



Testimony to Vermont Blue Ribbon Tax Structure Commission: The Role of the Lottery in Vermont's Tax Policy

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by Alicia Hansen

Thank you for inviting me to testify today.

First I'd like to explain why any discussion of tax reform merits an examination of the state lottery.

The lottery is an implicit tax, No state government labels lottery profits tax revenue, but they should. The lottery must be evaluated as a tax, and when we subject it to the tests of sound tax policy, it fails.

In 2008 lotteries generated over \$60 billion in consumer spending. This translated to a profit for state coffers of over \$17 billion. Slightly over half the money spent is returned to players as prizes. Part of the remainder covers operating costs-including vendor commissions, equipment, administration and advertising-and the rest is transferred to state coffers. States call their portion "profit" but it is actually implicit tax revenue.

Lottery proponents argue that a tax is a mandatory payment, and playing the lottery is voluntary, so lottery revenue cannot be tax revenue. But they're confusing the purchase of a product with the payment of the tax on the product. Purchasing 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.

State-run lotteries fail the tests of sound tax policy in multiple ways: They are not economically neutral, they are not simple to administer, and they are not transparent. The tax system should be as clear and simple as possible; taxpayers should understand what is being taxed and what the rates are. The lottery tax, however, is hidden. 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.

In FY2008, the implicit tax rate on Vermont's lottery tickets was 28%.¹ Can anyone imagine walking into a Vermont store and paying a 28% sales tax on a board game, iPod, video game or any other recreational item?

It's important now more than ever to examine the government's reliance on lottery tax revenue for two reasons: states' attempts to use lottery revenue to deal with state budget shortfalls and the simultaneous decrease in lottery revenue.

Although it initially seemed that lottery revenue was recession proof, revenue has now fallen slightly. According to a report from the Rockefeller Institute of Government,² state revenues from all sources of authorized gambling fell 2.8 percent in FY2009, Lottery income, the largest source of state gambling revenue, fell 2.6 percent. Vermont's lottery profits (implicit tax revenue) dropped 7.7%.

This desire on state's parts to fill coffers with gambling revenue could be a boon for the gambling industry as well, and the combination of desperate state treasurers and gambling companies both looking for more money has led to a slew of new lottery proposals, products and marketing strategies, some of which I will describe.

More states are turning to video lottery terminals (VLTs), especially at state racetracks. VLTs are one type of lottery game that has not suffered during the recession. VLTs are more like casino games than traditional lotteries, and lottery critics often argue that they're more likely to cause gambling addictions. From a tax policy standpoint, they pose a transparency problem in that people who play VLTs may not even realize they're playing the lottery; when we think of playing the lottery, we think of buying a ticket, not playing slots at the track.

Another tactic that a few state lotteries have taken is attempting to allow players to place bets on the internet. In March 2005 the Georgia House—but not the Senate—passed a bill that would have allowed the lottery to create individual online accounts so players could purchase tickets on the agency's Web site. Two other states have since considered this plan.

Next are casino-style table games. The New York Lottery is permitting state-run casinos to add video roulette, craps and blackjack to the already extensive array of New York State Lottery products. It seems likely that this trend will continue in many other states, even though casino table games certainly do not seem like lottery games.

Lotteries are also focusing more than ever on marketing, and some are partnering with sports franchises to draw in more players. Maryland, for one, has partnered with the Baltimore Orioles and the Baltimore Ravens to promote bubble gum-scented scratch-off tickets, to sell lottery tickets at sporting events, and to offer season tickets as prizes.

One trend that's constantly in the media spotlight is that lottery jackpots are becoming larger. Not surprising, this has coincided with increasing ticket prices. One dollar used to be the most common price for a ticket, but many states have recently increased the price of some of their instant tickets to \$10, \$20 or even \$30. When the Michigan Lottery introduced a \$50 ticket, it sold out after less than three days.

The most recent development is that Powerball and Mega Millions, once considered rival games, have joined forces, and states will now be able to offer both high-jackpot multistate games.

Finally, while this is not exactly a new development, there is more evidence of lottery's regressivity, meaning that the lower-income players spend a disproportionate amount. In June the *Indianapolis Star* looked at Hoosier Lottery's sales data and public data and found evidence that the lower-income players spend a disproportionate amount on the state's lottery.³ They also found that lottery billboards were placed more often in lower-income neighborhoods. Lottery players throughout the country tend to have lower incomes and less educations, and state lottery agencies that are determined to rely on the lottery to handle budget crises will probably have to market heavily to this demographic.

To close I'd like to read a quote from the Feb. 2008 issue of *International Gaming and Wagering Business* (IGWB) magazine.⁴ The quote is a bit long but it will make the point that the methods used to raise huge amounts of lottery revenue currently and in the near future are probably not palatable to most principled lawmakers:

"The lottery industry is under tremendous pressure to continue to perform and provide ever-increasing revenues," said Maryland Lottery Director Buddy Roogow. "The environment in which we work is becoming increasingly competitive because of the internet, because of the explosion of casinos and racinos around the country, and because of the interactive games that are available

In light of Roogow's comments, lotteries can't rely on the same combination of lotto and numbers games that have served them well over the years. U.S. lottery sales this decade have been driven primarily by mega-jackpots in the multi-state lotto games, and by increasing price points, and payouts, for instant tickets. ...

Lotteries in Europe have generally not seen the rapid growth of instant ticket sales that American lotteries have seen, primarily because the price points and prize payouts haven't changed significantly, noted Matthew Mansfield, Vice President of Product Marketing and Design for GTECH Corp. . . .

Lotteries fortunate enough to have monitor games are reaping the benefits of a product category that is receiving a lot of attention from vendors. More than a dozen U.S. lotteries offer those games, which generally begins with keno and are often limited to social environments such as bars and clubs.

"Monitor games are probably right now the areas of great interest and development potential for the marketplace in the United States," said Mansfield. "It's clearly an opportunity to provide more visual entertainment for the players and diversity of game to choose from."

He envisioned a future where retail venues could offer monitor "walls" similar in concept to some of the instant ticket displays currently on the market. Multiple monitors would offer multiple games, and players would choose the games they want. ...

Currently on the market are versions of poker, horse and car racing, and more are in the works.

"We can now put virtually any game you can think of on a monitor," said Maryland's Roogow. "Monitor games are part of where the future lies for us. ... I think they allow us to penetrate the emerging market more effectively...young people who may go to bars and restaurants, places where they can congregate. "

"I think what's important for the future of lotteries...is distribution—getting where the customers are ...into more nontraditional outlets that in the past have been unapproachable," said [Louisiana Lottery Vice President of Marketing Bonny] Botts. "These include places like drugstores, big box retailers, even the corner Starbucks."

[1] For an explanation of how the implicit tax rate is calculated, see Alicia Hansen, *Tax Foundation Background Paper* No. 54, "Gambling with Tax Policy: States' Growing Reliance on Lottery Tax Revenue" (June 2007), p. 22, available at <http://www.taxfoundation.org/news/show/22457.html>.

[2] Lucy Dadayan, Nino Giguashvili, and Robert B. Ward, *Rockefeller Institute Fiscal Features*, "From a Bonanza to a Blue Chip? Gambling Revenue to the States," June 19, 2008, pp. 9 -12.

[3] *Lottery Post*, "Study finds wealthy counties get most benefit from Indiana Lottery profits," June 11, 2009, available at <http://www.lotterypost.com/news/195110>.

[4] Patricia A. McQueen, "Lotteries tap new game concepts to boost sales, interest," *International Gaming and Wagering Business* 29 no. 2, (Feb. 2008), p. 30 - 35.