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Lottery fever: Is it healthy?

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"LOTTERY FEVER: IS IT HEALTHY?"

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Introduction

Throughout the history of governments and their relations with the people, there has existed a necessary evil which is anything but popular. This evil is the principle of taxation. While it is widely accepted that the collective benefits that accompany a reasonable level of taxation are worth the individual pecuniary inconveniences, the prospect of raising taxes always aggravates the general public. Because politicians view more and more services as the route to increased public satisfaction, ideas for new programs and ventures arise each day in the states making it imperative that additional revenue sources be tapped or existing programs be cut. The former is the preferred method, but this task is much easier said than done as raising taxes is the worst nemesis of politicians.

Just when the sky seems to be caving in on all the poor, unfortunate politicians in the country, a new revenue generator emerges on the scene in the form of the state lottery. On the contrary, lotteries are not a new phenomenon in the the United States or anywhere else for that matter. They have been around for centuries, and where they abound a plethora of controversial issues surrounding the games of chance also exists.

Objective

While one usually thinks of a lottery in the context of numbers games (often illegal) or raffles in the private sector, the tendency for U.S. state governments to operate revene-generating lotteries is the norm today. Of the fifty United States, an unprecedented thirty-two boast lotteries today. The creativity of the states to capitalize on the public's desire to gamble demonstrates the clever resourcefulness of politicians in their quest to raise additional revenues without resorting to tax increases - a seemingly impossible task. The mere presence of a government-sponsored lottery would not appear to be an issue of controversy. On the other hand, many people are opposed to the lottery trend for various reasons. Others thoroughly enjoy playing the lottery and support the benefits it provides for the states. Hence, the advantages and disadvantages of state lotteries warrant examination as they currently impact the lives of people in at least 64% of the states in the United States.

History

Lotteries were originally used by the ancient Romans for festive entertainment. They were then passed on to feudal princes and later to merchants as profit-making devices. Realizing the revenue potential, governments jumped on the lottery bandwagon in sixteenth century Europe establishing monopoly power over the lotteries. America got its first taste of lotteries when the English colonial settlement at Jamestown was made possible in part by lottery proceeds.

As the Quakers were the only significant group that demonstrated opposition to government-supported lotteries in colonial America, lotteries flourished during this period. Funds were raised for public works, city and county expenses, schools, administrative expenses, industry, and relief for the poor in a time when state tax structures had yet to be developed. Lotteries were used to finance the Continental Army, Dartmouth, Harvard, Princeton, and other worthy institutions (Will, p.78). Interestingly, churches endorsed the system because they were often the main recipients of the funds (Weinstein, p.9).

As the lottery fervor burgeoned, corruption and dishonesty became apparent in the process. The early 1800s were marked by scandals of embezzlement and numbers fixing so that eventually lotteries were prohibited in most states. David Weinstein cites several factors which contributed to the decline of lotteries in the 18th and 19th centuries in the United States (Weinstein, p.12). First of all, private financial mechanisms developed enough during this period to sufficiently supply the resources necessary for new causes and projects. Hence, lotteries were no longer needed for this purpose. Secondly, lotteries underwent changes from local projects with specific objectives to vast arrangements motivated by sheer profit interests. Finally, corruption and mismanagement soured the public on the once popular revenue-generators. These factors are relevant to the fate of the lotteries operating today. One would assume that public discontent with the lotteries caused by the aforementioned factors and/or numerous others would mean the demise of the recent boom in state lottery adoption and operation.

While state lotteries became virtually extinct in the late 1800s and all of the first half of the twentieth century, they re-emerged on the scene in 1963 when traditionally conservative New Hampshire implemented the first lottery of the century. Their decision was based on their opposition to tax increases despite pleas from some that corruption would accompany a lottery. New York, New Jersey, Connecticut, Pennsylvania, and a host of others were soon to follow New Hampshire in reviving the lottery tradition. Thirty-two states now operate lotteries.

Opposition to Taxation

The last decade, the 1980s, was characterized by decreased tax revenues, decreased federal assistance, and a renewed desire to get rich quick by the public. This environment was quite conducive to lottery introduction as lottery revenues, when compared to taxes, are "relatively painless" to obtain in the words of the vast number of politicians who back state lotteries. According to A.W. Oppenheimer, the executive director of special revenue in Connecticut, "People seem less annoyed at losing their hard-earned money on the lottery than paying it in the form of taxes" (Dentzer, p.68). This comment would appear to lack insight when one considers the facts that taxes are involuntary and lottery participation is strictly voluntary. However, the fact that people are indeed less annoyed at losing their money in lotteries than through taxation is actually a reflection of the failure of the public to fully comprehend the principle of taxation by popular consent.

As mentionened earlier, most people agree that a reasonable level of taxation is beneficial. Nonetheless, politicians are very reluctant to impose new taxes in fear of public reprisal. This is because many people are unable to see the link between the economic pain of paying for the benefits and the benefits themselves, i.e. roads, schools, defense, services, etc. These people often view the decision to tax as an arbitrary political privilege. Therefore, it is no wonder that politicians are afraid to impose certain taxes.

Political Cowardice

Instead of confronting their fear to tax by implementing state lotteries, politicians at the state level are able to raise revenues without damaging their popularity. In doing so, they are actually deceiving the public to some extent. The public does not view lottery participation as a form of taxation although the state retains much of the [Boceeds. Therefore, the public is misallocating some of its resources.While taxpayers think that state governments are operating on a monetary level based soley on known taxes, all the revenue that is being retained by the stae adds to the accepted level of taxation causing the misallocation.

Lottery as a Tax

Thomas Jefferson called the lottery "a wonderful thing; it lays taxation only on the willing" (Beck, p.16). While the proceeds of taxation and the proceeds of lotteries both go into state coffers, the semantic problem of the association of lottery revenue as a form of taxation is a major cause of the controversy surrounding lotteries. The difficulty lies in the claims of those who view the purchase of a lottery ticket as an implicit tax. These same individuals also claim that because lower income groups compose a high percentage of the total ticket-purchasing population, the implicit tax is regressive and, thus, undesirable. On the other hand, lottery advocates deny that a ticket purchase is a tax of any sort.

By definition, a tax is "a compulsory payment to support governmental activity." The purchase of a lottery ticket is not compulsory by any means. Therefore, it would appear that opponents of lotteries have no valid argument based on the lottery as a regressive, implicit tax because, technically, it is not even a tax. However, considering the fact that lotteries are state-owned enterprises which operate for profit, the proceeds from this activity are the same as taxes collected by the state.

Regressivity

Whether or not lottery participation is a form of taxation is a crucial issue, but the real cause of concern is based on the statistics on the demographics of ticket purchasers. While lottery play is indeed voluntary, the implications of lottery participation may indicate that the financial burdens are unproportionately the burden of lower income groups. Although, this effect is not the result of a tax per se, it is the result of the lottery and, hence, it warrants investigation.

Various studies have been conducted to determine if lotteries have a regressive effect. The Field Institute's California Poll found that heavy players, those who buy at least twenty tickets every forty-five days, are more likely to be minorities, poor, and less educated, while non-players are overwhelmingly white, have higher incomes, and have more education Schreiner p.52). Another study by Roger Brinner and Charles Clotfelter conducted in Massachusetts, Connecticut, and Pennsylvania indicates that expenditures on lottery tickets increase by only 50-66% with respective 100% increases in income levels (Briner & Clotfelter, p. 399) This clearly is a regressive outcome.

The findings of Brinner and Clotfelter are disputed in claims by William McConkey and William Warren. Their more recent data indicates that in a five to ten year period in five different states, there is not a single case in which the lowest income groups participated in lotteries at a rate equal to or above their percentage in the population (McConkey & Warren, p.315). Their findings also indicate that the middle income segment of the population contains that major patrons of the lotteries (p.315). Furthermore, the average players tend to be married, possess some college or technical school training, and have average incomes of $28,900 in 1986 terms (p.315). Numerous other recent studies support the claim that the middle class supplies the majority of the lottery players.

What is one to make of the contradictory conclusions drawn by the different studies? Realistically, the only assumption that can be made with a high degree of confidence is that because the demographics vary from region to region, there is no uniform pattern for the type of individual that participates in a state lottery. A study with a wider scope is necessary if generalizations are to be made regarding the demographics and, more importantly, the contingent regressivity of lotteries. The results of such a study would likely indicate that regressivity may not be characteristic of every state's lottery, but, on the other hand, the presence of regressivity is determined by the type of ticket buyer unique to each state.

The contention that lotteries are regressive is best disputed by those who argue that lottery tickets are consumer goods, and, consequently, regressivity is not a factor when lottery tickets are considered mere goods instead of implicit taxes. One must not forget that lotteries are entirely voluntary.

Consumer Surplus

As a consumer good, a lottery ticket exists as a store of risk capital. It is, no matter how slim the odds, a potential opportunity to win big stakes. It also represents a chance for the consumer to fantasize "what could be" in the midst of an otherwise uneventful life. Not only are lottery tickets goods, but, according to certain individuals who are proficient in normative analysis, there are positive individual welfare aspects that are by-products of state lotteries.

The logic of the normative analysis follows. Because the rational individual views a lottery ticket as a pleasurable good from which an amount of utility is derived in light of a possible winning ticket, each individual has a unique demand curve that corresponds with the number of tickets purchased and the price of the ticket. Charles Clotfelter and Philip Cook, experts in the field, point out that the price in this framework is actually "the cost of buying a probability distribution of prizes that has an expected value of one dollar" (Clotfelter & Cook, p.535) The individual's demand curve is downsloping as the marginal utility of additional tickets decreases with the purchase of each additional ticket.

The positive welfare aspects are apparent because the price the state sets for a lottery ticket is lower than most consumers would be willing to pay for the same product along a portion of the individual's demand curve. This means that up to a certain level of quantity demanded by the consumer, there is additional utility that is created from the sale of lottery tickets by the state that accrues to the consumer with each purchase. This consumer surplus would not exist if the state did not sponsor lotteries as the lottery ticket as a good would not exist. Hence, the operators of state lotteries can be credited with providing consumers with a surplus of value, and surplus value is considered quite a benefit from the consumer's perspective. This line of thinking shows lotteries to be welfare-enhancing.

Of course the consumer surplus argument is not without its critics. As the consumer surplus defense is based on the rational individual's downward-sloping demand curve and existence of a pre-determined price that is lower than several prospective prices that the consumer would be willing to pay for the same good, the critics attack the existence of the traditional demand curve. Clotfelter and Cook employ the caveat frequently used in welfare economics of the case of "children and madmen" to emphasize their point (p.536). Their contention is that the demand curve in some supposed consumer surplus analysis situations is actually irrelevant because it is based on misinformation and irrationality (similar to that of a child or madman). In other words, the people who purchase lottery tickets are misled by the poor odds of winning, they are irrational, and they are not able to judge what is best for themselves. While some may believe that this notion succeeds in discounting the significance of the consumer surplus argument, by criticizing the ability of individuals to judge what is best for themselves, they actualy contradict what is fundamental in economic analysis. If the individual cannot be trusted to make prudent economic decisions, what can be said of economic theory? Clotfelter and Cook put forth a shallow argument in this respect.

Revenue Potential

While the issue of who bears the losses from nonwinning lottery tickets is pertinent, the other side of the coin must not be ignored. Aside from the paltry few who do strike it rich, there are a great many people who benefit from the state's revenue that is generated. The state's profits from the lotteries are used to advance worthy causes or at least are designed to further such ends. On the surface, it would appear that the revenue potential of lotteries would compensate for the contingency of regressive ticket purchasing. However, this is not the case.

Michigan State University economist Ronald Fisher says, "Claims that the lottery is a fiscal panacea are simply wrong," as they contribute "just pennies" to a state's budget (Shapiro, p.21). The United States Census [Breau determined in a 1986 study that the average revenue from lottery ticket sales amounts to only 1.9 cents of every dollar of state revenue while sales taxes account for 29%, federal aid 24%, income taxes 22%, and user fees 8% (p.21). In Pennsylvania and Maryland, where lottery receipts are the highest as a percentage of total revenue of all the states, ticket sales are a mere 4% of total revenue (Clotfelter & Cook, p.535). The data clearly indicates that traditional taxes are still a more effective way to raise large amounts of revenue. Nonetheless, it is not shrewd to discount the importance of millions of dollars simply because the amounts are not as substantial as tax dollars.

Traditional taxes cost a penny or two to collect per dollar generated while lotteries can absorb up to 75% of each dollar collected (Flaherty, p.33). Lottery costs, as opposed to simple tax administration expenses, entail a variety of different aspects. There are commissions to retailers, ticket production expenses, consulting services from private firms, advertising, computer expenses, salaries, and numerous other expenses from promotion to public relations. The prizes attribute on the average from 40-50% of the total ticket sales. When coupled with the expenses, less than half of the original revenue is left for the states' discretion. Despite the high costs of lottery administration, the proceeds are quite significant totalling in the millions of dollars annually. Furthermore, many of the expenses prove to be boosts for those who are employed by the lotteries or those who conduct business with the state lotteries.

Impact of the Revenue

In about half of the states that have lotteries, the proceeds go into the general funds. The other states earmark the revenue for specific purposes. The states that designate special purposes for the money are often required to do so by law. New York, for example, is required to direct 45% of lottery revenue for education. This format is not always beneficial to the targeted program because fund increases are not always funnelled toward that specific program. In such cases the state merely cuts back on other funds scheduled for the program. Thus, the supposed emphasis on the program the lottery supports is a facade for the state to merely provide lip service to the program while diverting money to other sources.

In Iowa, the focus of the lottery's profits is on economic development. Since its inception in 1985 when Iowa's economy was in a sad state of affairs, the Iowa lottery has created over 35,000 jobs and raised nearly $150 million in benefits for the state according to the Iowa Lottery's 1989 Annual Report. While these lottery revenues over approximately four and a half years are not substantial in relationship to total tax revenues generated during the same period, $150 million is hardly anything to scoff at. The money is distributed under the guidelines of the Iowa Plan which is a process in which the legislature directs the funds to different state agencies. The state agencies do the actual administering of the programs and review the applications for the competitive funding programs.

The Department of Economic Development receives most of the attention for distributing lottery profits. Their primary job is issuing grants and loans to businesses to expand or to get off the ground. The Community Economic Betterment Account is the title of the fund that is targeted for economic development, and its funds are allocated on a competitive basis to large and small firms alike.

The economy in Iowa also receives a boost from lottery proceeds in other, more indirect ways. For example, all three major public universities as well as numerous community colleges have received funds to establish business training programs and improve the quality level of the educators themselves.

The Iowa Department of Natural Resources uses funds to develop new facilities and upgrade existing ones. Historical museums, community centers, and cultural activities are also financially supported through lottery proceeds. Iowa state agencies are also seeking to promote bio-technology, immunology, laser science, and other innovative fields. All of these undertakings are beneficial to the state's economic health. Finally, other recipients of the Iowa Plan funded programs include the Departments of General Services, Natural Resources, Public Defense, Research Development Awards, Iowa Conservation Corps, Incubator Grants, Iowa Product Development Corporation, Labor Management, Main Street Iowa, Satellite Center, and the Iowa Welcome Center.

Gambling Fever/Consequences

The clarity of the whole lottery controversy is very murky in light of the potential political misguidance of state lotteries, the disputes about the possible regressivity in lotteries, the relatively high costs of administration, the promise of a consumer surplus, the relatively low percentage of total state revenues that lottery profits compose, and the apparent excellent benefits that states receive as a result of lotteries. The issue is further confounded by the debate over state support of gambling.

A 1989 study indicated that Americans wager more than $240 billion annually, a figure that is growing about 10% each year (Welles, p.112). Americans bet twice as much as they spend on education, fifteen times what they donate to churches, and half of what they spend on food (Colson, p. 64). Many experts charge that computers have made possible the instantaneous distribution of odds on any race or game in the country meaning that the potential for gambling to become an addiction is much greater than ever before (Church, p.20). While gambling fever has been on the rise as of late, it is certainly not a new phenomenon. The Old Testament tells of the wager Samson. The ancient Romans even had rules governing their games of chance. Cards and dice used for betting have been commonplace all over the world for centuries. In keeping up with their tradition, the participation of Catholic parishoners in Bingo is second only to their participation in mass (Marty, p.847).

Why is the prospect of state-supported gambling disturbing to some people if gambling has been around forever? Like discussions about sex and alcohol, discussions of gambling arouse the emotions of the people who view gambling as a social evil. Whether gambling is a social evil or not remains to be seen. Before that can be determined, an investigation into some inherent aspects of gambling must take place.

Why do people gamble? Simply, most people risk money in order to accumulate more money. Not only does gambling provide people with an opportunity to win money, but it also provides an arena for excitement. Gambling is an entertainment medium. The pleasurable experience of making a wager allows the individual to escape from reality for a brief instant in a "protest against economic rationality and budgeting of funds" (Lester, p.92). For the lower and middle classes, gambling allows them to display independence and power in decision making. The upper classes are able to engage in Thorsten Veblen's theory of "conspicuous consumption" for purposes of ostentatious behavior through gambling activities.

The urge to gamble could also be viewed as a human flaw. Avoiding reality-even for a brief instant-may be a demonstration of irresponsible behavior. Our society is characterized by Puritan remnants that are very suspicous of fantasizing for entertainment's sake. Furthermore, the work ethic of our Yankee forefathers is based on thrift and industrious attitudes. The proverb that "there is no such thing as a free lunch" would indicate that participation in gambling activites is not only frivolous, but is also irrational. The association of gambling with drunkenness, tobacco, and other toxic forms of behavior also leads one to question the morality of gambling.

In addition to the question of the morality of gambling, there are occasional adverse consequences of gambling. Problem gamblers are known to lose interest in their family and friends, severe their ties with religious and community groups, become prone to divorce or marital difficulty, and often become involved with loan sharks and organized crime. The characteristics of the **problem gambler** all sound very disturbing. Indeed, they are disturbing, but they are characteristics of an extremely small segment of the population. Virtually every study conducted on problem gambling indicates that these consequences are only probable if the bettor devotes the majority of his/her time to gambling. The demographics of lottery players clearly show that these types of people do not devote very much time or money at all to lottery games. The purchase of lottery tickets usually amounts to a couple of dollars at the grocery counter.

Lotteries as Unique

The important point is that lottery players are not the same types of players that are prone to gamble excessively. Hence, the consequences and characteristics of compulsive gamblers do not apply to the average lottery participant. Opponents of lotteries argue that the government should not promote gambling of any type. Even if the lotteries do raise revenues for the state, operation of a lottery openly encourages the public to believe in luck, chance, fate, and the apparent unimportance of virtues claim the critics. Under ordinary circumstances, the critics may be right. However, the lottery scenario in 1990 is unique.

The lottery does not have the image it carried with it when states in the nineteenth century chose to abolish them. The private groups that once operated them for profit have been supplanted by state governmental authorities which return the revenue to the states. The corrupt element and signs of mismanagement that plagued earlier lotteries are no longer the case in today's state lotteries. Illegal bookies have been replaced by competent administrators. Lotteries are now legitimate, and, more importantly, **two-thirds** of the public solidly backs them (Flaherty, p.31).

Despite the facts that the odds of winning some forms of the lottery are as bad as 1 in 3 million to 1 in 12.9 million (Church, p.19) and the present value of the prizes is significantly less than advertised because winnings are paid out over twenty year intervals, the lottery proves to be pleasurable to the ticket buyer. Says Ed Stanek, Commissioner of the Iowa Lottery, consumers "...can spend $1 and then spend the rest of the week dreaming what they would do if they actually won" (Church, p.19). It is not the state's place to portray a big brother image and tell the public what to buy and what not to buy. If a program is backed by popular demand, why not give the public what they want?

Appraisal of State Lotteries

There are a variety of issues to consider in the appraisal of the recent lottery craze. When considered in sum, it appears that the disadvantages of lotteries are not significant enough to warrant the disbanding of operating lotteries and the prevention of new lotteries as the advantages are too great.

The public is not being exploited by the state governments. According to Dr. S. Blotnick, a noted psychologist and author, "...people know they will lose [most probably]" (Blotnick, p.18). They buy the tickets for entertainment. The average person spends a couple dollars a week on a slim chance of winning without having to deal with a stockbroker, filling out forms, or overcoming any entrance barriers. State lotteries harm virtually no one and actually are a boost for the state governments.

The regressivity argument has several flaws. First of all, the purchase of a lottery ticket is technically not a tax as it is not a compulsory act. Secondly, the more recent data indicates that the average player is not in a low income group. The majority of the players are in the middle income bracket. Finally, lottery play affords people with opportunities to be entertained cheaply.

The two-thirds of the population who enthusiastically support the idea of state lotteries receive a surplus of value from their ticket purchases. The criticism that this surplus is not real would only hold up if it was believed that this segment of the population (67%) operated irrationally. It is hardly likely that such a high number of American people is not competent enough to make intelligent economic decisions.

Granted, lottery receipts pale in comparison to total tax revenue. Traditional taxes are also easier to collect because they avoid the commissions, ticket production fees, consulting fees, advertising expenses, and other fees. However, it is not fair to compare tax revenue with lottery revenue. Simply put, lottery ticket purchases are not taxes. Moreover, lottery revenues attribute millions of dollars to the states each year. The fact that tax revenues are far greater is irrelevant.

It can be argued that the state is behaving in a less than admirable fashion by promoting lotteries through their deceptive tactics. Because of this problem and because the public does not realize that the state is actually misallocating resources, the state should attempt to demonstrate to the public this apparent problem. The state governments should also refrain from misleading advertising practices. Finally, an honest attempt to inform the public of the poor odds of winning and the inferior payout rate in relationship to other forms of legal gambling should be made.

The effectiveness of programs lottery revenues support is a topic beyond the scope of this paper. However, it is not hard to see that the various grants, loans, educational funds, state agency funding, research awards, and cultural sponsorships are bound to have a positive net impact on the participating states.

State support of gambling will probably always be an issue of controversy. The fact remains that people always have gambled, and they always will. Compulsive gambling is indeed a problem in America as evidenced by the increased level of reported gambling scandals. State lotteries, however, are not another medium that breeds compulsive gamblers. Lottery players do not devote the amount of time to gambling that is typical of the problem gambler. Hence, lottery play is basically a harmless pastime which raises money for the state.

The problems that plagued lotteries in years prior in the United States are not apparent today. The state governments run the lotteries under tight controls keeping the corrupt element out of the picture. Big jackpots entice the public to play the exciting games. Furthermore, the people realize that this honest game is a painless way to raise revenue for the government.

The outlook for state lotteries appears to be bright. Those states who now operate lotteries are finding new, creative ways to promote their games, and the states that do not have lotteries are seeing the benefits their neighbors are receiving while they miss out on the financial dividends. The current seven-state Lotto America has emerged offering bigger jackpots and more fun. This collectivization of lottery efforts has led some people to believe that a national lottery is inevitable.

Like politicians at the state level, those at the national level are quite averse to raising taxes. Hence, a prospective national lottery may soon be a reality. In light of the federal budget problems, a national lottery appears even more probable as a tool to attack the large budget deficits that have become the norm.

Whether or not a national lottery does come about, state lotteries will likely continue to flourish. People are becoming more and more comfortable with them, and state governments are growing very fond of the additional revenue generated as a result of the lotteries. Harnessing the public's desire to gamble and channeling it into state revenue projects is proving to be a standard in state government. The scenario can be summed up best by a word of advice to the prospective lottery ticket purchaser: If you play, you won't win, but the state will.

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