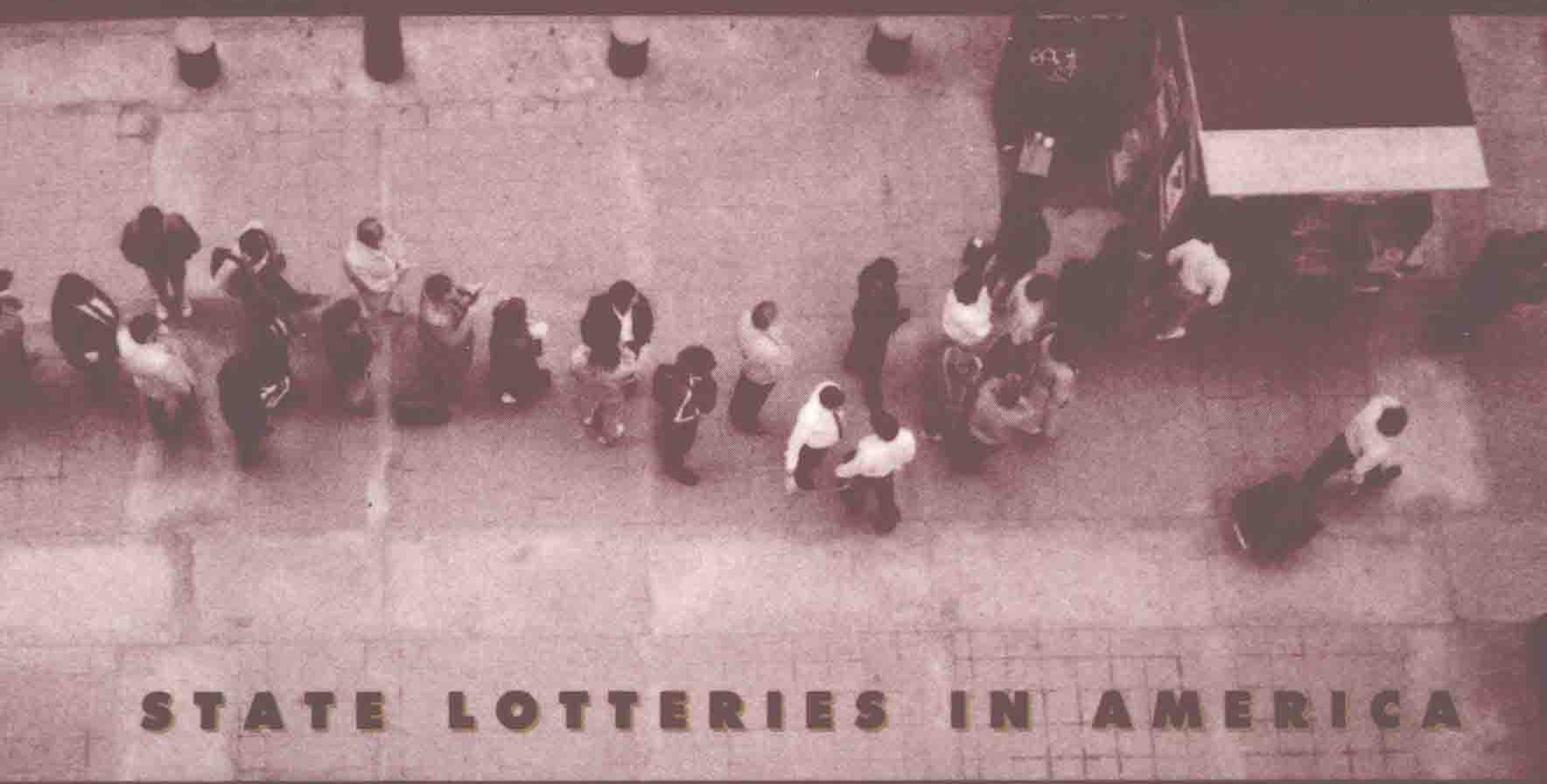
SELLING

1 2 3 4 5 6 7 8 9 10 11 12

HOPE



STATE LOTTERIES IN AMERICA

CHARLES T. CLOTFELTER

AND PHILIP J. COOK

Selling Hope

State Lotteries in America

Charles T. Clotfelter
and Philip J. Cook

Harvard University Press
Cambridge, Massachusetts
London, England

For Lucile
C.T.C.

For my parents
P.J.C.

Printed in the United States of America
10 9 8 7 6 5 4 3 2

First Harvard University Press paperback edition, 1991

Library of Congress Cataloging-in-Publication Data

Clotfelter, Charles T.
Selling hope : state lotteries in America / Charles T. Clotfelter and Philip J. Cook.
p. cm.
Bibliography: p.
Includes index.
ISBN 0–674–80097–4 (alk. paper) (cloth)
ISBN 0–674–80098–2 (paper)
1. Lotteries—United States—States. 2. Lotteries—Government policy—United States—States. I. Cook, Philip J., 1946–
II. Title.
HG6126.C55 1989 89–32398
336.1′7′0973—dc20 CIP

Selling Hope

A National Bureau of Economics Research Book

Preface to the 1991 edition

The lottery industry in the United States grew tenfold during the 1980s. As a result of this extraordinary growth, the lottery has emerged as the largest form of commercial gambling, generating greater revenues (over $10 billion per year) than all casino operations combined, and much greater revenues than parimutuel betting or bingo. Twenty years ago lotteries were an interesting but rather minor curiosity in public finance and household expenditure patterns. Today they have become a ubiquitous and prominent activity of state governments, and figure importantly in the budgets of an increasing number of households.

Lotteries are important in public finance because they are the fastest-growing source of state revenue and because they engender controversy about the proper role of government. It was the perceived need for a new source of revenue that pushed the New Hampshire legislature to create the first legal lottery of the twentieth century in 1964. Thereafter the quest for new revenues helped sell the lottery to one state after another during the 1970s and 1980s, to the point that now two-thirds of the states are in this business. And business it is, much more so than any other major endeavor of state governments. Lottery directors understand their mission to be that of making as much money as possible for the state treasury. As a consequence, they have been open to a variety of innovations that may increase profits, including new games, improvements in the statewide networks for taking bets, and more appealing and sophisticated advertising campaigns. Such marketing efforts have enhanced sales, but in other respects they may be problematic. Critics assert that it is inappropriate for the government to encourage people to gamble, and that lottery expenditures impose a disproportionate burden on less affluent and less educated families. Still, a strong majority of the public supports the lottery, in part because it does satisfy some of the revenue needs of the state.

Lotteries are not just a source of revenue, but also a source of entertainment to the millions who play. They are important, then, when viewed as a new commodity occupying an increasingly prominent place in household budgets. Some 60 percent of the adult public living in lottery states play, though most of these players are only spending a few dollars now and again. However, most lottery sales go to regular participants who spend over $20 per week. Part of the appeal may stem from marketing devices intended to create an exaggerated impression of the chance of winning. But with or without this encouragement, most people are tempted by a chance to win a lot of money, even when the odds are very long. Further, the lottery has become part of popular culture, with its folklore of betting systems and tales of multimillion dollar winners. The lottery thus offers a pleasant diversion akin to professional sports and soap operas, although for some it represents a more serious activity.

The purpose of this book is to document the lottery phenomenon and analyze it as a consumer commodity, a business, and a source of government revenue. In accordance with the National Bureau of Economic Research guidelines for its studies, the book does not offer policy recommendations, although it does present a good deal of evidence for evaluating policy issues. And certainly there are a number of issues to be considered during the 1990s. Most important, perhaps, is the introduction of new games that represent a turn to a "harder" form of gambling. There are various possibilities under consideration, including sports betting (pioneered by the Oregon lottery) and player-operated video slot machines (first introduced in South Dakota). Another possibility is a telephone betting system that would allow people to place bets from their homes while watching a lottery game show. Also important for public consideration is the perennial question of what limits should be placed on advertising and promotion of lottery games. Legislatures in a few states have imposed restrictions on their ads without any obvious harm to their sales trajectories, but most states' advertising is restrained only by the prevailing standards of commercial advertising. Finally, there are difficult questions to be answered about the future of multistate lotteries and interstate competition among lotteries. The limits on interstate commerce in lottery tickets will ultimately be decided by Congress, which also will no doubt revisit the possibility of launching a national lottery. These are among the issues challenging those who are concerned with the growth and evolution of lotteries, and they are relevant both in existing lottery states and in states still debating the question of adoption. We intend our book to serve as a guide in considering these issues.

In contrast to many studies sponsored by the National Bureau of Economic Research, this presentation has been tailored for a readership broader than those conversant with the statistical and mathematical models common in economic scholarship. Econometric analysis, for example, is relegated to notes and appendixes. In this effort to broaden readership we have benefited from the advice and encouragement of the NBER.

The project was begun in 1986 as an equal collaboration. Before long it became clear that Philip Cook's administrative responsibilities as director of Duke University's Institute of Policy Sciences and Public Affairs would make it necessary to revise the basis of our collaboration. As a result, Charles Clotfelter took responsibility for Chapters 1–4 and 9–10, while the two of us wrote the rest together. The framing of the book is decidedly a joint effort, as are its major arguments.

Financial support provided by Duke University, the Ford Foundation, and the National Bureau of Economic Research made our project possible. One of the indispensable items this aid generated was the research assistance of a number of graduate and undergraduate students at Duke. We are grateful for the diligent help of all these students: Graham Barr, Allan Brunner, Susan Coppedge, Jon Danielsson, Sheri Gravett, Eva Herbst, Will McKinnon, Harriet Morgan, Ying Qian, Ross Ullmer, Meg Wimmer, and Angela Woo. We also thank Sonja Turner, Martha Wall, and Bernice Wheeler for assistance with manuscript preparation, Amanda Heller for many helpful editorial suggestions, Dek Terrell for his commendable work with computer programming and figures, and Marshall Adesman for his invaluable contributions as librarian, research assistant, and manuscript preparer. The Duke University Library helped us with dozens of inquiries and searches; we are especially indebted to Stuart Basefsky and the staff in the public documents, reference, and interlibrary loan departments.

We were also aided by numerous state lottery officials and others in state governments. While a few lottery agencies refused our requests for specific data, for the most part lottery personnel cheerfully cooperated with our many inquiries. They provided annual reports, examples of advertisements, unpublished tabulations, and answers to our survey questions. We also obtained data from the Arizona State University Survey Research Laboratory, Broadcast Advertisers Reports, the Gallup Organization, the *Los Angeles Times,* and the University of California Survey Research Center.

From the beginning we received useful suggestions from dozens of colleagues, too numerous to name. In particular, comments from seminar participants at the NBER, McMaster University, Yale, Rochester, Harvard, and Duke were very helpful, as were detailed remarks from Michael Aronson, Robert Bates, Douglas Bernheim, Richard Bostic, Larry Braidfoot, Roger Brinner, Eugene Christiansen, James Clotfelter, Larry DeBoer, Robert Entman, Edward Gramlich, Joel Huber, Robert Inman, H. Roy Kaplan, Mark Kleiman, Helen Ladd, Terri LaFleur, Theodore Marmor, John McCann, Daniel Nagin, Dick Netzer, Jonathan Skinner, Frederick Stocker, Kip Viscusi, Burton Weisbrod, and Franklin Zimring.

C.T.C.

P.J.C.

January 1991

National Bureau of Economic Research

(See page 324 for a statement about the relation of the Directors to the work and publications of the National Bureau of Economic Research.)

Contents

PART I

The Setting

1.

A New Role for the States

Hope springs eternal in the human breast.

—Alexander Pope, *An Essay on Man*

In the waning days of summer 1984, lines of people stretched outside delicatessens and liquor stores in Chicago, Springfield, and East St. Louis. These people were all waiting to buy a product, one that had become page-one reading and the subject of countless everyday conversations. Sales of this product throughout the state of Illinois reached $8 million a day, representing a rate of roughly thirteen thousand units purchased every minute. The product? A lottery game called lotto, featuring a top prize that had grown to $40 million. This product was remarkable for two reasons. First, it had created a fever pitch of excitement with few parallels in consumer behavior. And second, its manufacturer was not a commercial firm but rather the state of Illinois.

For the first six decades of the twentieth century lotteries were banned in every American state. Yet today three-fourths of the U.S. population lives in states where lotteries are not only legal but provided by state government itself. One after the other states have embraced this form of public finance, adhering for the most part to a single model for the lottery's operation and financing. In each state the government has ended its former prohibition of lotteries, made itself the sole provider, and used the profits from the operation as a new source of revenue. In doing so the states have entered unfamiliar terrain. They have gone into business selling a popular consumer product, and they have carried on with Madison Avenue gusto and an unfettered dedication to the bottom line. The complete about-face from prohibition to promotion in one state after another is remarkable, to say the least.

The purpose of this book is to examine state lotteries and the states' role in them. Lotteries are a historical curiosity, a cultural phenomenon, a rapidly evolving new industry, and a consumer craze, and in this book we pay attention to all of these issues. But there are also more serious points to be considered, including the propriety of this new source of public revenue and the long-term social and economic consequences of the state's giving official encouragement to gambling.

To illustrate the rapid evolution and growth of the lottery as well as the policy issues that have arisen along the way, we begin with an account of one state's experience. For this purpose we have chosen Illinois, one of the first states to climb onto the bandwagon. The state's experience with the lottery provides an interesting case study that touches on all the matters that concern us. It provides a representative story as well, for Illinois is as close to Middle America in demographics and temperament as it is in geography.

One State's Story

As in every other American state, lotteries in Illinois had been illegal since the nineteenth century.[1] To be sure, gambling in the state had remained popular, at least among a large portion of the population. Horse racing had been legal since 1927, and by 1963 attendance at racetracks in the state was almost 6 million a year.[2] Despite the official prohibition of lotteries, people found several ready alternatives. The Irish Sweepstakes was popular in the Midwest, as it was throughout the United States; a Michigan factory worker won half a million dollars in 1972. In Illinois illegal lotteries in the form of "policy" games flourished, especially in the black neighborhoods of Chicago. In the early 1970s an estimated twenty-three policy "wheels" were operating in Chicago, grossing some $20 million a year. A survey of the South Side and West Side of Chicago showed that over 40 percent of the residents of those neighborhoods played policy.[3] And, as in much of the country, bingo had long been played under the auspices of churches and other charities, although it was not until 1971 that the state of Illinois legalized, regulated, and taxed it.

The idea of having a state-run public lottery in Illinois began to receive serious attention in the early 1970s. Lotteries had already appeared in the Northeast, and by 1972 seven states were operating them. In particular, the success of the New Jersey lottery seems to have captured the attention of the Illinois legislature, as it did in other states. A proposal for a lottery patterned after New Jersey's—one operated by a commission appointed by the governor—was passed in one house of the Illinois legislature in 1972 on the strength of a provision that would earmark a portion of the $100 million estimated revenues for financially strapped school systems. The bill died, however, after the governor threatened to veto it.

But debate on the lottery question continued into 1973. Supporters of the idea, including Chicago's Mayor Richard Daley, stressed the potential for revenue to the state. Some proponents argued that a state lottery would cut into the business of the illegal gambling syndicate. But there was vigorous opposition to the lottery idea. Some opponents maintained that it would place an unfair burden on the poor and on compulsive gamblers. Others based their arguments on morality, one calling the lottery "another step toward the destruction of our ethical values."[4] The *Chicago Tribune* editorialized against lotteries on several occasions, criticizing the low proportion of revenues returned as prizes and charging that state sponsorship of a lottery teaches an ethic of easy money over the value of hard work.[5] Despite such opposition, the lottery won approval. What appeared to win the day was a proposed tangible use for the lottery's revenue as well as the support of the new governor, Dan Walker. In a special legislative session the lottery became linked to an emergency funding package for the Chicago area transit system. A poll showed that by a wide margin state residents preferred a lottery over an increase in the sales tax as a source of funding. In December 1973 the state legislature passed a lottery bill, and the governor signed it into law with assurances that the lottery would be run honestly.

The new state lottery agency began selling tickets in July 1974, and honesty was indeed a byword from the beginning—along with publicity. Balls imprinted with winning numbers were selected mechanically rather than by hand, and the device was transported throughout the state for drawings. A congressional ban on televised drawings ended in 1976, and thereafter television became a vital part of the lottery's marketing. Tickets were sold in some 7,500 retail establishments, including grocery stores, convenience stores, liquor stores, and drugstores. According to its director, the lottery agency itself was designed to be operated as a business. It was broken into three conventional business divisions—operations, finance, and marketing—each with its own deputy, who took on the role of a corporate vice president.[6] Following the example of New Jersey rather than the higher-priced lotteries run by New Hampshire and New York, the Illinois lottery set the price of its tickets at fifty cents. Prizes ranged from $20 to $1 million (the latter paid out over twenty years). Subsequently the lottery introduced other games, first a similar one with tickets selling for a dollar, then an "instant game" featuring scratch-off spaces revealing winning combinations. The public responded to the new lottery with enthusiasm. Sales were brisk, winners became celebrities, and predictions of high revenues were fulfilled. In the first fiscal year sales were $129 million, increasing to $163 million in 1976. In 1988 dollars the second year's sales were just under $30 per capita.

But then the bloom began to fade. Sales dropped in 1977 and again in each