

# PAYCHECK and POLITICS

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## SUMMARY

Estimates show an Arkansas lottery would generate \$169 million in sales. Only 33 percent of this amount, about \$55 million annually, would be available as tax revenue for the state treasury.

The creation of a lottery would decrease state and local sales tax revenue by about \$9.6 million, while revenue from state personal income taxes would increase by about \$1.4 million. The net tax effect of a lottery, including new lottery tax revenue, state and local sales taxes, and personal income taxes, would be about \$47.4 million.

Even though they have lower incomes, low-income taxpayers (the poorest 20% of taxpayers) account for 16 percent of total lottery spending, and this population would be hurt disproportionately by the creation of a lottery. The poorest 20 percent of taxpayers would see their taxes increase by 1.37 percent of their income (a tax increase of about \$98 annually). As a percent of income, the richest 1 percent of taxpayers would see a much smaller tax increase of only 0.02 percent (or \$121 annually).

Even during good economic times, a lottery is an unstable source of tax revenue. From 1997 to 1998, available lottery tax revenues declined in 17 states; from 1998 to 1999, 15 states saw declines; from 1999 to 2000, 19 states had lottery tax revenue decreases.

A state lottery could encourage problem gambling by children and their parents. The creation of a lottery could have unintended social and economic consequences for children and their families.

## An Arkansas Lottery A Bad Bet for Education & Families?

By Richard Huddleston

**T**he political debate over whether Arkansas should establish a lottery has heated up in recent months. A recent ballot initiative to eliminate the sales tax on food would have resulted in the loss of over \$600 million in state, local and federal revenue. While the measure was overwhelming defeated by the voters at the polls in November, the Arkansas Supreme Court recently upheld a lower court's decision in the *Lake View* case declaring the state's school-funding system to be inadequate and unconstitutional. This decision will likely require the state to increase spending on education by \$500 million to \$1 billion annually.

The *Lake View* case, coupled with a long-term Medicaid funding crisis, will place increasing pressure on state policy-makers to raise new revenue. The lottery is receiving renewed attention as an

option for meeting the state's future revenue needs.

But what is the potential of the lottery to meet the state's long-term revenue needs? Is it the panacea that some claim it is, or would it fail to raise the new revenue needed to adequately fund the state's future education needs? Is it a creative revenue source for the state or is it simply a way to raise revenue by increasing the tax burden on vulnerable families with dreams of winning a large cash jackpot? Just what are the facts concerning the lottery?

### How Much Revenue Might a Lottery Raise?

Predicting the amount of revenue an Arkansas lottery would raise is difficult. The amount of lottery revenue that any state can raise depends on numerous factors, such as the state population base, the personal income of its citizens,

tourism, interstate traffic, the mix of lottery games utilized by the state, the availability, both in state and in surrounding states, of other forms of gambling (such as casinos), and citizen willingness to play the lottery.

While the revenues lotteries raise vary significantly across states, it would be foolish to ignore the experiences of other states in assessing the revenue potential of an Arkansas lottery. How much “revenue” does the typical state lottery generate? According to data from the U.S. Census Bureau for the 37 states with lotteries in 2000, the typical state lottery generated \$127 in per capita sales. Per capita, or per person, measures, however, can be very misleading because of state-by-state differences in the incomes of their citizens. A more appropriate measure to look at lottery sales as a percentage of state personal income. For the 37 states, the average lottery yielded about less than one-half of one penny for each dollar of personal income in the state (0.44%).

There is some reason to believe, however, an Arkansas lottery might not generate revenues equal to the national average. Compared to many states with high lottery yields, Arkansas is poorer, has a lower population base, and has more conservative attitudes about gambling. Rather than com-

state personal incomes between \$40 and \$80 billion). These six states included Iowa, Kansas, Nebraska, West Virginia, New Mexico, and New Hampshire. To provide a more stable and reliable estimate, AACF examined the three most recent years of lottery data collected by the U.S. Census Bureau.

<b>TRADITIONAL LOTTERY SALES AND REVENUE FROM SURROUNDING AND SIMILAR STATES</b>			
<b>3-Year Average, 1998-2000</b>			
	<b>SALES AS % OF PERS. INCOME</b>	<b>REVENUE AS % OF PERS. INCOME</b>	<b>REVENUE AS % OF TOTAL SALES</b>
Iowa	0.22	0.05	22.93
Kansas	0.25	0.07	29.19
Louisiana	0.27	0.11	39.44
Missouri	0.33	0.11	32.91
Nebraska	0.16	0.04	24.13
New Hampshire	0.49	0.16	32.67
New Mexico	0.25	0.06	23.28
Texas	0.49	0.19	38.74
West Virginia	0.39	0.11	42.64
<b>State Median</b>	<b>0.27</b>	<b>0.11</b>	<b>32.67</b>

Note: Estimates for West Virginia exclude revenue from video lottery terminals (VLTs).  
Source: AACF calculations of annual lottery data from the U.S. Census Bureau and state personal income data from the U.S. Bureau of Economic Analysis

pare Arkansas to the average U.S. lottery state, a more valid approach would be to examine the experiences of other states more demographically or economically similar to Arkansas. AACF examined data from lotteries in Louisiana, Missouri, and Texas, and six states closer demographically (populations between 1.5 million and 3 million) or economically (total

From 1998 to 2000, these nine states had median lottery ticket sales of about 0.27 percent of state personal income. According to the UALR Institute for Economic Advancement, total state personal income for Arkansas in 2002 will be \$63.8 billion.<sup>1</sup> At this level, an Arkansas lottery might generate about \$169.4 million in total sales. This is considerably lower than the national average.

While \$169 million in lottery revenue sounds impressive, it is important to distinguish between total or gross lottery sales and the proceeds/revenues actually available to the state after administrative costs and prizes are paid out. In 2000, 37 states had lotteries. For the average (median) state, prizes and administrative costs consumed nearly 69 cents of every dollar of lottery ticket sales (after

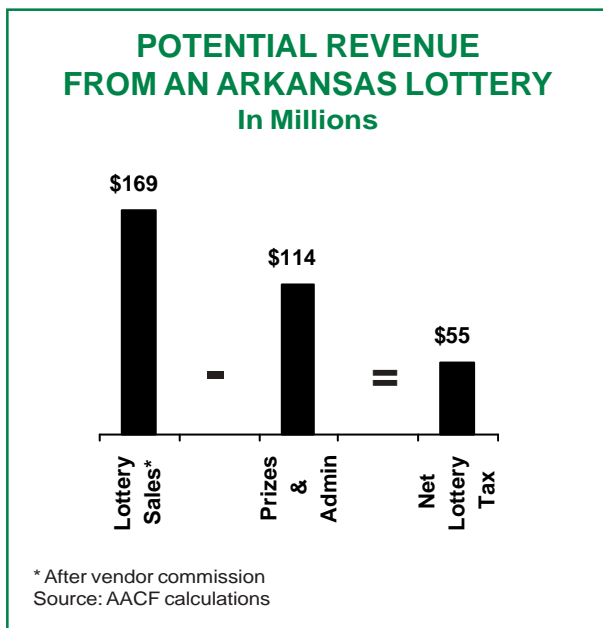
vendor commissions), leaving about 31 cents in available revenues for governments to spend on public services. However, in AACF's three-year sample of nine similar/ surrounding states, the median state lottery generated about 33 cents (32.67%) in available tax revenue for every dollar of lottery sales.

**At this rate, an Arkansas lottery would only generate about \$55.4 million in net lottery tax revenue that would be available to the state to fund services and programs, such as education.**

It is important to note these estimates are for a traditional lottery only, and do not include revenues generated video lottery terminals (VLTs). VLTs are machine-based lottery games similar to the video poker machines found in casinos. VLTs can significantly increase the revenues over those a traditional lottery would generate.

As of early 2001, only five lottery states allowed VLT play – Delaware, Oregon, Rhode Island, South Dakota, and West Virginia. In 2000, these states had net lottery revenues significantly higher than the average lottery state (U.S. median per capita lottery sales of \$127): Delaware, \$419;

Oregon, \$485; Rhode Island, \$709; South Dakota, \$161; and West Virginia, \$139. In fact, three of the five states – Rhode Island, Oregon, and Delaware –



**NET IMPACT OF A LOTTERY ON MAJOR ARKANSAS TAXES**

Lottery Tax Revenue	\$55,357,869
State and Local Sales Taxes	-\$ 9,366,000
State Personal Income Taxes	+\$ 1,448,347
<b>Net Tax Revenue</b>	<b>=\$ 47,440,216</b>

Source: AACF, November 2002

were the Top 5 states in net lottery revenues generated per capita.

While VLTs can significantly increase lottery revenues, most states have been reluctant to include these machines as part of their lotteries because of legitimate fears they might increase addicted gambling most often associated with heavy casino play.

**Money Spent on a Lottery Must Come From Elsewhere** *Impact on Sales Taxes.* If Arkansas adopted a traditional lottery, it would see \$169 million in lottery sales, with about \$55 million in net lottery tax revenues. It is important to note, however, that money spent on an Arkansas lottery would have to come from somewhere else, either from savings or purchases of other goods and services. Given the low rate of savings among Arkansas citizens (more than one in four Arkansas families have negative net worth), it's most likely money for lottery purchases would come from reduced purchases of other goods and services. This, in turn, would reduce state and local tax revenue generated from sales of other good and services.

According to a 2000 study by Arkansas Advocates for Children & Families, the average taxpayer spends about 5.7 percent of their income on state and local sales taxes. At this rate, the \$169 million in lottery sales would result in the loss of about \$9.6 million in state and local sales tax revenue.

*Impact on State Personal Income Taxes.* In contrast, the adoption of a lottery would increase tax revenue from the Arkansas personal income tax. AACF estimates about \$98.5



New Hampshire	193,013	126,148	6,448	60,417	41,125,735	0.47	159.19	0.15	48.89
New Jersey	1,738,485	972,799	52,739	712,947	312,867,642	0.56	206.61	0.23	84.73
New Mexico	110,616	62,378	23,414	24,824	39,942,882	0.28	60.81	0.06	13.65
New York	3,313,737	1,768,155	99,946	1,445,636	658,720,315	0.50	174.62	0.22	76.18
Ohio	2,155,789	1,274,979	95,456	785,354	317,818,321	0.68	189.88	0.25	69.18
Oregon	1,659,542	841,982	233,728	583,832	94,853,509	1.75	485.05	0.62	170.64
Pennsylvania	1,589,307	828,691	56,502	704,114	362,391,499	0.44	129.41	0.19	57.33
Rhode Island	743,972	590,679	6,506	146,787	30,575,607	2.43	709.68	0.48	140.02
South Dakota	121,701	13,133	7,979	100,589	19,611,489	0.62	161.23	0.51	133.26
Texas	2,657,290	1,508,850	270,886	877,554	581,311,795	0.46	127.44	0.15	42.09
Vermont	75,031	46,792	8,999	19,240	16,369,382	0.46	123.24	0.12	31.60
Virginia	981,271	637,614	117,109	226,548	221,077,766	0.44	138.63	0.10	32.01
Washington	452,809	289,608	62,353	100,848	184,517,693	0.25	76.82	0.05	17.11
West Virginia	252,983	94,935	21,599	136,449	39,282,577	0.64	139.90	0.35	75.46
Wisconsin	379,809	232,404	32,185	115,220	150,962,502	0.25	70.81	0.08	21.48
<b>State Average</b>						<b>0.55</b>	<b>163.95</b>	<b>0.20</b>	<b>58.81</b>

Source: U.S. Census Bureau

million of projected lottery sales of \$169 million would be returned to players in the form of prizes. Based on the experiences of other states, AACF further estimates about 21 percent of the prizes awarded would be higher-level prizes subject to state income taxes paid by Arkansas residents, resulting in new state income tax revenue of about \$1.4 million.<sup>2</sup>

In sum, AACF estimates an Arkansas lottery would yield about \$47.4 million in new net tax revenue for the Arkansas tax system after adjusting for decreases in sales taxes (\$9.6 million) and increases in state personal income taxes (\$1.4 million).

### Who Will Pay for the Lottery?

While playing the lottery is voluntary, it is still a voluntary tax paid by consumers for the privilege of taking a shot at winning a large lottery

cash jackpot. Who would pay the lottery tax? According to estimates from the Institute on Taxation and Economic Policy, out-of-state players would pay about 16 percent of an Arkansas lottery tax. In-state players would pay roughly 84 percent of the lottery tax.

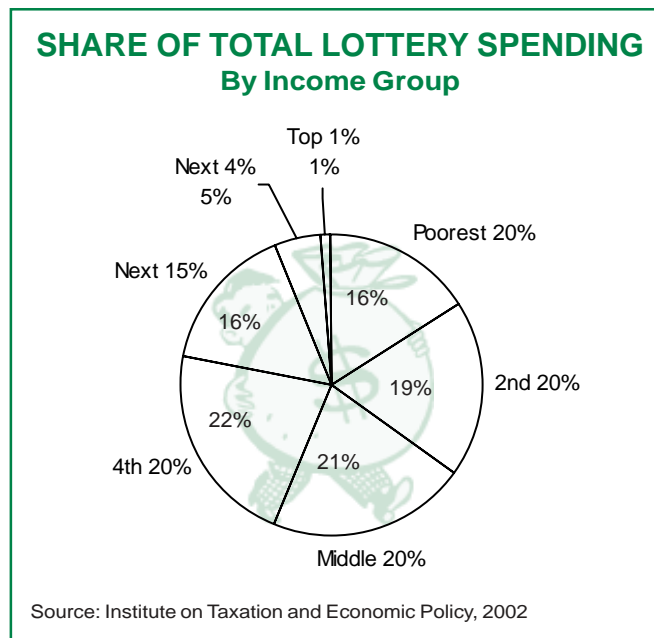
AACF analysis shows the state's poorest taxpayers (with incomes below \$12,000) would be those hardest hit if Arkansas established a lottery. As a percent of their income, their

taxes would increase by 1.37 percent, or \$98 per year.<sup>3</sup> In contrast, the top 1 percent of taxpayers, those making more than \$241,000 annually, would see their taxes increase by only 0.02 percent. *Implementing a lottery would make the state's already regressive tax system even more unfair!*

### Is the Lottery a Reliable Source of Funding?

One of the bedrock principles of state tax administration is the revenue generated by any given tax be reliable and predictable. While there may be extreme instances when the revenue from any tax may decline during a period of economic downturn (as occurred with many states during fiscal year 2000,) it is very unlikely the revenue generated from an established tax will see an actual decline during good economic times.

However, this is exactly what happened during a



IMPACT ON TAXPAYERS OF ESTABLISHING A LOTTERY							
INCOME GROUP	Lowest 20%	2nd 20%	Middle 20%	4th 20%	Next 15%	Next 4%	Top 1%
INCOME RANGE	<\$12,000	\$12,000-\$20,000	\$20,000-\$34,000	\$34,000-\$54,000	\$54,000-\$104,000	\$104,000-\$241,000	>\$241,000
AVERAGE INCOME	\$7,400	\$16,300	\$26,900	\$44,500	\$73,200	\$141,400	\$574,600
Tax Change as % of Income	1.37	0.75	0.51	0.32	0.19	0.11	0.02
Average Tax Change	\$98	\$116	\$128	\$133	\$130	\$152	\$121
Group's Share of Lottery Tax	16%	19%	21%	22%	16%	5%	1%

Source: AACF calculations from Institute on Taxation and Economic Policy data

four-year period from 1997-2000 when state economies were good. Even during good economic times, the lottery proved to be an unstable and unreliable source of tax revenue from year to year. From 1997 to 1998, 17 of 37 lottery states saw lottery revenues decline from the previous year; from 1999 to 2000, 15 states had a decline in lottery tax revenue; and from 1999 to 2000, lottery tax revenues declined in 19 of 37 states.

### Gambling by Children

Children can positively benefit from lotteries when revenues are used to fund children's programs, such as public education.

Lotteries, like other forms of gambling, can negatively impact children in other ways. Studies suggest that the costs of parental gambling are borne heavily by children:

- Children of problem gamblers have higher levels of tobacco, alcohol and illegal drug use, and overeating compared to their peers.
- Three-fourths of problem gamblers' children reported their first gambling experi-

ence before age 11, compared to 34 percent of their classmates.

- The children of compulsive gamblers are twice as likely to come from homes involv-

children. Although it is illegal to sell lottery tickets to children in every state, such sales occur with great frequency according to state studies. One survey found 27 percent of 15- to 18-year-olds in Minnesota

had purchased lottery tickets.<sup>5</sup> Even higher numbers were reported in Louisiana (32%), Texas (34%), and Connecticut (35%).<sup>6</sup>

According to the National Gambling Impact Study, some states (Massachusetts and Connecticut are two examples) sell lottery tickets through self-service vending machines, often without supervision as to who buys them.<sup>7</sup> In Illinois, one study found a 16-year-old girl was

successful in purchasing lottery tickets from 49 of 50 central Illinois lottery vendors.<sup>8</sup>

A study conducted by the Massachusetts Attorney General's Office found children as young as 9 were able to buy tickets 80 percent of the time and 66 percent were able to place bets on Keno games. Seventy-five percent of high school seniors in Massachusetts reported having played the lottery.<sup>9</sup>

A major criticism of lotteries has been the aggressive and

STATES WITH LOTTERY REVENUE DECREASES					
1997-98		1998-99		1999-2000	
Arizona	-2.1%	Colorado	-13.9%	Connecticut	-6.4%
Florida	-2.9%	Illinois	-2.3%	Idaho	-15.2%
Georgia	-2.1%	Kansas	-1.1%	Indiana	-20.6%
Illinois	-10.7%	Louisiana	-6.3%	Iowa	-2.6%
Iowa	-3.5%	Maine	-13.2%	Kansas	-2.6%
Maine	-3.8%	Maryland	-1.8%	Kentucky	-3.4%
Minnesota	-2.6%	Minnesota	-5.1%	Louisiana	-7.4%
Nebraska	-3.0%	Nebraska	-9.1%	Michigan	-1.1%
New Jersey	-3.6%	New Mexico	-2.1%	Minnesota	-3.3%
New Mexico	-11.2%	New York	-7.2%	Missouri	-1.6%
New York	-0.8%	Ohio	-7.2%	Montana	-8.6%
Ohio	-16.0%	Pennsylvania	-7.58%	Nebraska	-9.0%
Pennsylvania	-1.5%	Vermont	-13.5%	New Hampshire	-4.5%
Texas	-7.6%	Virginia	-5.3%	Ohio	-3.7%
Vermont	-14.1%	Washington	-1.5%	Texas	-23.1%
Virginia	-23.4%			Vermont	-1.8%
Wisconsin	-5.6%			Virginia	-11.9%
				Washington	-11.5%
				Wisconsin	-14.6%

Source: AACF calculations of U.S. Census Bureau data

ing separation, divorce, or the death of a parent before the age of 15.

- Compared to their classmates, children of problem gamblers rate themselves as more insecure, emotionally down and unhappy with life, and perform poorer at work and school. They are also acknowledged suicide risks at twice the rate of classmates.<sup>4</sup>

Studies also suggest lotteries encourage illegal gambling by

sophisticated advertising and marketing strategies some states have used to promote lottery sales. Because they are part of a government agency, state lotteries are not subject to federal truth-in-advertising laws. A common criticism has been that lottery advertising often intentionally misleads because it fails to report important information, such as the minuscule odds of actually winning a lottery jackpot. Another criticism has been the use of lottery advertising themes conflicting with a state's duty to promote the public good, such as hailing the value of luck over hard work as a means to financial success, or instant gratification and entertainment over investment and savings. Some states, such as Virginia, Minnesota, and Wisconsin, had to ban ads designed to induce people to play.

**W**hile some have hailed a lottery as one way to help relieve the state's budget woes and increase spending for education, the evidence sug-

gests it would fall far short of raising the money needed to adequately fund education. Moreover, the lottery is also an unstable source of tax revenue. Unlike other sources of tax revenue tending to increase from year to year, especially when economic times are good, lottery revenue yields are much more unpredictable. The adoption of a lottery would also make the tax system more regressive, as its cost would be borne disproportionately by low-income families. Finally, a lottery might encourage excessive gambling by not only parents, but by children, thereby increasing the likelihood of families to suffer from the negative social and economic consequences often accompanying problem gambling.

#### Notes:

- 1 Estimate of \$63,806,000,000 given by John Shelnut, UALR Institute of Economic Advancement, November 22, 2002.
- 2 After vendor commissions, we estimate that prizes would constitute about 58.3% of total lottery sales (or \$98.5 million). Of this amount, about 25 percent (or \$24.6 million) would be higher-level prizes requiring the filing of an income tax statement (smaller prizes are likely to be treated as casual income and not included on tax return). Of this amount, about 84% (\$21 million) would be won by Arkansas residents and thus subject to personal income taxes. We further assume that all of this income would be subject to the top state income tax rate of 7 percent (technically, 7 percent is the top marginal rate and is levied only income above \$25,000). This results in

state personal income tax revenue of about \$1.4 million. This methodology was suggested by Richard Sims, Institute on Taxation and Economic Policy.

- 3 The estimate is derived from a methodology using the following: % share of lottery spending by income group (estimates supplied by ITEP). Slottery spending by income group (% share of lottery spending by each income group \* total lottery sales), lottery spending by income as % of personal income (\$ lottery spending by income group divided by personal income earned by income group), and \$ tax change per taxpayer in each income group (lottery spending as a % of personal income \* average income per taxpayer in each income group).
- 4 National Coalition Against Legalized Gambling, "Social and Economic Consequences of Gambling," from <http://www.ncalg.org/pages/quotes.htm>.
- 5 Robyn Gearey, "The Numbers Game," *The New Republic*, May 19, 1997, p.19.
- 6 Joe Gyan, Jr., "More Louisiana Youths Try Gambling than Drugs," *Advocate* (Baton Rouge, La.), August 8, 1997; Lynn S. Wallisch, "Gambling in Texas: 1995 surveys of Adult and Adolescent Gambling Behavior," Texas Commission on Alcohol and Drug Abuse, August 1996, p.78; Lyn Bixby, "Lottery Pitch Seen as Luring Kids," *Hartford Courant*, October 23, 1997, p. A4.
- 7 National Gambling Impact Study Commission Final Report, June 18, 1999.
- 8 Thomas Radecki, "The Sales of Lottery Tickets to Minors in Illinois," *Journal of Gambling Studies*, vol 10, no 3, 1994.
- 9 Scott Harshbarger, Attorney General of the Commonwealth of Massachusetts, "Report on the Sale of Lottery Tickets to Minors in Massachusetts," July 1994, pp.3-4; Harshbarger, Attorney General of the Commonwealth of Massachusetts, "Kids and Keno are a Bad Bet: A Report on the Sale of Keno Tickets to Minors in Massachusetts," October 1996, p.1; Howard J. Shaffer, "The Emergence of Youthful Addiction: The Prevalence of Underage Lottery Use and the Impact of Gambling," Massachusetts on Compulsive Gambling, January 13, 1995, p.9.

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