⁰³

Despite the skepticism, a group of educators and business leaders expressed support for the plan, which passed the senate. However, in late April when it became clear that the bill would not pass the house by the end of the session, the governor announced his decision to postpone the plan and conduct a "year-long, statewide conversation on the topic before proceeding."¹⁰⁴

Ten companies have already submitted non-binding bids to lease the lottery, half of which exceed \$1.5 billion.

103 *Lottery Post*, "Indiana Senate approves lottery sell-off," (February 28, 2007), available at <http://www.lotterypost.com/news/151913.htm>.

104 *Lottery Post*, "Indiana Lottery privatization on hold," (April 23, 2007), available at <http://www.lotterypost.com/news/154915.htm>.

105 Evan Halpe, "Schwarzenegger may try to privatize California lottery," *Los Angeles Times*, May 10, 2007, available at <http://www.latimes.com/news/local/la-me-lottery10may10,0,1542996.story?coll=la-home-center>.

106 *Lottery Post*, "GOP legislators question math in Texas lottery-sale plan," (February 9, 2007), available at <http://www.lotterypost.com/news/150728.htm>.

California

California governor Arnold Schwarzenegger has been working with investment banks to develop a plan to lease the lottery to a private company for up to 40 years for a lump-sum payment or multiple payments, possibly totaling as much as \$37 billion. The governor's plan allegedly would not decrease the amount of lottery revenue currently allocated to public schools. Concerned with the lottery's poor performance relative to other states, the governor believes a private company would greatly increase the amount of revenue to the state.¹⁰⁵

Colorado

In Colorado, senate Republicans have put forth a plan to sell the lottery to a private firm for \$2.2 billion upfront, plus a share of future winnings. Revenue would be used for veterans' facilities, open space and higher education. If two-thirds of state legislators approve the measure, the public will vote on it this fall.

Texas

In his 2007 State of the State Address, Texas governor Rick Perry proposed a plan to privatize the Texas Lottery by selling it to private interests for at least \$14 billion in order to raise funds for public education, health care for the uninsured and cancer research.

The lump sum from the sale would be invested and would allegedly generate \$1.3 billion annually,¹⁰⁶ which is about \$300 million more than the profit currently generated by the lottery. However, the funds earmarked for education under this plan would be \$250 million less per year than is currently generated, and the governor acknowledges that those funds would have to come from the general fund.¹⁰⁷ He justifies this shuffling of funds by pointing to the potentially greater stability of the revenue stream under the plan. His proposal has met a cool reception in the legislature.

Michigan

Michigan lawmakers looking for a way to deal with a budget shortfall are also tentatively consider-

ing lottery privatization. The state would receive an upfront payment and possibly annual revenue. Privatization could be more difficult here than in other states, however, due to a constitutional amendment passed in 2004 requiring that any changes in gambling laws be put to a statewide referendum.

Maryland

Maryland lawmakers are approaching the privatization idea very tentatively. Facing a \$1.3 billion budget shortfall for FY 2008 and reluctant to raise explicit taxes,¹⁰⁸ some lawmakers are toying with the idea of using the lottery to generate more revenue through VLTs (which have been heatedly debated for five years) and/or privatization.

A 2006 study by the Department of Legislative Services concluded that growth in lottery revenue has not kept pace with the rest of the state's economy.¹⁰⁹ Most of the sales increases during the last decade are attributed to an increase in the percentage of sales returned as prizes, not an increase in new customers.¹¹⁰ A private firm, some believe, may be able to expand the customer base. Many legislators, however, believe the idea is too risky and point out that such a plan is likely to require voter approval since the lottery is established in Maryland's constitution.

New Jersey

New Jersey officials are conducting a year-long review of the possibility of selling or leasing certain state assets, including the New Jersey Turnpike and the lottery, to private companies to address budget woes.

West Virginia

While no formal privatization plan is under consideration in West Virginia, a state senator recently noted that the lottery could sell for \$4 billion and suggested that the state consider privatization to help fund the teachers' retirement system. The state's lottery director, however, says he has not considered privatization, and the senator who made the proposal said he will not support a formal plan until more research has been done.¹¹¹

107 Ibid.

108 *Lottery Post*, "Will Maryland sell off its lottery?," (February 15, 2007), available at <http://www.lotterypost.com/news/151078.htm>.

109 Ibid.

110 Ibid.

111 Jake Stump, "West Virginia resisting trend to privatize Lottery." *Charleston Daily Mail*, May 13, 2007, available at <http://www.daily-mail.com/story/News/2007051010/West-Virginia-resisting-trend-to-privatize-Lottery/>.

PROS AND CONS OF LOTTERY PRIVATIZATION

In addition to the aforementioned concerns that have been raised over privatization, there are other benefits and drawbacks to all of these plans. Lawmakers looking to sell a lottery for a one-time

The lottery business has become a game of one-upmanship in which every state looks for ways to convince its residents and out-of-staters to play the lottery more often and spend more.

payment must consider what will happen after the lump-sum payment is used up. Will they use the money slowly—and solely—for education or other earmarked projects or jump at the chance to fund pet projects, shuffling funds so they appear to be keeping spending promises? When the money runs out, will they simply create other sources of state-run gambling revenue to fund education without “raising taxes,” such as state-run slot machines at racetracks or state-owned casinos (as Kansas is currently doing¹¹²)?

Another drawback is that if a sale takes place, the state will grant the private vendor a monopoly. When states began enacting lotteries in 1963, they removed constitutional bans only to create government monopolies. What would be the justification for removing the government monopoly only to create a monopoly for a private company?

The main benefit of most of these plans, which far outweighs the drawbacks, is that they would remove the state at least in part from a business it should not have entered in the first place. However,

the state will still be indirectly involved in two ways. Some states have stipulated that a private vendor that purchases the lottery must abide by certain regulations and submit to state oversight. Even a state that does not specify this will still be indirectly involved in ticket pricing: the company that buys the lottery will set its prices high enough to recoup its investment and make a profit. The prices will be based on what the state charges the company, which in turn is based on how much revenue the state “needs,” not on a competitive price set by the market. Unless states allow lotteries to be run privately by multiple companies, like any other business, ticket buyers will not be offered a reasonably low price.

STATES ADD VIDEO LOTTERY TERMINALS

A number of states are attempting to increase revenue by introducing or expanding VLTs. Oregon already has VLTs, but in 2005, in response to a call from the governor’s budget for more lottery revenue, the state added video slots to the video poker it had already offered for 14 years. Rhode Island also attempted to add more VLTs at one of its racetracks. The state had already approved the addition of more machines and the expansion of the building that housed them, but in August 2006 the Newport City Council refused to change an ordinance prohibiting “casino-type gambling” in the commercial-industrial zone into which the building would have expanded.

Several states without VLTs are also considering adding them. Proposals for VLTs and non-lottery video gaming devices have been especially popular recently. In 2003, 19 states considered bills or proposals to start or increase video gaming devices at racetracks (not all of them related to the lottery).¹¹³ In July 2006 the governor of New Jersey reversed his opposition to the machines and said they should be considered, in part because the nearby states of Pennsylvania, Delaware and New York all

112 Sue South, “Governor signs casino bill hoping new law will spur development,” *Miami County Republic*, April 18, 2007, available at http://www.kccommunitynews.com/articles/2007/04/19/miami_county_republic/news/m-mc-news-casino.bill.signed.txt.

113 Eugene Martin Christiansen, “Status report on U.S. gambling initiatives,” ATE On-Line (2004), available at <http://www.ateonline.co.uk/default.asp?showid=14&pageid=1870>.

114 Ohio School Boards Association Legislative Report, Vol. 25, No. 25 (May 31, 2004), available at <http://www.osbaohio.org/53104LR.htm>.

115 Andrew A. Green, “As slots languish, tracks race ahead,” *Baltimore Sun*, May 18, 2006, available at <http://www.baltimoresun.com/news/local/bal-te.md.slots18may18,0,4143815.story?page=2&coll=bal-sports-horse>.

116 Texas Comptroller of Public Accounts, “Casinos, Lottery Machines Hurting Texas Racetracks,” *Fiscal Notes* (July/August 2006), available at http://www.cpa.state.tx.us/comptrol/fnotes/fn0607_08/stretch.html.

have video gaming machines. This is not the first time VLTs have been proposed in New Jersey, but Atlantic City casinos have opposed them because of the potential competition. Some legislators believe voters would need to approve VLTs by referendum, but others believe this is not the case since VLTs would simply be a new type of lottery game, not a new type of gambling.

In Ohio, supporters of an initiative to bring video slot machines to seven racetracks and two downtown Cleveland locations conducted a petition drive to place the issue on the November 2006 ballot. In 2004, legislators voted down a bill that would have placed a constitutional amendment on the ballot allowing VLTs, which supposedly would have helped counteract a shortage in the education budget. However, Ohio educators were not all enthusiastic about the proposal. The Ohio School Boards Association expressed concern that “local voters are likely to perceive that the VLT monies going to education will reduce or eliminate the need for local levies” and “the use of VLTs to fund education is an unstable source of revenue.”¹¹⁴ In the 2006 initiative, the proposed slot machines were not video lottery terminals; instead the slot machine revenue would have gone directly to a “Learn and Earn” scholarship and local economic development fund and bypassed the lottery and legislature. The funds would have been controlled by the Ohio Board of Regents. Supporters questioned whether current lottery revenue actually benefited education, or was diverted to other programs. The proposal failed at the ballot box, but its appearance on the ballot is evidence of taxpayers’ distrust of current lottery earmarks for education.

Maryland has been engaging in a heated battle over VLT legalization for five years and the governor and legislature appeared to reach an impasse in 2005. Various house and senate bills have been considered, including one that would have abolished the state lottery agency and the state racing commission and replaced them with the State Lottery and Horse Racing Agency. VLTs have been seen as a way to revive a faltering racing industry, but VLT legislation has failed three years in a row, and the racing industry has begun to revive. But some still support bringing VLTs to racetracks, especially since racetrack gambling has recently started in Pennsylvania, potentially drawing money out of Maryland. During then-governor Ehrlich’s first two years in office, the state faced revenue shortfalls, and he preferred slot machines to raising sales and

income taxes, claiming slots could generate \$1 billion annually.¹¹⁵ In 2006, he again proposed a VLT plan but did little to advance it in the legislature. Governor Martin O’Malley has recently continued the quest for slots as a way to keep the Maryland horseracing industry afloat.

In Texas in 2005 a state representative introduced a bill to allow VLTs at racetracks, but no action has been taken. Video lottery is seen as a way to bolster Texas’s horse and greyhound industries, and industry groups have expressed support for the legislation. They worry about the money Texans spend on nearby states’ VLTs and casinos, and blame Texas’s lack of VLTs for damaging the state’s racing industry. In 2004, the Texas comptroller estimated VLTs could raise more than \$1 billion a year in state revenue.¹¹⁶

In addition to VLTs, states are taking advantage of the latest technology to offer other new types of high-tech games. Kansas recently introduced pocket-sized, slot machine-like instant-win lottery “tickets.” The \$20 game is selling briskly, and the state has plans for other varieties. A similar product has been offered in Iowa.

EDUCATION FUNDING APPEARS TO BE GREATER PRIORITY

All of the aforementioned tactics through which states have attempted to generate more lottery money in recent years have been prompted by the perceived need for more state revenue, often in the area of education. A number of lottery states have recently emphasized education as the central theme of their lotteries. Five of the six most recently enacted lotteries—North Carolina, Oklahoma, Tennessee, South Carolina and New Mexico—earmark proceeds solely for education, and three of those states have the word “education” in the name of the lottery or the agency that oversees it. Education was also the focal point of the debates over enactment of these lotteries.

In several other states, legislators have taken steps to “safeguard” money raised for education and ensure the public that their purchases really are benefiting education. In July 2005 the Kentucky Lottery held a news conference to announce that all lottery revenue, starting at the beginning of FY 2006, would go directly to college scholarships. When voters approved the lottery 18 years ago, they were promised that all of the revenue would benefit education, but many Kentuckians have been

skeptical over the years since revenue first went into the general fund before being filtered out to education programs.¹¹⁷ The governor of Oregon, in a ceremony at an elementary school, signed a bill in April 2006 to devote a larger portion of lottery revenue to school districts for the 2006-07 school year. And in Georgia, the governor has called for a constitutional amendment to prevent lottery money from being used for any program other than HOPE college scholarships and pre-kindergarten classes. Of course, it is impossible to guarantee the efficacy of these alleged safeguards.

What Does the Future Hold for State-Run Lotteries?

In 1999 the National Gambling Impact Study Commission recommended a moratorium on the expansion of all gambling in the U.S. Clearly its advice has not been heeded. Battles over lottery enactment and expansion are being waged in a number of states.

MOST NON-LOTTERY STATES ARE CONSIDERING LOTTERIES

For most non-lottery states, it is no longer a question of whether a lottery will be enacted, but a question of when. Legislators and governors stress the supposed need for additional revenue to deal with budget shortfalls and the perceived loss of money to neighboring states. They campaign fervently for lotteries and talk about the noble goals of providing college scholarships and improving the public schools. There is less and less of a stigma to all forms of legalized gambling as they become more commonplace. Twenty years ago, lottery researchers searched for the reasons certain states enacted lotteries. Now, 43 years into the modern lottery era, with only eight non-lottery states left, the question is: Why do certain states not enact lotteries? Utah is the only non-lottery state to not seriously consider a lottery, but for the remaining seven, it will most likely be just a matter of time before they give in.

WHICH STATE WILL BE NEXT?

Wyoming

Wyoming lawmakers have been considering a lottery for over a decade. In 2004 a lottery bill passed the house but not the senate. The bill would have allowed Wyoming to join the multi-state lottery Powerball but not to create a lottery of its own. This is the model used by North Dakota. A bill to create a referendum on Powerball was voted down in a close house vote in 2005. However, in May 2006 an interim legislative committee authorized legislation allowing Wyoming to join the multi-state lottery. The Joint Travel, Recreation, Wildlife and Cultural Resources Committee deliberated but did not pass the bill earlier this year. Some have blamed the horse racing industry for killing the bill out of fear it would reduce horse racing revenue.

Alabama

In Alabama a 1999 referendum to remove a constitutional ban on lotteries failed at the polls. The proposed lottery, which was modeled on Georgia's lottery, was intended to provide college scholarships. It was heavily promoted by Gov. Don Siegelman, who campaigned as the "education governor" and promised to raise money for education without increasing taxes.¹¹⁸ The legislation was reintroduced in 2004 in the House Tourism and Travel Committee but died in committee. The 2006 gubernatorial race once again brought the issue to the forefront. Siegelman lost the governorship in 2002 but entered the 2006 race and again made the lottery an issue, forcing his challenger in the Democratic primary to address the topic. He did not win the nomination, but the lottery has now been brought into the political arena once again and it may stay there for the foreseeable future.

Arkansas

Arkansas voters rejected a lottery at the polls in 2000, and a 2003 proposed constitutional amendment to allow a lottery failed to make it through the legislature. Legislators are still concerned with finding additional public school funding, especially

117 *Lottery Post*, "All Kentucky lottery money to fund education," (July 1, 2005), available at <http://www.lotterypost.com/news/115666.htm> July 1, 2005.

118 *Governing.com*, 2006 *Governors Election Guide*, available at <http://www.governing.com/govraces/al.htm>.

119 *Lottery Post*, "Arkansas Gov. candidate's lottery figures appear unrealistic," (January 24, 2006), available at <http://www.lotterypost.com/news/127163.htm>.

since the Arkansas Supreme Court ordered the state to increase public school funding. In 2006 two candidates for statewide office proposed a lottery as the solution, including a gubernatorial candidate who claimed a lottery could raise as much as \$250 million dollars a year.¹¹⁹ At the same time, a Texas businessman started a petition drive for a lottery and casino ballot initiative in Arkansas. He abruptly ended the petition drive, but promised to bring the issue back for the 2008 general election. Earlier this year, the state legislature took up a lottery bill, with the support of the lieutenant governor.

Mississippi

In 1992, Mississippi voters took the first step toward lottery enactment by removing a constitutional ban, but the following year lawmakers refused to create a lottery, citing a lack of widespread support throughout the state and a likely veto by the governor. Since then there has been a rapid expansion in other types of gambling in the state but little sustained interest in creating a lottery, and in 2004 a lottery bill died in committee. However, in 2005 and 2006 legislators found a renewed interest in the subject and filed multiple lottery bills. They did not act on any of the bills, and in 2007 a bill to create a lottery for a Hope College Scholarship Fund also died in committee. It seems likely that the issue will be raised in subsequent legislative sessions.

Nevada

Lottery proposals are nothing new in Nevada. The legislature has been trying to authorize a lottery since 1975, but opposition from the casino industry has been a major stumbling block. Most recently, bills were considered in 2001, 2003 and 2005. The 2005 bill would have established a lottery to help pay senior citizens' property taxes. If any bill passes, a referendum will be necessary to remove a constitutional ban. The Governor's Task Force on Tax Policy has recently expressed support for a lottery, as has the Nevada State Education Association. Earlier this year, on the 25th try, a bill made it through the House of Representatives on a mostly party-line vote supported largely by Democrats, but it has not been acted on in the senate at press time. This is not the first time the house has passed a lottery bill, but none has ever made it through the senate. The bill would allow voters to decide the issue, although the legislature would have to approve the bill again in 2009 before it would appear on the ballot in 2010.

The legislation has the support of the Nevada State Education Association, which anticipates new

funds for textbooks, computers, and other instructional materials. The bill is opposed by several major gaming corporations.

POSSIBLE LOTTERY LOSSES IN TWO STATES

VLTs are profitable but controversial in South Dakota, and a group of citizens gathered enough signatures to put VLT repeal on the ballot in November 2006. However, state officials refused to place the issue on the ballot, citing a 1995 state Supreme Court decision holding that measures initiated in petition drives may not be used to repeal existing laws. In August 2006 the state Supreme Court overturned its earlier decision, and VLT repeal was on the November ballot. It failed by a large margin of 67 to 33 percent.

In Kansas, the lottery agency is attempting to do away with a sunset provision, which requires that the lottery periodically renew its operations. It was due to sunset in 1992, 1996, and 2002, but each time, the legislature extended the lottery, most recently in 2001, extending it until 2008. The lottery's executive director claims the sunset requirement costs the state money and hinders the lottery agency's ability to negotiate long-term vendor contracts. If the legislature doesn't renew the lottery in this year, it will have to stop all sales on January 1, 2008.

Conclusion

Clearly, the lottery fails the tests of sound tax policy. However, no state has abandoned a lottery in the past century and, unfortunately, none is likely to do so soon. The lottery "privatization" plans that have sprung up in some states very recently would be an improvement on the current system but not ideal since states would retain some direct or indirect involvement.

Simply labeling lottery funds tax revenue would be a step in the right direction; it would at least increase transparency. Ideally states themselves would reclassify the revenue, but a federal agency such as the Bureau of Economic Analysis could also tackle the issue.

Selling the lottery or reclassifying the "profits" would perhaps not be necessary, however, if more policymakers, voters and taxpayers were aware that lotteries exemplify poor tax policy. Voters in states that do not yet have lotteries would be less likely to support them at the ballot box, armed with the

knowledge that they would be voting for a regressive, non-neutral tax increase. As for lotteries already in operation, given the rate at which they are expanding and raising tax revenue, it seems unlikely that policymakers would be willing to completely relinquish a source of revenue that allows them to increase spending while claiming credit for keeping taxes low.

If they did, however, they would improve their tax systems by increasing accountability, transparency and economic neutrality, as well as decreasing regressivity. Legislators would find that they do not truly need the tax revenue raised by lotteries; they would either get by without it or raise it through explicit taxation enacted legislatively—and honestly. They could allow lotteries to continue in the private market or even ban them entirely. In either case, the cessation of state-run lotteries would result in more principled state tax systems.

Methodology

Comparisons of state lottery data present some challenges not encountered with other types of state financial data, for the following reasons:

- Lotteries are a relatively new phenomenon and did not start at the same time in every state. There is no uniform system of financial reporting. VLT and VGD sales and profits are not reported the same way in every state or by every organization that gathers lottery data; sometimes they are not included in state comparisons at all. Some states report charitable gaming revenue as government lottery transfers. The handling and reporting of unclaimed prizes is also not uniform across states.

- Lotteries do not always fit neatly into existing government agencies and not all states have the same amount of government oversight. Some lottery agencies are quasi-government agencies; some are under the department of revenue.
- There are occasional problems with fraud and record keeping. (For example, in 2000 the Pennsylvania lottery's record keeping was found by auditors to be "seriously deficient.")¹²⁰
- Organizations that collect lottery data are not uniform in their collection and reporting procedures. There are differences with regard to what should be considered "profit," "proceeds," "government transfers," "revenue," etc. It can be difficult to reconcile lotteries as a type of gambling with lotteries as an activity of state government; the two methods of financial reporting are not entirely the same. Data from various organizations do not always match entirely, although differences are generally small. Some organizations (such as the North American Association of State and Provincial Lotteries) gather data directly from state lottery agencies; others (Census Bureau) from states' annual financial reports. For this reason, charts in this paper that use different sources may not be strictly comparable.
- Financial reporting is further complicated by many variables: 43 jurisdictions, numerous games in each jurisdiction, varying retailer commissions and bonuses, and frequent changes in products offered. In addition, reporting of sales is done in over 100,000 convenience stores, racetracks and bars.

¹²⁰ Pennsylvania Department of the Auditor General, Lottery Audit, May 2000, available at <http://www.auditorgen.state.pa.us/Department/Info/Investigations/LotteryRpt.html.news/150728.htm>.



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