

It's Elementary

A Monthly Column by EFAP Director John Yinger
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Don't Gamble with New York's Lottery

Governor Spitzer's executive budget proposed leasing New York State's lottery to a private company. This is a terrible idea.

Under the current lottery set up, the State of New York receives a stream of revenue from the implicit tax it imposes on lottery ticket sales. The implicit tax rate, which is defined as government revenue divided by the sum of ticket sales and administrative costs, was 147 percent in 2007. This is not a typo; in New York, as in all other states with a lottery, the implicit lottery tax rate is many times larger than the state's sales tax rate.

Under Governor Spitzer's proposal, New York State would give up the rights to the stream of revenue from ticket sales in exchange for a large upfront payment. This payment would be invested in a fund, and the investments would yield a stream of revenue. Four billion dollars of the fund would be used as an endowment for the State's higher education system, and the associated revenue would be used to improve the quality of this system. The proposal assumes that the remaining revenue stream would be sufficient to provide the \$2.1 billion annual revenue the state currently receives from the lottery, with a provision for annual growth.

In short, this proposal exchanges one stream of revenue for another stream of revenue with a different label.

Proponents of this proposal argue that the current stream of revenue from lottery sales is risky and the new stream will not be, thereby stabilizing the state budget. This makes no sense. If the lottery sales stream is risky then a private company will pay less for it upfront and the corresponding low-risk stream

from the endowment will be lower. Adjusting for risk, the value of the two streams will be equal. The state could account for fluctuating lottery revenues just as well by setting up a rainy day fund.

Proponents also argue that turning the lottery over to a private company will raise the value of the fund because a private company would do a better job maximizing lottery revenue. In fact, however, the most effective way to maximize lottery revenue is through misleading advertising and specializing in lottery games that target desperate people who are most likely to turn to gambling. The high implicit tax rate and the current advertising for New York State's lottery already stretch the boundaries of ethical behavior. (Try finding a clear explanation for the odds of winning amidst all the marketing on the New York State lottery website!) Turning the lottery over to a profit-making institution would, without an unprecedented regulatory effort by the State, result in new games and new advertising campaigns that would increase the private company's profits through misdirection and exploitation. This is not an appropriate source of new revenue for the State.

Lotteries have many social costs, including cost associated with gambling addiction, lost sales tax revenue, and devaluation of the work ethic. At some point in the future, the voters in New York State might decide that these costs are so severe that lotteries should be de-emphasized in the State's revenue system. This type of adjustment would not be possible if the State were bound by a long-term lease to a private company.

Lotteries provide a form of entertainment that is valued by many people in New York State. The best approach to lotteries is to keep them in the public sector, to monitor and address the social costs they impose, to make sure that lottery advertising provides accurate and accessible information about the odds of winning, and to avoid games and advertising campaigns that exploit the State's most vulnerable citizens.