



Vermont Legislative Research Shop

Leasing the Lottery

Many states from New York to Indiana have explored the possibility of leasing their state lotteries. This has stirred up long-standing arguments about state-supported gambling and privatization. Central to these arguments include issues such as: how privatization will affect the marketing of the lotteries; demographics of lottery players; and, whether it is in the public interest to have more people playing the state lotteries.

Who Plays the Lottery and Why

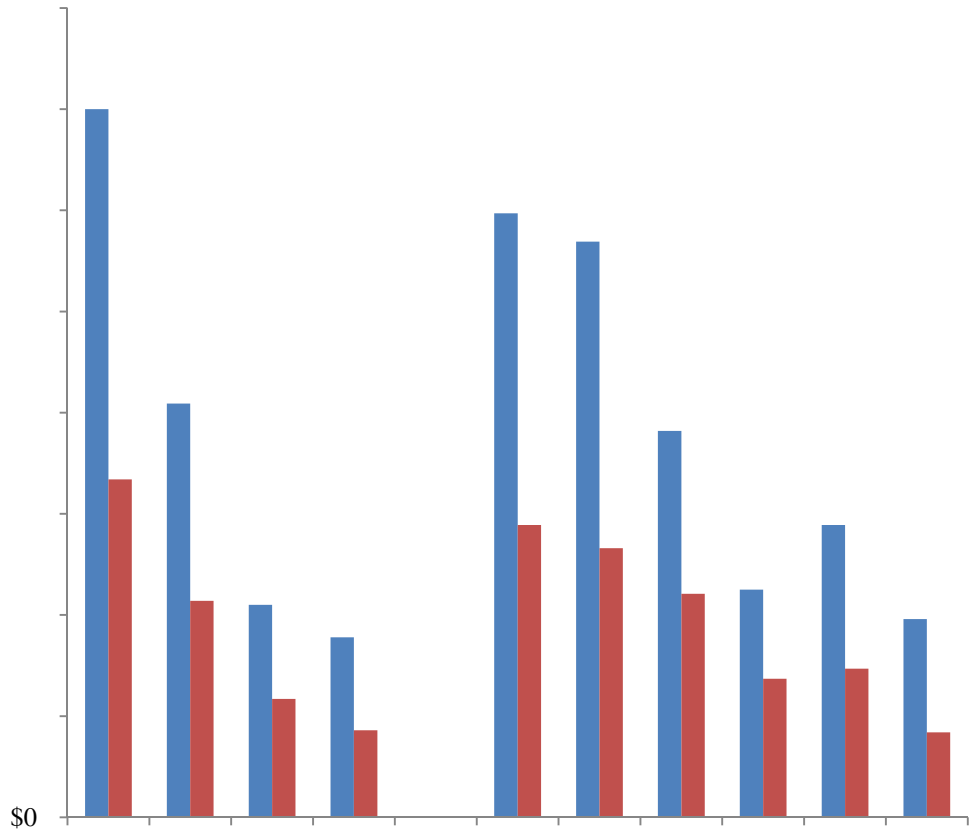
There are two basic motivations for playing the lottery—pleasure and money. In 1986, lottery players in California were asked if they played more for fun or money, the results were evenly divided. However, when income was taken into account, those making \$30,000 or less are 25 percent more likely to cite money as their motivation. The reverse was true for those at upper incomes.¹

Roughly one third of adults in lottery states play at least once a week, nonetheless, a small percentage of players account for a large percentage of lottery sales each week. The most active 10 percent of players account for approximately 50 percent of lottery wagers.²

There are some clear demographic patterns in terms of who plays the lottery. The frequency of playing the lottery falls as levels of education increase, and is highest in adults' middle years, approximately 25 to 65. Contrary to conventional wisdom the data examined does not show a correlation between lottery play and household income over the broad middle range or \$10,000 to \$60,000 in yearly income in 1986.³

The Report to the National Gambling Impact Study Commission, a U.S. government study published in 1999, summarized the demographics of lottery players from survey data published the same year. Their findings are reproduced in Figure 1 below.

¹ Clotfelter, C. T, and Cook, P.J., "On the Economics of State Lotteries," *The Journal of Economic Perspectives*



customer bases before designing a campaign.⁶ Some state lotteries have advertising codes of conduct. The Indiana code includes (in 1999) the following:

- Commercials will treat the talent, players and customers with class and dignity.
- No children will be used in advertising nor will advertising be directed toward them.
- The Lottery will not be promoted as an alternative to work and terms like checking account, savings account and references to financial institutions will be avoided.
- Ads will be careful not to sell the dream of a “way out” of their current financial situation or flash big signs of extreme wealth.
- Odds of winning will be clearly stated in advertising where appropriate.⁷

One main criticism of lottery marketing is that it legitimizes gambling and makes it seem benign in the eyes of the citizenry. Clotfelter et al. (1999) argue that the message of lottery advertising is subversive, because it tells people that success is dependent on picking the right number. They argue that in the end this “education” may actually decrease economic growth by eroding the propensity to work, save, and invest in education. In this view, the lottery is an entity designed entirely for short-term gains.

Another issue raised by critics of lottery marketing is that increased lottery marketing, especially if states lease the lottery to private companies, could actually result in a decrease in state revenues. The logic behind this argument is as follows: people who play the lottery come disproportionately from lower socioeconomic status and if they are induced to spend their money on lottery tickets by marketing campaigns, then they will spend less money on other things that the state taxes, such as clothes, alcohol, cigarettes and other goods.⁸

Government Oversight of Privatized Lotteries

While states may be trying to relieve themselves of responsibilities associated with running lotteries by leasing them, even leased lotteries will still require governmental oversight. States will have to monitor lotteries to make sure that they abide by various parameters as set by the states, and actually pay what they promised to the states. While there is no data on how much rgC92.nning nted

Lottery as Education Funding

Currently of 42 states that have lotteries, 23 earmark some or all of their profits for education. Though the money may be earmarked for education, lottery proceeds do not contribute much to education funding. According to an analysis reported in *The New York Times* state lottery profits account for anywhere from less than 1 percent to 5.3 percent of total education funding.¹⁰

spent on education. This means that earmarking has the result of increasing education spending, despite the fact that between 30 and 50 cents of every dollar earmarked is diverted away from education.¹⁷

Throughout the Nation and Abroad

Vermont

Vermont Governor Jim Douglas recently proposed leasing the Vermont state lottery to private investors. He proposed charging \$50 million up front plus guaranteed annual payments of \$23 million¹⁸, which is how much the lottery current earns in annual profit.¹⁹ The basic policy question is whether the lease is a good long-term investment for the state, or simply a one-time benefit.

If we look at the Vermont lottery as an investment, we can measure how the investment will do over time. The most widely used method for measuring investments is the Net Present Value (NPV) analysis. This analysis looks at what something is worth today based on projections of future values. To find the present day value you need to be able to discount a future investment by dividing the future value by the opportunity cost of investing the money elsewhere. For most instances the current Treasury-Bill rate is used because it is an investment that has no risk of loss. The current T-Bill rate in this analysis was 2.2 percent. We also assumed that profits for the Vermont lottery would increase 10 percent a year on average for the next 20 years (which is a little less than the S&P average for growth).

Using the NPV analysis we were able to find the price break-even point at which Vermont would earn the same amount of money over a twenty year period regardless of whether the lottery was sold or not. If Vermont were to sell the lottery for \$50 million upfront, it would have to receive over \$24.5 million annually (with an increase of 10 percent a year) for 20 years. If the sale was made in this way the lottery would provide the same financial benefit for Vermont as continuing to operate the lottery publicly assuming \$23 million in lottery profits a year and continued to growth of 10 percent a year for the next 20 years. (See chart on following page) This analysis provides numbers similar to the Governor's proposal.

¹⁷ William N. Evans and Zhang, Ping, "The Impact of Earmarked Lottery Revenue on State Educational Expenditures," March 5, 2005, retrieved February 25, 2008 from http://www.bsos.umd.edu/econ/evans/wpapers/evans_zhang_earmark_lottery.pdf

¹⁸ Jim Douglas, "Governor's Budget Address: Achieving Prosperity through Affordability, January 22, 2007, retrieved February 13, 2008 from http://governor.vermont.gov/speeches/Budget_Address_1-22-08.pdf.

¹⁹ Dave Gram, (2008. January 21), "Vermont, Other States Weigh Privately Run State Lottery," *The Boston Globe*, retrieved February 13, 2008 from http://www.boston.com/news/local/connecticut/articles/2008/01/21/vermont_other_states_weigh_privately_run_state_lottery/.



for argument.²² In 2006, the state lottery had \$3.6 billion in sales, which amounted to \$1.3 billion in profit.²³ Governor Schwarzenegger believes that this figure is much lower than it should be. According to the *Sacramento Bee*, Californians spend on average \$81 per year on the lottery, while the national average is \$158.²⁴ The state also has fewer lottery retail locations per person than all but two lottery states.²⁵ If California could get its lottery sales up to the national average then there would be billions more dollars for education and healthcare.

Indiana

In late 2006, Governor Mitch Daniels proposed leasing the Hoosier Lottery to a private company in exchange for at least \$2 billion up front to fund education programs and \$200 million annually to the state, and possibly a profit sharing scheme. The year before Daniels' proposal the Hoosier Lottery brought in about \$200 million in profits.²⁶ The proposal has been held up in the Indiana House of Representatives, and in November of 2007 Governor Daniels formally dropped the proposal, although he said that one company was willing to pay \$1 billion up front and \$200 million a year for a thirty year lease.²⁷

Illinois

In early 2007, Illinois attempted to lease its state lottery. The state was proposing terms that were closer to a sale than a lease: it wanted \$10 billion up front, in exchange for which investors would get all of the profits from the lottery for the next 75 years. This is an extreme proposal, as the state made about \$630 million in *profits* in 2006, and could potentially make a lot more than \$10 billion over the next 75 years. Although Governor Blagojevich would invest some of the money for long term education funding, it seems logical that the state would actually lose money on the deal. If lottery sales remained steady over the next 75 years, the state would theoretically earn \$47.25 billion in profits, without adjusting for inflation, which makes the \$10 billion up front seem like a very bad deal. According to state officials, the leased lottery would still have to abide by state advertising and sales laws.²⁸ The legislature eventually voted down this proposal, creating a bill making it illegal for any state official to sell or lease any part of the state lottery.

²² Jonathan Kaplan, "Gambling on the future: Should California Privatize the State Lottery?" *California Budget Project*, retrieved February 11, 2008

from http://www.natlotcomm.gov.uk/UploadDocs/Contents/Documents/NLC%20report%2007_Web%20final.pdf.

²³ Judy Lin, "A push to make lottery private," *The Sacramento Bee*, May 11, 2007, p. A1, retrieved January 30, 2008 from <http://www.sacbee.com/111/story/175750.html>.

²⁴ Judy Lin, "A push to make lottery private."

²⁵ Jonathan Kaplan, "Gambling on the future: Should California Privatize the State Lottery?"

²⁶ Duhigg, Charles and Anderson, Jenny, "Illinois Is Putting Lottery on Block for Quick Payoff," *The New York Times* January 23, 2007, retrieved February 6, 2008 from

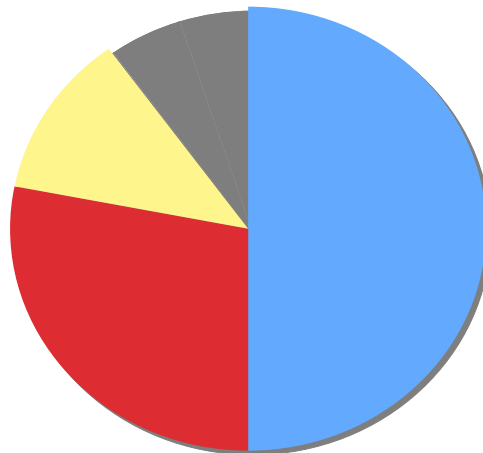
The United Kingdom

In 1994, Great Britain launched their National Lottery, which is considered semi-privatized. The National Lottery Commission, a government agency, licenses the right to operate the lottery to a private firm for a seven year period. Private companies submit proposals to the commission, which awards the license based on the following criteria:²⁹

- “Ultimately, the license will be awarded to the bidder that is able to support the greatest forecast returns to good causes whilst demonstrating that they can meet other required standards;
- “The next operator will need to demonstrate it is able to manage the transition to the third license transition without any interruption of service”

The lottery is leased for short periods with a lot of oversight, a model very different from the proposals of various US governors. A private group called Camelot has won all three bids for the license since the creation of the lottery in 1994. The following is a rough breakdown, according to the National Lottery Commission, of where lottery sales money goes:³⁰

Allocation of UK Lottery Revenue



According to a recent article in *The Independent*, the Camelot Group is currently going to fall about £1 billion short of its projected funding for good causes. Sales have remained steady for the past few years, but have not been improving enough to adjust for inflation.³¹

According to the National Lottery Commission, 70 percent of British adults play the lottery on a regular basis, which means that the privatized lottery has been highly successful at increasing lottery sales.³² According to a 2003 survey, 47 percent of respondents believe that they play the lottery now more than they did when it first came out. A 1998 survey of 12-15 year olds in England and Wales found that the introduction of new forms of gambling, including the National Lottery, had increased the amount of underage